

Chapter - 1

Nature, Objective and Scope of Audit

STUDY MATERIAL NEW

Ques-2 Assurance engagements are not restricted to audit of financial statements alone. Discuss.

Ans. There are various types of assurance Engagements:-

Reasonable assurance engagement:- It provides high level of assurance. It draws reasonable conclusions on the basis of sufficient appropriate evidence. Example of Reasonable assurance engagement is audit engagement.

Limited assurance engagement:- provides lower level of assurance than reasonable assurance engagement. It performs fewer procedures as compared to reasonable assurance engagement Example of limited assurance engagement is review engagement.

Moderate assurance engagement:- Besides reasonable assurance engagements and limited assurance engagements, there is another kind of assurance which is related to matters other than historical financial information. Such an assurance may relate to prospective financial information and not to historical financial information. It may relate to providing assurance on internal controls in an entity.

"Prospective financial information" means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It can be in the form of a forecast or projection or combination of both.

STUDY MATERIAL NEW

Ques-3 An assurance engagement involves a three party relationship. Discuss meaning of three parties in such an engagement.

Ans. A three party relationship involving a practitioner, a responsible party, and intended users

An assurance engagement involves abovesaid three parties.

A practitioner is a person who provides the assurance. The term practitioner is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.

A responsible party is the party responsible for preparation of subject matter.

Intended users are the persons for whom an assurance report is prepared. These persons may use the report in making decisions.

STUDY MATERIAL NEW

Ques-5 An audit does not provide absolute assurance. Discuss how nature of audit procedures itself is one of the reasons due to which audit cannot provide absolute assurance.

Ans. The auditor carries out his work by obtaining audit evidence through performance of audit procedures.

However, there are practical and legal limitations on ability of auditor to obtain audit evidence. For example, an auditor does not test all transactions and balances. **He forms his opinion only by testing samples.** It is an example of practical limitation on auditor's ability to obtain audit evidence.

Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence.

The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. It may be engaged in concealing fraud by designing sophisticated and carefully organized schemes which may be hard to detect by the auditor. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine

It is quite possible that entity may have entered into some transactions with related parties. Such transactions may be only paper transactions and may not have actually occurred. The auditor may not be aware of such related party relationships or audit procedures may not be able to detect probable wrong doings in such transactions.

STUDY MATERIAL, RTP MAY 20, MTP OCT 20, RTP NOV 21,

Ques-9. There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain with examples.

The auditor carries out his work by obtaining audit evidence through performance of audit procedures. **However, there are practical and legal limitations on ability of auditor to obtain audit evidence.** For example, an auditor does not test all transactions and balances. **He forms his opinion only by testing samples.** It is an example of practical limitation on auditor's ability to obtain audit evidence.

Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence.

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MTP APRIL 2024

Ques-18 Nature of financial reporting itself is one of causes of inherent limitations of audit of financial statements. Explain

Ans: Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.

One of the premises for conducting an audit is that management acknowledges its responsibility of preparation of financial statements in accordance with applicable financial reporting framework and for devising suitable internal controls. However, such controls may not have operated to produce reliable financial information due to their own limitations.

Therefore, nature of financial reporting itself is one of causes inherent limitations of audit.

MTP JULY 2024

Ques-21 The management of Cool Drinks Limited suspects that some employees of the company may be involved in making fraudulent payments to dummy workers at its various plants in the country. Therefore, they are considering appointment of a firm of auditors to conduct audit involving detailed examination of accounts. However, one senior person among Board members, Mr. P, objects to use of word "audit" in proposed assignment. Comment. Also, discuss how audit is different from investigation.

Ans: Audit is distinct from investigation. Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation. The objective of audit, on the other hand, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.

The scope of audit is general and broad whereas scope of investigation is specific and narrow.

In the given situation, management of company suspects that some of its employees may be involved in making fraudulent payments on account of dummy workers at its different plants in the country. Such an assignment is in the nature of "investigation".

Therefore, Mr. P is right in objecting the use of word "audit" in the proposed assignment.

MTP AUGUST 2024

Ques-22 CDE Private Limited, a manufacturing company, had made investment in shares of some blue-chip companies. Additionally, it had temporarily deposited some of its extra funds in fixed deposits with a scheduled bank. Dividend from shares amounting to ₹ 1.80 lakhs (net of TDS, TDS = ₹ 0.20 lakhs) and bank interest of ₹ 2.70 lakhs (net of TDS, TDS = ₹ 0.30 lakhs) were credited in bank account of the company. During the year 2023-24, it has also sold some shares resulting in net gain of ₹ 5 lakhs. The company has shown above incomes under head "Other income" for consolidated amount of ₹ 9.50 lakhs in the statement of Profit and Loss. No other information is furnished in the financial statements put up for audit. As the auditor of the company, discuss whether the above situation constitutes "misstatement" in the financial statements of the company. Also state, few examples of misstatements.

Ans: Misstatement refers to a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework.

In the given situation, there is a difference in amount to be recorded as well as in disclosure of a financial statement item from what is required in accordance with applicable financial reporting framework. The company should have recorded gross amount of dividend and interest amounting to ₹ 2.00 lakhs and ₹ 3.00 lakhs respectively in its financial statements in accordance with AS 13. Therefore, amount recorded under head "Other income" should have been for ₹ 10 lakhs (2 lakhs+3 lakhs+5 lakhs).

Further, in accordance with disclosure requirements of Schedule III of the Companies Act, 2013, other income shall be classified in the above situation as: -

- (a) Interest Income of ₹ 3 lakhs
- (b) Dividend Income of ₹ 2 lakhs
- (c) Net gain on sale of investments of ₹ 5 lakhs

Few examples of misstatements are:

- Charging of an item of capital expenditure to revenue or vice-versa.
- Difference in disclosure of a financial statement item vis-à-vis its requirement in applicable financial reporting framework.
- Selection or application of inappropriate accounting policies.
- Difference in accounting estimate of a financial statement item vis-à-vis its appropriateness in applicable financial reporting framework.
- Intentional booking of fake expenses in statement of profit and loss.
- Overstating of receivables in the financial statements by not writing off irrecoverable debts.
- Overstating or understating inventories.

MTP NOV 2024

Ques-6 Rajul Ltd. engaged an external practitioner CA Rajul to provide assurance on its prospective financial information for the upcoming year, which includes projections for a new product line. The company projected a 15% increase in revenue, estimating total sales of ₹ 75 crore, driven by the expected launch of this new product. Mention the applicable Engagement and Quality Control Standard and the level of assurance that will be provided in the given situation. Also explain how Prospective Financial Information is different from Historical Financial Information

Ans: In the given situation, Standards on Assurance Engagements will be applicable and such type of assurance engagement provides only a "moderate" level of assurance.

In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that management's assumptions on which the prospective financial information is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions and it is properly presented and all material assumptions are adequately disclosed.

"Historical financial information" and "Prospective financial information." The former relates to information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods. The latter relates to financial information based on assumptions about occurrence of future events and possible actions by an entity. Therefore, historical financial information is rooted in past events which have already occurred whereas prospective financial information is related to future events.

Chapter - 2

Audit Strategy & Programme

RTP MAY 19, RTP NOV 20

Ques-2 Evolving one audit programme applicable to all business under all circumstances is not practicable. Explain

Ans. Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable. However, it becomes a necessity to specify in detail in the audit programme the nature of work to be done so that no time will be wasted on matters not pertinent to the engagement and any special matter or any specific situation can be taken care of.

STUDY MATERIAL, RTP MAY 19

Ques-3 Explain the significant point's auditor would consider while developing an audit programme.

Ans. Developing the Audit Programme :

- 1. Written Audit Programme:** The auditor should prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.
- 2. Audit objective and instruction to assistants:** The programme may also contain the audit objectives for each area and should have sufficient details to serve as a set of instructions to the assistants involved in the audit and as a means to control the proper execution of the work.
- 3. Reliance on Internal Controls:** In preparing the audit programme, the auditor, having an understanding of the accounting system and related internal controls, may wish to rely on certain internal controls in determining the nature, timing and extent of required auditing procedures. The auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts.
- 4. Timings of performance of audit procedures:** The auditor normally has flexibility in deciding when to perform audit procedures. However, in some cases, the auditor may have no discretion as to timing, for example, when observing the taking of inventories by client personnel or verifying the securities and cash balances at the year-end.
- 5. Audit planning:** The audit planning ideally commences at the conclusion of the previous year's audit, and along with the related programme, it should be reconsidered for modification as the audit progresses. Such consideration is based on the auditor's review of the internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures

EXAM DEC 21/ MTP AUGUST 2024

Ques-6 M / s. TP & Co., a firm of Chartered Accountants, is auditor of KSR Ltd. For many years. KSR Ltd. Has diversified their business into newer areas during the last year. The senior member of the audit team handed over the standard audit program of earlier years to the audit assistants and instructed them to follow the same; the assistants are conducting the audit accordingly. Whether the attitude of the audit assistants is justified or they are required to keep an open mind? Guide them.

Ans. The Assistant Engaged – Be Encouraged to Keep an Open Mind:

To start with, an auditor having regard to the nature, size and composition of the business and the dependability of the internal control and the given scope of work, should frame a programme which should aim at providing for a minimum essential work which may be termed as a standard programme. As experience is gained by actually carrying out the work, the programme may be altered to take care of situations which were left out originally, but are found relevant for the particular concern. Similarly, if any work originally provided for proves beyond doubt to be unnecessary or irrelevant, it may be dropped. The assistant engaged in the job should be encouraged to keep

an open mind beyond the programme given to him. He should be instructed to note and report significant matters coming to his notice, to his seniors or to the partners or proprietor of the firm engaged for doing the audit. In the given case, the attitude of assistants of TP & Co. is not justified. They should keep an open mind and go beyond the programme to take care of newer areas of the business of KSR Ltd. into which the Company has diversified.

RTP MAY 2024

Ques-9 The assistant of CA K is assigned responsibility of drafting "audit programme" relating to purchases appearing in financial statements of "Broad Industries", a partnership firm. The said firm is a GST registered tax payer and is engaged in manufacturing of packing boxes from a special type of paper taxable under GST. Help him by drafting a sample audit programme for purchases.

Sample audit programme pertaining to purchases

Name of Concern : Broad Industries
 Financial Year : 20XX-XX
 Prepared by : Name of person with date
 Reviewed by : Name of person with date
 Approved by : Name of person with date

S.no.	Nature of Procedure	Extent of Check	Basis of Sample	Done by
(a)	Vouch few purchase invoices of paper from purchase records of concern.			
(b)	Trace these invoices into account books of concern.			
(c)	Verify few purchase invoices of paper on GST portal			
(d)	Trace few purchase invoices of paper in stock records to ensure that these have been added to stocks of raw material.			

MTP JULY 2024

Ques-11 Sanjana is of the view that there exist some disadvantages in the use of audit programmes but most of these can be removed by following some concrete steps. Do you agree with her perspective? Comment.

Ans: The view of Sanjana is appropriate. Some disadvantages are there in the use of audit programmes but most of these can be removed by following some concrete steps. The disadvantages are: -

- (i) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.
- (ii) The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.
- (iii) Inefficient assistants may take shelter behind the programme i.e., defend deficiencies in their work on the ground that no instruction in the matter is contained therein.
- (iv) A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.

All these disadvantages may be eliminated by imaginative supervision of the work carried on by the assistants; the auditor must have a receptive attitude as regards the assistants; the assistants should be encouraged to observe matters objectively and bring significant matters to the notice of supervisor/principal.

Chapter - 3

Risk Assessment and Internal Control

EXAM MAY 18, RTP MAY 2023

Ques-10 Briefly discuss the limitations of internal control.

Ans. Limitations of Internal Control:

- (i) **Internal control can provide only reasonable assurance:** Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by inherent limitations of internal control.
 - (ii) **Human judgment in decision-making:** Realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error.
 - (iii) **Lack of understanding the purpose:** Equally, the operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.
 - (iv) **Collusion among People:** Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.
 - (v) **Judgements by Management:** Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.
 - (vi) **Limitations in case of Small Entities:** Smaller entities often have fewer employees due to which segregation of duties is not practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties.
- On the other hand, the owner-manager may be more able to override controls because the system of internal control is less structured. This is taken into account by the auditor when identifying the risks of material misstatement due to fraud

EXAM MAY 18, RTP MAY 19, EXAM MAY 19

Ques-11 The auditor should understand and consider the risks that may arise from the use of information technology (IT) Systems.

Ans. IT poses specific risks to the Company's internal control, which include-

- (i) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- (ii) Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
- (iii) The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- (iv) Unauthorised changes to data in master files.
- (v) Unauthorised changes to systems or programs.
- (vi) Failure to make necessary changes to systems or programs. Inappropriate manual intervention.
- (vii) Potential loss of data or inability to access data as required.

RTP MAY 19

Ques-12 So far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded.

Internal control normally contributes to such assurance. Explain stating clearly the benefits of evaluation of internal control to the auditor.

Ans. Benefits of Evaluation of Internal Control to the Auditor

The review of internal controls will enable the auditor to know:

- (i) whether errors and frauds are likely to be located in the ordinary course of operations of the business;
- (ii) whether an adequate internal control system is in use and operating as planned by the management;
- (iii) whether an effective internal auditing department is operating;
- (iv) whether any administrative control has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);
- (v) whether the controls adequately safeguard the assets;
- (vi) how far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned;
- (vii) how reliable the reports, records and the certificates to the management can be;
- (viii) the extent and the depth of the examination that he needs to carry out in the different areas of accounting;
- (ix) what would be appropriate audit technique and the audit procedure in the given circumstances;
- (x) what are the areas where control is weak and where it is excessive; and
- (xi) Whether some worthwhile suggestions can be given to improve the control system.

STUDY MATERIAL, RTP NOV 20

Ques-16 The risks of material misstatement may exist at the financial statement level and assertion level. Explain the two levels.

Ans. Risks of Material Misstatement at Two levels

The risks of material misstatement may exist at two levels:

- (i) **The overall financial statement level-** Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
- (ii) **The assertion level for classes of transactions, account balances, and disclosures-** Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

RTP MAY 21, MTP APRIL 2022

Ques-22 The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the classes of transactions in the entity's operations that are significant to the financial statements, controls surrounding journal entries etc. Explain the other considerations in this regard.

Ans. The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following are as:

- (a) The classes of transactions in the entity's operations that are significant to the financial statements;
- (b) The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
- (c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions;
- (d) How the information system captures events and conditions that are significant to the financial statements;
- (e) The financial reporting process used to prepare the entity's financial statements;
- (f) Controls surrounding journal entries.

RTP NOV 21

Ques-24 Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as complex calculations. Also, risks of material misstatement may be greater for significant

judgmental matters that require the development of accounting estimates, arising from matters such as accounting principles for accounting estimates may be subject to differing interpretation etc. Explain in detail.

Ans. Risks of Material Misstatement- Greater for Significant Non-Routine Transactions

Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

- Greater management intervention to specify the accounting treatment.
- Greater manual intervention for data collection and processing.
- Complex calculations or accounting principles.
- The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

Risks of material misstatement- Greater for Significant Judgmental Matters

Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:

- Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
- Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

MTP APRIL 2024

Ques-39 Internal Control Questionnaire is a comprehensive series of questions concerning internal control. A company is engaged in business of manufacturing of chemicals. It has two plant locations in city "A" and one plant location in city "B" involving huge value of assets. Building at three locations is owned by the company. The company earns handsome profits and does not want to suffer losses due to business interruptions. It has a dedicated department for looking after insurance matters. As an auditor, prepare an internal control questionnaire concerning this department for obtaining staff responses.

Ans: **Internal Control Questionnaire**

- Are competitive quotes obtained from different insurers?
- Is comprehensive insurance cover obtained for fire, flood, burglary, earthquake risks etc.?
- Are all three locations in city A and B covered?
- Are all assets consisting of building, plant & machinery and inventories covered?
- Is there an adequate procedure to ensure that assets acquired between two renewal dates are also covered by insurance?
- Is there an official who decides on value for which policies are taken?
- Does officer who decides on policy value review periodically adequacy of insurance cover?
- Is loss-of-profits insurance cover taken?
- Have there been any instances of rejection of claims?
- Are pending claims followed-up with insurers?

RTP MAY 2024

Ques-40 Satranga Foods Private Limited is engaged in manufacturing of pickles. The auditors of the company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that misstatements in revenue recognition are not identified by planned audit procedures. Identify and explain that particular risk in detail.

There is a possibility that planned audit procedures may not achieve desired result and fail to detect misstatements in revenue recognition. Such a risk is referred to as "detection risk".

SA 200 defines detection risk as the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

For example, auditor of a company uses certain audit procedures for the purpose of obtaining audit evidence and reducing audit risk, but still there will remain a risk that audit procedures used by the auditor may not be able to detect a misstatement which by nature is material, then that risk is known as detection Risk.

Detection risk comprises sampling and non-sampling risk.

- (a) **Sampling risk** is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. It simply means that the sample was not representative of the population from which it was chosen.
- (b) **Non-sampling risk** is the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. Like an auditor may reach an erroneous conclusion due to application to some inappropriate audit procedure.

RTP MAY 2024

Ques-41 IT related risks can have an impact on audit. In what different ways, such risks can have an impact on audit of financial statements?

IT related risks can have an impact on audit in different ways discussed as under: -

Impact on substantive checking

Inability to address IT risks may lead to non-reliance of data obtained from systems. In such a case, all information, data, and reports would have to be tested thoroughly for their completeness and accuracy. It could lead to increased substantive checking i.e. detailed checking.

Impact on controls

It can lead to non-reliance on automated controls, system calculations and accounting procedures built into applications. It may result in additional audit work.

Impact on reporting

Due to regulatory requirements in respect of internal financial controls in case of companies, it may lead to modification of auditor's report in some instances.

MTP NOV 2024

Ques-16 KR & Associates, an auditor of FDP Ltd., observed that the company has implemented various internal controls addressing financial reporting, operational efficiency, and compliances during their preliminary evaluation. CA Karan suggests that all controls should be assessed to mitigate the risk of material misstatement in the financial statements, while CA Rajat is of the view that only those controls deemed relevant to the audit should be assessed based on professional judgment.

Comment, whether the auditor should assess all the internal controls or limit the assessment to only those considered relevant by the auditor during the audit. Also, discuss the factors influencing the auditor's judgment on the relevance of controls.

Ans: There is a direct relationship between an entity's objectives and the control it implements to provide reasonable assurance about their achievement. FDP Ltd. has implemented internal controls addressing financial reporting, operational efficiency, and compliance. However, not all of these objectives and controls are relevant to the auditor's risk assessment.

Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:

- ✚ Materiality.
- ✚ The significance of the related risk.
- ✚ The size of the entity.
- ✚ The nature of the entity's business, including its organisation and ownership characteristics.
- ✚ The diversity and complexity of the entity's operations.
- ✚ Applicable legal and regulatory requirements.
- ✚ The circumstances and the applicable component of internal control.
- ✚ The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
- ✚ Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

In the given case, CA Karan suggests that all controls should be assessed to mitigate the risk of material misstatement in the financial statements, while CA Rajat is of the view that only those controls deemed relevant to the audit should be assessed based on professional judgment.

Based on the factors mentioned above, it can be concluded that the auditors should assess only those controls deemed relevant to mitigate the risk of material misstatement in FDP Ltd.'s financial statements.

RTP JAN 2025

Ques-3 The auditor of EFG Ltd., a company engaged in the Tours & Travel business, needs to obtain an understanding of the company's control environment. To do this, the auditor evaluates whether:

- (i) Management has created and maintained a culture of honesty and ethical behaviour; and
- (ii) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

What is included in control environment? Also explain the elements of control environment.

Ans: The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:

- (i) Management has created and maintained a culture of honesty and ethical behaviour and
- (ii) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

The control environment includes:

- (i) the governance and management functions and
- (ii) the attitudes, awareness, and actions of those charged with governance and management.
- (iii) the control environment sets the tone of an organization, influencing the control consciousness of its people.

Elements of the Control Environment

Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:

(a) Communication and enforcement of integrity and ethical values

The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behaviour are the product of the entity's ethical and behavioural standards, how they are communicated, and how they are reinforced in practice. The enforcement of integrity and ethical values includes, for example, management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts. The communication of entity policies on integrity and ethical values may include the communication of behavioural standards to personnel through policy statements and codes of conduct and by example.

(b) Commitment to competence: Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.

(c) Participation by those charged with governance: It includes attributes of those charged with governance such as their independence from management, their experience and stature, the extent of their involvement and the information they receive and the scrutiny of activities.

(d) Management's philosophy and operating style: Management's philosophy and operating style encompass a broad range of characteristics. For example, management's attitudes and actions towards financial reporting- what approach is taken by management in selecting accounting policies, approach in developing accounting estimates etc. Matters such as approach of management to taking and managing business risks, management's attitude towards information processing and accounting function and personnel reflects upon management's philosophy and operating style.

(e) Organisational structure: The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed. Establishing a relevant organisational structure includes considering key areas of authority and responsibility and appropriate lines of reporting. The appropriateness of an entity's organisational structure depends, in part, on its size and the nature of its activities.

(f) Assignment of authority and responsibility: Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established.

(g) Human resource policies and practices: Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions. Human resource policies and practices often demonstrate important matters in relation to the control consciousness of an entity.

MTP APRIL 2025

Identify and briefly explain the component of risks of material misstatement involved in the following situations:

i) GHK Private Limited is a start-up engaged in providing comprehensive solutions to the issue of paddy stubble burning, mainly catering to the needs of farmers of North-western India. Due to the importance given by governments to this issue, companies have entered the market in the past few years. Many of these companies have not been successful and have gone bust.

ii) A company has devised a control that its inventory of perishable goods is stored in appropriate conditions in a controlled environment to prevent any damage to inventory. Responsibility is fixed on two people to monitor the environment using sensors and to report on deviations.

iii) Shree Foods Private Limited is engaged in the manufacturing of garlic bread. The auditors of the company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that the misstatements in revenue recognition are not identified by planned audit procedures.

Ans: (i) It has been stated that many companies engaged in providing holistic solutions to problem of stubble burning have not been successful. It shows that line of activity is inherently risky. Therefore, there is a greater possibility of misstatements. The component of risks of material misstatement involved in given situation is "inherent risk."

(ii) The company has devised a control that its inventory of perishable goods is stored in appropriate conditions and responsibility is fixed on two persons to monitor environment using sensors and to report on deviations. There is a possibility that persons given responsibility do not perform their work and report deviations. The component of risks of material misstatement involved in given situation is "control risk".

(iii) There is a possibility that planned audit procedures may not achieve desired result and fail to detect misstatements in revenue recognition. The risk alluded to it is "detection risk".

Chapter - 5

Audit of Financial Statements

STUDY MATERIAL NEW

Ques-1 How will you vouch and/or verify the following:

(a) Goods sent out on Sale or Return Basis.

Ans. (a) Goods Sent Out on Sale or Return Basis:

- (i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
- (ii) Verify that price of such goods is unloaded from the sales account and the trade receivables record. Check the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.
- (iii) Ensure that the goods in respect of which the period of approval has expired at the end of the year, have either been received back or customers' accounts have been debited.
- (iv) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the end of the year lying with the party, has been included in the closing inventory.

STUDY MATERIAL NEW

Ques-2 How will you vouch/verify the following:

(a) Foreign travel expenses.

Ans. (a) Foreign Travel Expenses:

- (i) Examine Travelling Allowance bills submitted by the employees stating the details of tour, details of expenses, etc.
- (ii) Verify that the tour programme was properly authorised by the competent authority.
- (iii) Check the T.A. bills along with accompanying supporting documents such as air tickets, travel agents bill and hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.
- (iv) See that the tour report accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the purpose of the tour as shown by the tour report conforms to the authorisation for the tour.
- (v) Check Reserve Bank of India's permission, if necessary, for withdrawing the foreign exchange. For a company the amount of foreign exchange spent is to be disclosed separately in the accounts as per requirement of Schedule III to the Companies Act, 2013 and Accounting Standard 11 "The Effects of Changes in Foreign Exchange Rates".

STUDY MATERIAL NEW / RTP NOV 21

Ques-3 How will you vouch and/or verify payment of taxes?

Ans. Vouching of Payment of Taxes:

- (i) Payment on account of income-tax and other taxes consequent upon a regular assessment should be verified by reference to the copy of the assessment order, assessment form, notice of demand and the receipted challan.
- (ii) Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.
- (iii) The interest allowed on advance payments of income-tax should be included as income and penal interest charged for non-payment should be debited to the interest account.
- (iv) Nowadays, electronic payment of taxes is also in trend. Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards.
- (v) The entity can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. This should be checked by the auditor.
- (vi) It is not necessary for the entity to make payment of taxes from his own account in an authorized bank. While vouching such e-payment, the auditor should cross verify the payments of taxes through the receipted challan along with PAN No /TAN No. etc.

STUDY MATERIAL NEW

Ques-11 You are the statutory auditor of Jupiter Ltd. for the FY 2022-23. During the course of audit, you noticed that the company has PPE under construction i.e. Capital Work in Progress. What disclosures should the company give with respect to the ageing schedule of such capital work in progress as required by Schedule III to the Companies Act, 2013?

Ans. Capital-Work-in Progress

(a) For Capital-work-in progress, following ageing schedule shall be given:

(Amount in `)					
	Amount in CWIP for a period of				Total*
CWIP	Less than 1 year	1-2 years	2-3 years	More than 3 years	
Projects in Progress					
Projects temporarily suspended					

*Total shall tally with CWIP amount in the balance sheet.

(b) For capital-work-in progress, whose completion is overdue or has exceeded its cost compared to its original plan, following CWIP completion schedule shall be given:**

(Amount in `)				
	To be completed in			
CWIP	Less than 1 year	1-2 years	2-3 years	More than 3 years
Project 1				
Project 2				

**Details of projects where activity has been suspended shall be given separately.

EXAM MAY 18, EXAM NOV 20

Ques-16 ABC Limited appointed XYZ & Company Chartered Accountants as a Statutory Auditor of the Company for the year 2019-20. CA. X, Partner of XYZ & Company was looking after the audit of other income of the company which consists of interest income on fixed deposits. As a Statutory Auditor how would CA. X verify interest income on fixed deposits for the year 2019-20?

Ans. CA X, partner of XYZ & Company, would carry out the following audit procedure for verifying interest income on fixed deposits of ABC Limited:

1. Obtain a listing of fixed deposits opened during the period under audit along with the applicable interest rate and the number of days for which the deposit was outstanding during the period. Verify the arithmetical accuracy of the interest calculation made by the entity by recomputing i.e. multiplying the deposit amount with the applicable rate and number of days during the period under audit.
2. For deposits still outstanding as at the period- end, trace the same to the direct confirmations obtained from the respective bank/ financial institution.
3. Obtain a confirmation of interest income from the bank and verify that the interest income as per bank reconciles to the calculation shared by the entity.
4. Also, obtain a copy of Form 26AS (TDS withholding by the bank/ financial institution) and reconcile the interest reflected therein to the calculation shared by client.

EXAM MAY 19

Ques-22 While reviewing Employee benefits expenses of a company how you as an auditor you will value its hiring appraisal and retirement process?

Ans. While reviewing Employee Benefits expenses auditor needs to obtain a clear understanding about the organisation and its hiring, appraisal and retirement process in the following manner:

- (i) The auditor first tests the controls the company has set around the employee benefit payment process to determine how strong and reliable they are. If they are strong, the auditor can minimize the amount of transaction testing he must do. A common internal control over the employee benefit payment cycle includes maintaining of attendance records, authorisation and approval of monthly payroll processing and disbursement.
- (ii) The auditor selects a random sample of transactions and examines the related appointment letters, appraisal letters, attendance records, HR policies, employee master etc.
- (iii) The auditor performs Substantive analytical procedure consisting of monthly expense reasonability, comparison with previous accounting period, any analysis auditor may find relevant and most important of all setting an expectation in relation to the expense incurred during the period under audit and compare that with the client's business operations and overall trend in the industry.

RTP NOV 19

Ques-23 Explain with examples the audit procedure to establish the existence of intangible fixed assets as at the period- end.

Ans Since an Intangible Asset is an identifiable non-monetary asset, without physical substance, for establishing the existence of such assets, the auditor should verify whether such intangible asset is in active use in the production or supply of goods or services, for rental to others, or for administrative purposes.

Example- for verifying the existence of software, the auditor should verify whether such software is in active use by the entity and for the purpose, the auditor should verify the sale of related services/ goods during the period under audit, in which such software has been used.

Example- For verifying the existence of design/ drawings, the auditor should verify the production data to establish if such products for which the design/ drawings were purchased, are being produced and sold by the entity.

In case any intangible asset is not in active use, deletion should have been recorded in the books of account post approvals by the entity's management and amortization charge should have ceased to be charged beyond the date of deletion

EXAM JAN 21

Ques-34 Depreciation and amortisation expense generally constitute an entity's significant part of overall expenses and have direct impact on the profit/loss of the entity. What are the attributes, the Auditor needs to consider while verifying Depreciation and amortisation expense.

Ans. Depreciation and amortisation generally constitute an entity's significant part of overall expenses and have direct impact on the profit/ loss of the entity, hence auditors need to verify and ensure that such expenditure is appropriate, accurately calculated and has been accounted as per applicable provisions of Companies Act or other statutes, to the extent applicable on the respective industry and as per generally accepted accounting principles.

Auditor needs to consider the following attributes while verifying for depreciation and amortisation expenses:

- Obtain the understanding of entity's accounting policy related to depreciation and amortisation.
- Ensure the Company policy for charging depreciation and amortisation is as per the relevant provisions of Companies Act/ applicable accounting standards.
- Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.
- Whether depreciation and amortisation charges are valid.
- Whether depreciation and amortisation charges are accurately calculated and recorded.
- Whether all depreciation and amortisation charges are recorded in the appropriate period.
- Ensure the parts (components) of each item of property, plant and equipment that are to be depreciated separately have been properly identified.
- Whether the most appropriate depreciation method for each separately depreciable component has been used.

RTP MAY 21, MTP MAY 20, MTP APRIL 21

Ques-40 Newton Ltd. has made loans and advances on the basis of following securities to various borrowers. As an auditor what type of documents can be verified to ensure that the company holds a legally enforceable security?

- (i) Shares and Debentures
- (ii) Life Insurance Policy
- (iii) Hypothecation of goods.

Ans. Documents to be seen in case of Securities:

Types of Security	Documents etc. to be seen
(i) Shares and debentures	The scrip and the endorsement thereon of the name of the transferee, in the case of transfer.
(ii) Life Insurance Policy	Assignment of policy in favour of the lender, duly registered with the insurer
(iii) Hypothecation of goods	Deed of hypothecation or other document creating the charge, together with a statement of inventories held at the Balance Sheet date

MTP NOVEMBER 21

Ques-44. Management of Z Ltd. wants to include all the cost incurred by the Company in valuing the cost of its inventories. The Accountant is, however, of the view that certain costs should be excluded from the cost of inventories and should be recognised as expenses for the period in which they are incurred. What are such costs that should be excluded while determining the cost of inventories?

Ans. Examples of costs to be excluded in determining cost of Inventory:

In determining the cost of inventories, it is appropriate to exclude certain costs and recognise them as expenses in the period in which they are incurred. Examples of such costs are:

- (i) abnormal amounts of wasted materials, labour, or other production costs;
- (ii) storage costs, unless those costs are necessary in the production process prior to a further production stage;
- (iii) administrative overheads that do not contribute to bringing the inventories to their present location and condition; and
- (iv) selling and distribution costs.

In the given situation, contention of Z Ltd. is not correct to include all the cost of its inventories while determining the cost of inventory. However, contention of accountant is correct that certain cost should be excluded from the cost of inventories and to be recognised as expenses in period in which they are incurred

RTP NOV 21, RTP MAY 2022, PYQ MAY 2023

Ques-45. Explain how you will verify the items given while conducting an audit of an entity:

- (a) Payment of Taxes

Ans. Payment of Taxes:

- (i) Obtain the computation of taxes prepared by the auditee and verify whether it is as per the Income Tax Act/GST Act/ Rules/ Notifications/ Circulars etc.
- (ii) Examine relevant records and documents pertaining to payment of advance income tax and self-assessment tax.
- (iii) Payment on account of income-tax and other taxes like GST consequent upon a regular assessment should be verified by reference to the copy of the assessment order, notice of demand and the receipted challan acknowledging the amount paid.
- (iv) The penal interest charged for non-payment should be debited to the interest account.
- (v) Nowadays, electronic payment of taxes is also in trend. Such electronic payment of taxes by way of internet banking facility or credit or debit cards shall also be verified.

(vi) The assessee can make electronic payment of taxes also from the account of any other person. Therefore, it should be verified that the challan for making such payment is clearly indicating the PAN No./TAN No./TIN No./GSTIN etc. of the assessee on whose behalf the payment is made.

EXAM DEC 21, MTP MARCH 2023, RTP MAY 2023

Ques-47. How is " Cash and cash equivalents " disclosed in the Financial Statements as required under Schedule III (part 1) to Companies Act , 2013 ?

Ans. Disclosure of Cash & Cash Equivalent in the Financial Statements:

Regarding Cash and cash equivalents- Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:

(i) Cash and cash equivalents shall be classified as:

(a) Balances with banks;

(b) Cheque, drafts on hand;

(c) Cash on hand;

(c) Others (specify nature)

(ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.

(iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.

(iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.

(v) Bank deposits with more than 12 months' maturity shall be disclosed separately.

EXAM DEC 21, MTP APRIL 2023

Ques-48. CA R is the statutory auditor of QRS Ltd. While performing testing of additions during the year, he wanted to verify that

(i) All PPE (property, plant and equipment) are in the name of the entity he is auditing.

(ii) For all additions to land and building in particular, the auditor desires to have concrete evidence about the ownership.

(iii) The auditor wants to know whether the entity has valid legal ownership rights over the PPE, where it is kept as security for any borrowings,

Advise the auditor on the audit procedure to be undertaken by him to establish the Rights and Obligations of the entity over the PPE

Ans. Audit procedure to establish Rights and Obligations of the entity over PPE:

(i) In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, CA R, the statutory auditor of B Ltd, while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity.

Verify whether the PPE additions have been approved by authorized personnel

(ii) For all additions to land, building in particular, CA R, the statutory auditor of B Ltd, should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.

(iii) The auditor should insist and verify the original title deeds for all immoveable properties held as at the balance sheet date.

(iv) In case the entity has given such immoveable property as security for any borrowings and the original title deeds are not available with the entity, CA R, the statutory auditor of B Ltd should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security.

(v) In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

MTP MARCH 2022

Ques-50 XYZ Ltd made huge additions to Intangible assets during the period 01-04-2021 to 31-03-2022 i.e period under audit. You have been appointed as an auditor and you want to verify the additions made to intangible assets during the period. Suggest the audit procedure to verify the additions to intangible assets.

Ans. 1. Verify the movement in the intangible assets schedule (asset class wise like software, designs/ drawings, goodwill etc.) compiled by the management i.e. Opening balances + Additions - Deletions = Closing balances. Tally the closing balances to the entity's books of account.

2. Check the arithmetical accuracy of the movement in intangible assets schedule.

For additions during the period under audit, obtain a listing of all additions from the management and undertake the following procedures:

- (i) For all material additions, verify whether such expenditure meets the criterion for recognition of an intangible asset as per AS 26.
- (ii) Ensure that no cost related to research (or from the research phase of an internal project) gets recognized as intangible asset.
- (iii) Check the certificate or report or other similar documentation maintained by the entity to verify the date of use of the intangible which could be linked to date of commencement of commercial production/ economic use to the entity, for all additions to intangible assets during the period under audit.
- (iv) Verify whether the additions (acquisitions) have been approved by appropriate entity's personnel.
- (v) Verify whether proper internal processes and procedures like inviting competitive quotations/ proper tenders etc. were followed prior to finalizing the vendor for procuring item of intangible assets by testing those documents on a sample basis.
- (vi) In relation to deletions of intangible assets, understand from the management the reason and rationale for deletion and the manner of disposal. Obtain the management approval and disposal note authoring disposal of the asset from its active use. Verify the process followed for sale of discarded asset, example inviting competitive quotes, tenders and the basis of calculation of sales proceeds. Verify that the management has accurately recorded the deletion of intangible asset (original cost and accumulated amortization up to the date of disposal) and the resultant gain/ loss on disposal in the entity's books of account.

MTP OCT 2022

Ques-54 Explain how you would verify rent expense incurred by a company.

Ans: Rent expense can be verified by:

- ◆ Obtaining a month wise expense schedule along with the rent agreements.
- ◆ Verifying if expense has been recorded for all 12 months and whether the rent amount is as per the underlying agreement.
- ◆ Giving specific consideration to the escalation clause in the agreement to verify if the rent was required to be recorded on a straightline basis during the period under audit.
- ◆ Also, verifying if the agreement is in the name of the entity and whether the expense pertains to premises used for running business operations of the entity

EXAM MAY 2022, MTP APRIL 2023

Ques-58 B Ltd. is covered w / s 135 of the Companies Act, 2013 i.e. Corporate Social Responsibility (CSR) . What matters (other than the amount spent, amount not spent , amount required to be spent etc.) shall be disclosed by the company with regard to CSR activities done by the company?

Ans. Corporate Social Responsibility (CSR): Since B Ltd is covered under section 135 of the Companies Act, the following matters shall be disclosed by the B Ltd with regard to CSR activities:

- (a) total of previous years shortfall
- (b) reason for shortfall,
- (c) nature of CSR activities,
- (d) details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,
- (e) where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately

EXAM NOV 2022

Ques-61 S & Co. Chartered Accountants, are appointed as the auditors of ABC Ltd. CA S , the engagement partner , has come across the following while verifying equity share capital of the company : Fil 30 bali

- (i) He noticed that some of the equity shares are held by promoters.

(ii) Some shares are issued as sweat equity shares to the employees 4 What is the meaning of sweat equity shares? What are the disclosure requirements of such promoter's shareholding?

Ans. Meaning of Sweat Equity & Disclosure of shares held by Promoters:

Meaning Sweat Equity Shares: According to Section 54 of the Companies Act, 2013, the employees may be compensated in the form of 'Sweat Equity Shares'.

"Sweat Equity Shares" mean equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

Disclosure requirements of such promoter's shareholding: A company shall disclose Shareholding of Promoters* as below:

Shares held by promoters at the end of the year				% Change during the year***
S. No.	Promoter Name	No. of shares	% of total shares**	

* Promoter here means promoter as defined in the Companies Act, 2013.

** Details shall be given separately for each class of shares.

*** percentage change shall be computed with respect to the number at the beginning of the year or if issued during the year for the first time then with respect to the date of issue.]

MTP MARCH 2023

Ques-64. While verifying the legal and professional expenses of the client company, what audit procedures should the auditor perform?

Ans, while verifying the legal and professional expenses of the client company, the auditor should perform the following audit procedures

- Obtain a month-wise and consultant-wise summary.

In case of monthly retainerhip agreements, verify whether the expenditure for all 12 months has been recorded correctly.

For non- recurring expenses, select a sample and vouch for the attributes discussed above.

The auditor should be cautious while vouching for legal expenses as the same may highlight a dispute for which the entity may not have made any provision and the matter may also not have been discussed/ highlighted to the auditor for his specific consideration.

MTP MARCH 2024

Ques-75 You are part of engagement team conducting audit of an entity engaged in manufacturing business. State few audit procedures you would undertake to perform to verify that recorded sales in financial statements represent goods actually sold during the period and recorded sales are not overstated.

Following audit procedures can be performed to perform to verify that recorded sales in financial statements represent goods actually sold during the period and recorded sales are not overstated.

- Check whether a single sales invoice is recorded twice or a cancelled sales invoice has been recorded.
- Test check few invoices with their relevant entries in sales journal.
- Obtain confirmation from few customers to ensure genuineness of sales transaction
- Check whether any fictitious customers and sales have been recorded.
- Verify whether any shipments were done without the consent and agreement of the customer, especially at the year end to inflate the sales figure
- Whether unearned revenue recorded as earned.
- Whether any substantial uncertainty exists about collectability
- Whether customer obligations are contingent on other (financing, resale, etc.).
- Review sequence of sales invoices
- Review journal entries for unusual transactions
- Calculate the ratio of sales return to sales and compare it with previous year and enquire for the reasons for unusual variation.

MTP MARCH 2024

Ques-76 While performing statutory audit of Contra Industries Private Limited, a company engaged in manufacturing and assembling of LED lights, CA Varun has decided to attend physical inventory count process of the company on 30th and 31st March, 2024. The inventories are lying at three different locations - two such locations A and B are in one city and third location C is in another city. Further, company also sends inventories to some service providers for quality control and testing as such facilities are not available with the company. CA Varun is well-versed with this type of industry and has prepared a list of following matters which could be relevant to him in planning attendance at physical inventory count process for discharging his responsibilities in accordance with SAs: -

- Nature of inventories i.e. LED light components, parts, circuits, panels, body, WIP and finished packed LED lights
- Materiality of inventories at different locations A, B and C
- Stage of completion of work-in-progress
- Maintenance of perpetual inventory system by company
- Materiality of inventories lying with service providers
- Timing of physical inventory counting i.e. year end

There are two important matters which do not find place in above list. Without considering these crucial matters, it would be difficult for the auditor to properly plan his attendance at inventory count process in accordance with relevant SA. Discuss such matters.

The list given in the question does not contain following important matters: -

- Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting. The auditor has to evaluate management's instructions for recording and controlling physical inventory counting. It is important for the auditor to know beforehand how the inventory count will be conducted so as to assess its effectiveness.
- The nature of internal control related to inventories at different locations. It is possible that inventories at one location have unsatisfactory control leading to higher risk of material misstatement related to inventories at that particular location.

MTP APRIL 2024

Ques-79 It is important to carry out the Tests of Controls for checking effectiveness of internal control over sales as a part of the debtors' audit procedure. In above context, state the points which need to be considered in respect of trade receivables.

Ans: It is important to carry out Tests of Controls for checking the effectiveness of internal control over sales as a part of the debtors' audit procedure. Following points need to be considered in respect of trade receivables:

- Only bona fide sales lead to trade receivables.
- All such sales are made to approved customers.
- All such sales are properly recorded in the books of accounts.
- Once recorded, the debtors can be settled only by receipt of cash or on the authority of a responsible official.
- Segregation of duties at every point in sales transaction. (accounting for debtors, collecting the payments, sending reminders etc.)
- Debtors are collected on time.
- In case debtors are not collected in time, sending reminders and taking legal actions if required.
- Balances are regularly reviewed.
- A proper system of follow up exists and if necessary, adequate provision for bad debt should be made by preparing adequate ageing schedule of the debtors.

MTP JULY 2024

Ques-85 While verifying cash and cash equivalents of a company, CA D engagement partner, is very particular that Bank reconciliation statement (BRS) prepared by the management in respect of bank account maintained by the company is proper to rule out misstatements in cash and cash equivalents reflected in the financial statements of the company. The company does not use net banking and prefers to issue cheques to its creditors and receives

substantial payments locally through account payee cheques. Which aspects need to be taken care of and verified by CA D in respect of BRS?

Ans: CA D should ensure that BRS is signed by the authorized personnel so that he is able to assign responsibility in case of any errors.

Verification of BRS shall entail the following: -

- Tallying the balance as per bank book to the bank confirmation/ statement.
- Checking of all material reconciling items included under cheques issued but presented for payment to the underlying bank book forming part of books of account. In addition, the auditor should request for bank statements of subsequent period and should verify if the cheques issued have subsequently been cleared by the bank. For all cases where cheques have become stale i.e. 3 months or more have lapsed since the issue date, the same should not appear in the BRS and should instead be taken back to liabilities.
- Checking of all material reconciling items included under cheques deposited but not credited by bank by requesting for bank deposit slips, duly acknowledged by bank and verifying if the balances were credited by bank subsequently by tallying to the bank statement of subsequent period. For any instances related to cheques not cleared beyond reasonable time, the auditor should seek brief descriptions from the management and in case such explanations are found to be unsatisfactory, the auditor should verify the revenue recognition related to such parties was in order and as per the Company's revenue recognition policy.
- Checking of all material reconciling items included under amounts or charges debited/ credited by bank but not accounted for by requesting for bank statements for the period under audit and tallying the same. If the amounts are found to be material, the auditor should ensure that the management records the adjustments for the same in its books of account.

MTP DEC 2024

Ques-10 During the audit of HST Ltd., CA Mukund, the auditor, observed a significant volume of unsold electronic parts as inventory that had remained stagnant for more than two years. He noted that the company was facing difficulty selling these items due to the changes in the market. Additionally, some parts were damaged, and others were discontinued models. CA Mukund also ensured that the inventory was accurately valued to ensure proper financial reporting. You are required to outline the detailed audit procedures that are generally undertaken when auditing such inventories which at the time of observance of physical counting were noted as being damaged or obsolete.

Follow up for items that are obsolete, damaged, slow moving and ascertain the possible realizable value of such items. Carefully examine the valuation of obsolete and damaged inventory.

For the purpose, request the client to provide inventory ageing split and follow up for any inventories which at time of observance of physical counting were noted as being damaged or obsolete.

- Compare recorded costs with replacement costs.
- Examine vendor price lists to determine if recorded cost is less than current prices.
- Calculate inventory turnover ratio. Obsolete inventory may be revealed if ratio is significantly lower.
- In manufacturing environments, test overhead allocation rates and ensure that only direct labour, direct material and overhead have been included.

Verify the correct application of lower-of- cost-or-net realizable value principles.

RTP MAY 2025

CA Tripti is in midst of conducting audit of a company engaged in manufacturing of range of bicycles in an industrial township located in a North Indian state. As part of its activities, the company procures bicycle components from various small and medium sized enterprises. Besides, company imports few bicycle components from China on credit terms. The auditor notices that company has huge trade payables reflected in its financial statements. He wants to be sure that all trade payables reflected in financial statements have been valued appropriately. Suggest few audit procedures to be performed in this respect.

Ans: Audit procedures to be performed to verify that all trade payables reflected in financial statements have been valued appropriately are:

1. Review the process followed by the Company to identify if any old creditor balance needs to be written back. This will include a consistency comparison with the method used in the last year, and a determination of whether the method is appropriate for the underlying business environment.
2. Obtain the ageing of payable balances, and the list of vendors with whom the Company has disputes and any claims from customers, under litigation and compare with previous year.
3. Check that writes backs in the trade payable balances assessed as no longer payable have been approved by an appropriate and authorised member of senior management, for example, CEO/MD.
4. Check that the restatement of foreign currency trade payables has been done properly in accordance with AS 11.
5. Understand management's process to identify the principal amount and the interest due thereon (if any) remaining unpaid to any Micro, Small and Medium Sized Enterprises suppliers at the end of accounting year. Test check the management process to assess if the auditor could rely on the management process.

Chapter-6

Auditors Report

STUDY MATERIAL NEW

Ques-2 "The auditor shall evaluate whether the financial statements are prepared, in all material respects, in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgements." Discuss stating clearly qualitative aspects of the entity's accounting practices

Ans. Evaluations by the Auditor

The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.

This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

Qualitative Aspects of the Entity's Accounting Practices

1. Management makes a number of judgments about the amounts and disclosures in the financial statements.
2. SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.
3. In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgements. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:
 - (i) The selective correction of misstatements brought to management's attention during the audit.
 - (ii) Possible management bias in the making of accounting estimates.

STUDY MATERIAL NEW

Ques-3 Discuss the factors affecting the decision of the auditor regarding which type of modified opinion is appropriate.

Ans. The decision regarding which type of modified opinion is appropriate depends upon:

- (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- (b) The auditor's judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements.

Nature of Matter Giving Rise to the Modification	Auditor's Judgments about the Pervasiveness of the Effects or Possible Effects on the Financial Statements	
	Material but not Pervasive	Material and Pervasive
Financial statements are materially misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence	Qualified opinion	Disclaimer of opinion

STUDY MATERIAL NEW

Ques-4 Discuss the objective of the auditor as per Standard on Auditing (SA) 705 "Modifications to The Opinion in The Independent Auditor's Report".

Ans. As per Standard on Auditing (SA) 705 "Modifications To The Opinion In The Independent Auditor's Report", the objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:

- (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
 (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

EXAM JULY 21

Ques-26. CA Guru is in the process of preparing the final audit report of JPA Private Limited and would like to disclaim his opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence. How CA Guru shall amend the description of the auditor's responsibilities as required by SA 700 (Revised)?

Ans. Since the auditor, CA Guru, disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence of JPA Pvt Ltd, the auditor (CA Guru) shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

- (a) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;
- (b) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements, and
- (c) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised)

STUDY MATERIAL NEW / RTP NOV 19/ RTP NOV 2023

Ques-10 Communicating Key Audit Matter is not a substitute for disclosure in the Financial Statements rather Communicating key audit matters in the auditor's report is in the context of the Auditor having formed an opinion on the financial statements as a whole. Analyse.

Ans. **Communicating key audit matters in the auditor's report is not:**

- (i) A substitute for disclosures in the financial statements that the applicable Financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- (ii) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised);
- (iii) A substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- (iv) A separate opinion on individual matters

EXAM JAN 21 / RTP NOV 2023

Ques-24. What an auditor should state in "Basis for opinion" section of auditor's report and when the auditor modifies the opinion on the financial statements, what amendments he should make in this section?

Ans. **An auditor should state in "Basis for Opinion" section of Auditor's Report as under:**

Basis for Opinion:

The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:

- (i) States that the audit was conducted in accordance with Standards on Auditing;
- (ii) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- (iii) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- (iv) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Amendments an Auditor should make :

When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

- (i) Amend the heading "Basis for Opinion" required by para of SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and

(ii) Within this section, include a description of the matter giving rise to the modification.

EXAM MAY 2022

Ques-33. The senior member of the firm Kaur & Associates, Chartered Accountants, informed to its auditing staff that at the time of audit reporting regarding corresponding figures, when corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in specified circumstances. What are those exceptional circumstances?

Ans. Audit reporting Regarding Corresponding Figures:

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances:

1. If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:
 - (a) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
 - (b) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.
2. If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified.
3. Prior Period Financial Statements Not Audited- If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

Chapter – 7

CARO, 2020

RTP MAY 20

Ques-3. The head accountant of a company entered fake invoices of credit purchases in the books of account aggregate of ₹ 50 lakh and cleared all the payments to such bogus creditor. How will you deal as an auditor?

Ans. Here, the auditor of the company is required to report the fraudulent activity to the Board or Audit Committee (as the case may be) within 2 days of his knowledge of fraud. Further, the company is also required to disclose the same in Board's Report. It may be noted that the auditor need not to report the central government as the amount of fraud involved is less than ₹ 1 crore, however, reporting under CARO, 2016 is required.

MTP MARCH 21, EXAM NOV 19

Ques-4. M Ltd. has given certain loans to related parties and also has accepted certain deposits. As an auditor, how will you include the above items in paragraph 3 of CARO, 2020?

Ans. 1. Clause (iii) of paragraph 3 of CARO, 2020 states

Whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013. If so,

(i) Whether the terms and conditions of the grant of such loans are not prejudicial to the company's interest;

(ii) Whether the schedule of repayment of principal and payment of interest has been stipulated and whether the repayments or receipts are regular;

(iii) if the amount is overdue, state the total amount overdue for more than ninety days, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

2. Further, Clause (v) of paragraph 3 of CARO, 2020 states in case the company has accepted deposits,

(i) Whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any: ether relevant provisions of the Companies Act, 2013 and the rules framed there under, where applicable, have been complied with? If not, the nature of such contraventions is stated;

(ii) If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or not?

In the given situation, M Ltd. has given certain loans to related parties and also has accepted certain deposits. Thus, the auditor is required to report the same as per clause (iii) and (v) of Paragraph 3 of CARO, 2020.

MTP MARCH 2022 / EXAM MAY 2023

Ques-9. State the matters to be included in auditor's report as per CARO, 2020 regarding "Default in repayment of loan or borrowing to a financial institution, bank etc.

Ans. The auditor is required to report as per clause (ix) of paragraph 3 of CARO 2020

(a) whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below:-

Nature of borrowing, including debt securities	Name of lender	Amount not paid On due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any
	lender wise details to be provided in case of defaults to banks, financial institutions and Government.				

(b) whether the company is a declared wilful defaulter by any bank or financial institution or other lender;

- (c) whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported;
- (d) whether funds raised on short term basis have been utilized for long term purposes, if yes, the nature and amount to be indicated;
- (e) whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case;
- (f) whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised;

RTP MAY 22

Ques-12. Explain the Reporting requirements the auditor should ensure under CARO 2020 related to PPE and Intangible assets..

Ans. Reporting for PPE and Intangible assets - Clause (i) of Para 3 of CARO ,2020, requires the auditor to include a statement in the auditor's report on the following matters, namely -

- (i) (a) (A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;
- (B) whether the company is maintaining proper records showing full particulars of intangible assets;
- (b) whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
- (c) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof in the format below:-

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held -indicate range, where appropriate	Reason for not being held in name of company*
					*also indicate if in dispute

- (d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;
- (e) Whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements.

EXAM MAY 22

Ques-13. Q. G Pvt . Ltd. had fully paid up Capital and Reserves of 1.20 crore is at the end of F.Y 2020-2021. During the F.Y 2021-2022 , business was interrupted due to Covid restrictions and therefore the company incurred losses to the tune of 25 lacs . During the year, the company also borrowed 55 lakh each from a bank and a financial institution independently. It had a turnover of 850 lakh (other than revenue of 250 lakh from discontinuing operations) . Ascertain whether CARO , 2020 is applicable to the company .

Ans. Applicability of CARO, 2020 in case of Private Ltd. Company:

CARO, 2020 shall apply to every company including a foreign company except- a private limited company, not being a subsidiary or holding company of a public company,

- (i) having a paid-up capital and reserves and surplus not more than one crore rupees as on the balance sheet date; and
- (ii) which does not have total borrowings exceeding one crore rupees from any bank or financial institution at any point of time during the financial year; and

(iii) which does not have a total revenue as disclosed in Scheduled III to the Companies Act (including revenue from discontinuing operations) exceeding ten crore rupees during the financial year as per the financial statements.

Applying the above to the given case, G Pvt. Ltd., its paid-up capital and reserves are ` 95 Lakh (` 120 Lakh - ` 25 Lakh), borrowings from a Bank and financial institution are (` 55 Lakh + ` 55 Lakh) i.e., ` 1.10 Crore, turnover {including discontinuing operations (` 850 lakh + ` 250 Lakh)} ` 1100 Lakh i.e., ` 11 Crore.

Since its borrowings and turnover are exceeding the specified limit and therefore it is not exempt from the applicability of CARO, 2020.

MTP APRIL 2024

Ques-17 CA. Ravi Patnaik is conducting audit of a company for which reporting requirements under CARO, 2020 are applicable. He finds that cash credit facilities amounting to ` 4 crores were released to the company by branch of a bank for meeting its working capital requirements. He finds that out of above funds, ` 1 crore have been used by company for installing effluent treatment plant to meet State pollution control Board requirements.

Is there any reporting obligation upon him under CARO, 2020?

Ans: Clause (ix) (d) of CARO, 2020 whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated.

In the given situation, funds have been raised for meeting working capital requirements for ` 4 crores. Cash credit facilities for meeting working capital requirements are, by their very nature, short term borrowings. Out of above, ` 1 crore have been used by the company for investment in effluent treatment plant which is ostensibly for a long-term purpose.

Hence, the matter needs to be reported in accordance with requirements of Clause (ix) (d) of CARO, 2020.

Chapter – 9

Special Features of Audit of Different types of Entities

STUDY MATERIAL NEW / MTP APRIL 2023

Ques-7 As an auditor, what would be your areas of consideration while auditing the element of ROOM SALES during the audit of a 5-Star Hotel.

Ans. Following points merit consideration while auditing the element of ROOM SALES during the audit of a Hotel :-

- (a) The charge for room sales is normally posted to guest bills by the receptionist/ front office or in the case of large hotels by the night auditor.
- (b) The source of these entries is the guest register and audit tests should be carried out to ensure that the correct numbers of guests are charged for the correct period.
- (c) Any difference between the charged rates used on the guests' bills and the standard room rate should be investigated to ensure that they have been properly authorized.
- (d) In many hotels, the housekeeper prepares a daily report of the rooms which were occupied the previous night and the number of beds kept in each room. This report tends not to be permanently retained and the auditor should ensure that a sufficient number of reports are available for him to test both with the guest register and with the individual guest's bill.
- (e) Ensure compliance with the provisions of FEMA and RBI if receipts are in foreign currency. Ensure application of proper Conversion rate.
- (f) Special emphasis to be laid on receipts through Credit Cards.
- (g) The auditor should ensure that proper valuation of occupancy-in- progress at the balance sheet date is made and included in the accounts.

STUDY MATERIAL NEW / EXAM DEC 21

Ques-9 CA A is appointed as the auditor of a charitable institutions. Discuss the audit procedure undertaken by him while auditing the Subscription and Donation received by the charitable institution.

Ans. Audit Procedure in audit of Subscriptions & donations:

Audit Procedure to be undertaken by CA A in respect of Subscriptions and donations received by a Charitable Institution is:

- (i) Ascertaining, if any, the changes made in amount of annual or life membership subscription during the year.
- (ii) Whether official receipts are issued;
 - (a) confirming that adequate control is imposed over unused receipt books;
 - (b) obtaining all receipt books covering the period under review;
 - (c) test checking the counterfoils with the cash book; any cancelled receipts being specially looked into;
 - (d) obtaining the printed list of subscriptions and donations and agreeing them with the total collections shown in the accounts;
 - (e) examining the system of internal check regarding moneys received from box collections, flag days, etc. and checking the amount received from representatives, with the correspondence and the official receipts issued; paying special attention to the system of control exercised over collections and the steps taken to ensure that all collections made have been accounted for; and
 - (f) verifying the total subscriptions and donations received with any figures Published in reports, etc. issued by the charity.

STUDY MATERIAL NEW / RTP MAY 21/ EXAM JULY 21/ MTP APRIL 22

Ques-15 Define Government Audit & explain its objectives

OR

Government audit has not only adopted the basic essentials of auditing as known and practiced in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession. Explain stating clearly the definition of Government auditing as discussed in U.N. Handbook on Govt Auditing and Developing Countries and also state Objectives of Govt audit.

Ans. Government Audit is the objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity, made subsequently to their execution for the purpose of evaluating and verifying them, presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future action by the responsible officials and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

OBJECTIVES:-

1. Accounting for Public Funds: - It serves as a mechanism or process for public accounting of government funds.
2. Appraisal of Govt. Policies: -It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.
3. Corrective Actions: - Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures.
4. Administrative Accountability:- The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration

STUDY MATERIAL, EXAM MAY 19, MTP APRIL 2023

Ques-16 Central Govt. hold 55% of the paid up share Capital in Kisan Credit Co- operative Society, which is incurring huge losses. Advise when the Central Government can direct Special Audit under Section 77 of the Multi State Co- operative Society Act.

Ans. Central Government shall order for special audit only if that Government or the State Government either by itself or both hold fifty-one percent or more of the paid-up share capital in such Multi -State co-operative society. Under section 77 of the Multi-State Co-operative Societies Act, 2002, where the Central Government is of the opinion:

- I. that the affairs of any Multi-State co-operative society are not being managed in accordance with self-help and mutual deed and co- operative principles or prudent commercial practices or with sound business principles; or
 - Ii that any Multi-State co-operative society is being managed in a manner likely to cause serious injury or damage to the interests of the trade industry or business to which it pertains; or
 - Iii that the financial position of any Multi-State co-operative society is such as to endanger its solvency.
- Thus, in the given case since Central Govt is holding 55% shares and financial position of Kisan Credit co-operative society is in danger, Central government can direct for special audit.

RTP MAY 19, EXAM NOV 19

Ques-17 Discuss the matters which should be specially considered in the audit of accounts of a partnership.
OR

There are certain points which are required to consider Especially in the audit of accounts of a partnership. Discuss any three points briefly.

Ans. Matters which should be specially considered in the audit of accounts of a partnership:

- (i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.
- (ii) Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans; purchase of assets, extraordinary contracts entered into and other such matters as are not of a routine nature.
- (iii) Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.
- (iv) Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.
- (v) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreements. (vi)Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners.

(vii) Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio

EXAM MAY 19, MTP MAY 20, MTP NOVEMBER 21, MTP APRIL 2023

Ques-22 Discuss the powers of C&AG in Government Audit

OR

The C&AG Act gives powers to the C&AG in connection with the performance of his duties. Explain.

OR

The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 provides certain powers to the C & AG in connection with performance of his duties. Discuss.

Ans. Powers of C&AG: The C&AG Act gives the following powers to the C&AG in connection with the performance of his duties-

- i. To inspect any office of accounts under the control of the Union or a State Government including office responsible for the creation of the initial or subsidiary accounts.
- ii. To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.
- iii. To put such questions or make such observations as he may consider necessary to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which is his duty to prepare.

In carrying out the audit, the C&AG has the power to dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transactions as he may determine

RTP NOV 20, EXAM NOV 20, MTP NOV 21, MTP APRIL 2022

Ques-26 Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. Analyse and Explain

OR

What is the function of audit while examining various rules, regulations and orders with regard Audit against Rules & Orders by C&AG?

Ans. Audit against Rules & Orders - Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made there under. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority.

It is the function of the executive government to frame rules, regulations and orders, which are to be observed by its subordinate authorities. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. But, it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that:

- (a) They are not inconsistent with any provisions of the Constitution or any laws made there under;
- (b) They are consistent with the essential requirements of audit and accounts as determined by the C&AG;
- (c) They do not come in conflict with the orders of, or rules made by, any higher authority; and
- (d) In case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power.

EXAM NOV 20, MTP NOV 21

Ques-29 Explain the different types of revenue grants which local bodies may receive.

Ans. Local bodies may receive different types of grants from the state administration as well. Broadly, the revenue grants are of three categories:

- (a) **General purpose grants:** These are primarily intended to substantially bridge the gap between the needs and resources of the local bodies.

- (b) Specific purpose grants: These grants which are tied to the provision of certain services or performance of certain tasks.
- (c) Statutory and compensatory grants: These grants, under various enactments, are given to local bodies as compensation on account of loss of any revenue on taking over a tax by state government from local government.

EXAM JAN 21

Ques-31 You have been appointed as internal auditor of 'City Club' in Delhi. The receipts of the club were 50 lakhs during the previous year ending 2019-20. You are required to mention special points of consideration while auditing such receipts of the club

Ans. The special steps involved, to be considered by the Internal Auditor of City Club in conducting the audit of receipts of the club are stated below-

- (1) Vouch the receipt on account of entrance fees with members' applications, counterfoils issued to them, as well as on a reference to minutes of the Managing Committee.
- (2) Vouch members' subscriptions with the counterfoils of receipt issued to them, trace receipts for a selected period to the Register of Members; also reconcile the amount of total subscriptions due with the amount collected and that outstanding.
- (3) Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
- (4) Check totals of various columns of the Register of members and tally them across.
- (5) See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery; the amount considered irrecoverable should be mentioned in the Audit Report.
- (6) Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests, as well as, with the fees chargeable for the special services rendered, such as billiards, tennis, etc.

EXAM DEC 21, MTP MARCH 2022, MTP MARCH 2024

Ques-38 Audit of government expenditure is one of the major components of government audit conducted by the office of C & AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Explain those standards

Ans. Expenditure Audit: The audit of government expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are to ensure that there is provision funds authorised by competent authority fixing the limits within which expenditure can be incurred. These standards are—

- (i) that the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the Financial Rules and Regulations framed by the competent authority. Such an audit is called as the audit against 'rules and orders'.
- (ii) that there is sanction, either special or general, accorded by competent authority authorising the expenditure. Such an audit is called as the audit of sanctions.
- (iii) that there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority. Such an audit is called as audit against provision of funds.
- (iv) that the expenditure is incurred with due regard to broad and general principles of financial propriety. Such an audit is also called as propriety audit.
- (v) that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Such an audit is termed as the performance audit.

RTP MAY 2022

Ques-41 No inspection under Section 79 of Multi-State Co-operative Societies Act, 2002 shall be made unless a notice has been given to the multi-state co-operative society. Explain stating clearly when and how such inspection can be made. Also state the powers available with the Central Registrar in this regard along with provisions relating to communication of the inspection report under the said section.

Ans Inspection of Multi-State Co-operative societies under Section 79

1. **When:** The Central Registrar may, on a request from
 - (i) federal co-operative to which a Multi-State Co-operative society is affiliated or a creditor or
 - (ii) not less than one-third of the members of the board or
 - (iii) not less than one-fifth of the total number of members of a Multi-State co-operative society
2. **How:** By general or special order in writing in this behalf inspect or direct any person authorized by him by order in writing in this behalf to make an inspection into the constitution, working and financial condition of a Multi-State co-operative society.
3. **Opportunity of Being heard:** No inspection shall be made unless a notice of not less than fifteen days has been given to the multi-state co-operative society.
4. **Powers available:** The Central Registrar or the person authorized by him shall have the following powers:
 - (a) He shall at all times have access to all books, accounts, papers, vouchers, securities, stock and other property of that society and may, in the event of serious irregularities discovered during inspection, take them into custody and shall have power to verify the cash balance of the society and subject to the general or special order of the central registrar to call a meeting of the society where such general meeting is, in his opinion necessary.
 - (b) Every officer or member of a Multi-State Co-operative society shall furnish such information with regard to the working of the society as the central registrar or the person making such inspection may require.
5. **Inspection Report:** A copy of the report of inspection under this section shall be communicated to the Multi-State Co-operative society within a period of three months from the date of completion of such inspection.

EXAM MAY 2022

Ques-42 M / s T & Co. Chartered Accountants , a partnership firm , is appointed as an auditor of Treatment Hospital run by Smile Foundation , a charitable trust . Over and above the receipts of treatment of patients , during the year trust has received donations from various donors to treat COVID - 19 patients and also incurred some capital expenditure for further development of the hospital . On some of the investment income , income tax has been deducted . What are the special points to be considered by M / s T & Co. while auditing such transactions of Treatment Hospital ?

Ans. Audit of a Hospital:

(A) Receipts from treatment of patients

1. Register of Patients: Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.

2. Collection of Cash from patients: Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patient's bills.

(B) Donations from donors to treat the patients: Ascertain those legacies and donation received for a specific purpose have been applied in the manner agreed upon.

(C) Capital Expenditure Incurred: Verify the Capital Expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee.

(D) Where income-tax has been deducted from the Investment income, it should be seen that a refund thereof has been obtained since charitable institutions are exempt from payment of Income-tax. This involves:

- (i) vouching the Income-tax refund with the correspondence with the Income-tax Department; and
- (ii) checking the calculation of the repayment of claims/refund claim.

RTP NOV 2023

Ques-71 As an auditor, how will you verify the hire purchase transaction in the case of an entity engaged in the business of hire purchase?

Ans: Verification of Hire-purchase transactions: While checking the hire-purchase transaction, the auditor may examine the following:

1. Hire purchase agreement is in writing and is signed by all parties.
2. Hire purchase agreement specifies clearly -
 - (i) The hire-purchase price of the goods to which the agreement relates;

- (ii) The cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash;
 - (iii) The date on which the agreement shall be deemed to have commenced;
 - (iv) The number of instalments by which the hire-purchase price is to be paid, the amount of each of those instalments, and the date, or the mode of determining the date, upon which it is payable, and the person to whom and the place where it is payable; and
 - (v) The goods to which the agreement relates, in a manner sufficient to identify them.
3. Ensure that payments are being received regularly as per the agreement

RTP MAY 2025

A government department has been allocated a budget for infrastructure development. During the audit, the auditor observes the following:

- (i) Some payments were processed without proper approval from the competent authority.
 - (ii) A large-scale project was implemented, but no assessment has been made regarding the expected benefits were achieved or not.
 - (iii) Funds were utilised from an account for which no budgetary provision was made.
 - (iv) Certain expenditures were made without following the prescribed financial regulations.
 - (v) There were instances of unnecessary spending that did not align with financial propriety.
- Identify the different types of audits applicable to each of these observations.

Ans: The audit of government expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred.

- (i) When payments are processed without proper approval from the competent authority, an Audit of Sanctions is required. This ensures that there is sanction, either special or general, accorded by competent authority authorising the expenditure.
- (ii) In cases where a large-scale project has been implemented without any assessment of whether the expected benefits were achieved, a Performance Audit is necessary. This type of audit ensures that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them.
- (iii) When funds were utilised from an account for which no budgetary provision was made, an Audit Against Provision of Funds is conducted. This ensures that there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority.
- (iv) If expenditures are made without adhering to the prescribed financial regulations, an Audit Against Rules and Orders is applicable. This audit ensures that the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the Financial Rules and Regulations framed by the competent authority.
- (v) Instances of unnecessary spending that do not align with financial propriety fall under the scope of a Propriety Audit.

MTP APRIL 2025

While auditing a renowned four-star hotel in Pune, CA Shrey observes a gift shop operating within the hotel premises. On further enquiries, he comes to know that stocks in gift shop belong to gift shop owner and hotel receives rent for letting out this space. Discuss, how, auditor can verify payment of common amenities used by gift shop owner to the hotel.

Ans: While auditing a renowned four-star hotel in Pune, CA Shrey observes that a gift shop is operating within the hotel premises. Upon further enquiry, he finds that the stock in the gift shop belongs to gift shop owner and the hotel receives rental income for letting out the space. In this context, to verify the payment of common amenities used by the gift shop owner to hotel, the auditor may adopt the following audit procedures:

1. The auditor should obtain and examine the rental/lease agreement entered into between the hotel and the gift shop owner.
2. The auditor should verify rent receipts. This would enable the auditor to ensure that controls regarding revenue cycle are in order.

3. The auditor should satisfy himself that all taxes collected from gift shop have been paid over to the proper authorities.
4. Evaluate internal controls related to monitoring of utility consumption and collection of recoveries from tenants or concessionaires (like gift shops).
5. Verify the hotel's utility bills (electricity bill, water bill etc.) and assess whether cost sharing with the gift shop is proportionate and reasonable.
6. The auditor should verify that amounts charged for such amenities have been appropriately recorded in the hotel's books and that collections are reconciled with receipts.
7. The auditor should see that costs of repairs and minor renovation and redecoration are treated as revenue expenditure, where as costs of major alterations and additions to the hotel building and facilities capitalised.

Chapter-10

Audit of Banks

STUDY MATERIAL NEW

Ques-2 Discuss importance of implementation of KYC norms by a bank from perspective of an auditor of bank.

Ans: As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor's objective is to identify and assess the risks of material misstatement in the financial statements due to fraud, to obtain sufficient appropriate audit evidence on those identified misstatements and to respond appropriately. The attitude of professional skepticism should be maintained by the auditor so as to recognise the possibility of misstatements due to fraud.

The RBI has framed specific guidelines that deal with prevention of money laundering and "Know Your Customer (KYC)" norms. The RBI has from time to time issued guidelines ("Know Your Customer Guidelines - Anti Money Laundering Standards"), requiring banks to establish policies, procedures and controls to deter and to recognise and report money laundering activities.

STUDY MATERIAL NEW

Ques-7 "The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference". Explain

Ans: Nature of Discussions with the Engagement Team:-

- (a) Error that may occur
- (b) Errors that have been occurred in Past Years
- (c) Method by which can be conducted by Bank personnel
- (d) Audit response to identified risk
- (e) Need to maintain Professional Skepticism

STUDY MATERIAL ,MTP APRIL 2023, RTP MAY 2023,

Ques-10. Explain the audit approach you would follow to check the Operating Expenses of a Bank

Ans Auditing the Operating Expenses of a Bank:-

- (a) Internal Controls:-The auditor should study and evaluate the system of internal control relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit procedures.
- (b) Divergent Trends:-The auditor should examine whether there are any divergent trends in respect of major items of expenses.
- (c) Substantive analytical Procedures:-The auditor should perform substantive analytical procedures in respect of these expenses. eg. Assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years.
- (d) Vouching & Verification:- The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required

EXAM MAY 18, RTP NOV 20, MTP APRIL 21

Ques-11. Mr. A approaches a bank for financial assistance for his upcoming project. The bank branch manager, after verifying the proposal, is agreeable to financial Mr. A, but asks for the security of is offered to the bank. Discuss the nature of securities required to be offered to the bank

Ans Nature of Security:

I. Primary security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the principal security for an advance.

II. Collateral security is an additional security. Security can be in any form i.e. tangible or intangible asset, movable or immovable asset.

Examples of most common types of securities accepted by banks are the following.

- Personal Security of Guarantor

- Goods / Stocks / Debtors / Trade Receivables
- Gold Ornaments and Bullion
- Immovable Property
- Plantations (For Agricultural Advances)
- Third Party Guarantees
- Banker's General Lien
- Life Insurance Policies
- Stock Exchange Securities and Other Instruments

EXAM NOV 18/ MTP MARCH 22

Ques-12. "Ramjilal & Co. had been allotted the branch audit of a nationalized bank for the year ended 31st March, 2019. In the audit planning, the partner of Ramjilal & Co., observed that the allotted branches are predominantly based in rural areas and major portion of the advances were for agricultural purpose. "Now he needs your assistance on the following points so as to incorporate them in the audit plan:

(a) For determine of NPA norms for agricultural advances

(b) For accounts where there is erosion in the value of security / frauds. Committed by the borrower

Ans. (a) NPA norms for Agricultural Advances: **As per the guidelines, Agricultural Advances are of two types,**

(1) Agricultural Advances for "long duration" crops and

(2) Agricultural Advances for "short duration" crops

The "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops.

The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each State.

The following NPA norms would apply to agricultural advances (including Crop Term Loans):

A loan granted for short duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for two crop seasons and,

A loan granted for long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season.

(b) Accounts where there is erosion in the value of security / frauds committed by borrowers

Not prudent to follow stages of asset classification. It should be straightaway classified as doubtful or loss asset as appropriate.

(i) Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category and provisioning should be made as applicable to doubtful assets.

(ii) If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off or fully provided for by the bank.

EXAM NOV 18, RTP MAY 19, RTP NOV 19, MTP MARCH 2022

Ques-13. The auditor should examine the efficacy of various internal controls over advances in case of Banks to determine the nature, timing and extent of his substantive procedures. Explain what is included in the internal controls over advances.

Ans. Evaluation of Internal Controls over Advances: The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. In general, the internal controls over advances should include, inter alia, the following:

1. The bank should make an advance only after satisfying itself as to the credit worthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank.
2. All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
3. The compliance with the terms of sanction and end use of funds should be ensured.

4. Sufficient margin as specified in the sanction letter should be kept against securities taken so as to cover for any decline in the value thereof. The availability of sufficient margin needs to be ensured at regular intervals.
5. If the securities taken are in the nature of shares, debentures, etc., the ownership of the same should be transferred in the name of the bank and the effective control of such securities be retained as a part of documentation.
6. All securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to give title to the bank.
7. In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipt. The godowns should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.
8. Drawing Power Register should be updated every month to record the value of securities hypothecated. These entries should be checked by an officer.
9. The accounts should be kept within both the drawing power and the sanctioned limit.
10. All the accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly.
11. The operation of each advance account should be reviewed at least once a year, and at more frequent intervals in the case of large advances.

EXAM JULY 21, RTP NOV 21

Ques-28. Discuss the advantages of engagement team discussion done at the planning stage of the bank audit OR

The engagement team discussion ordinarily includes a discussion of the matters such as

- Errors that may be more likely to occur; Errors which have been identified in prior years;

Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures; etc.

Ans. Advantages of engagement team discussion done at the planning stage of Bank audit are:

- Specific emphasis should be provided to the susceptibility of the bank's financial statements to material misstatement due to fraud, that enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
- It further enables the audit engagement partner to delegate the work to the experienced engagement team members, and to determine the procedures to be followed when fraud is identified.
- Further, audit engagement partner may review the need to involve specialists to address the issues relating to fraud.

MTP NOV 21, EXAM JAN 21

Ques-29. Explain "Advances under Consortium" in the context of Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances

Advances under Consortium: Consortium advances should be based on the record of recovery of the respective individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, an NPA.

The banks participating in the consortium, therefore, need to arrange to get their share of recovery transferred from the lead bank or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

EXAM MAY 2022

Ques-36. After becoming Chartered Accountant, you have got your first assignment as an auditor of a bank branch dealing in various types of advances. What are the areas which you will be looking for obtaining sufficient appropriate evidence (for advances) besides studying and evaluating internal controls?

Ans. Audit Procedure in Audit of Advances in case of Bank Audit: The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of internal controls relating to advances, and by:

- (i) examining the validity of the recorded amounts;

- (ii) examining loan documentation.
- (iii) reviewing the operation of the accounts;
- (iv) examining the existence, enforceability and valuation of the security;
- (v) checking compliance with RBI norms including appropriate classification and provisioning; and
- (vi) carrying out appropriate analytical procedures.

RTP NOV 2023

Ques-41 TEP Industries Private Limited, a company engaged in obtaining rice from paddy, is enjoying a cash credit facility against hypothecation of paid stocks and book debts (eligible up to 90 days only) from LMV Bank for ₹4.00 crore. The letter sanctioning the above credit facility stipulates margin @ 25% on stocks and @ 40% on eligible book debts up to 90 days.

While preparing stock statement as on 30.6.23, accountant of the company calculates value of stocks for ₹5 crore (including 1 crore of rice which was lying in a low lying godown and was completely damaged during recent floods caused by river Yamuna) Debtors outstanding as on 30.6.23 are ₹ 3 crore (including 50 lacs outstanding for last 6 months) Trade creditors outstanding as on date are 2 crore. He calculates DP as on 30. 6. 23 for 3.30 crore. Is he correct? Justify with your workings.

What does drawing power calculated by you signify to the borrower company?

Ans: The calculation of DP is as under:

Value of stocks as on 30.6.23	' 5.00 crore
Less: value of damaged stocks	' 1.00 crore
Value of stocks considered as on 30.6.23	' 4.00 crore
Less: trade creditors	' 2.00 crore
Paid stocks	' 2.00 crore
Less: Margin @ 25%	' 0.50 crore
Drawing power for stocks [A]	' 1.50 crore
Value of Trade debtors	' 3.00 crore
Less: debtors outstanding for more than 90 days	' 0.50 crore
	' 2.50 crore
Less: Margin @ 40%	' 1.00 crore
Drawing power for Book debts [B]	' 1.50 crore
Total drawing power [A+B]	' 3.00 crore

Accountant's DP calculation is not correct. The drawing power of ` 3.00 crore signifies that company can utilize funds to the tune of ` 3.00 crore only against sanctioned cash credit limit of ` 4.00 crore

MTP NOV 2024

Ques-7 Mahavir and Associates is appointed as the statutory auditor of KBC Bank for the financial year 2023-2024. During the audit, Ms. Chandana, an article trainee, noticed that Sidharth Industries had an outstanding loan of ` 50,00,000 as on March 31, 2024. On March 29, 2024, the company made a payment of ` 10,00,000, reducing the outstanding loan balance to ` 40,00,000. However, on April 4, 2024, Sidharth Industries initiated a reversal transaction of ` 8,00,000, increasing the outstanding loan balance back to ` 48,00,000. The payment and subsequent reversal occurred within a short period, with the final outstanding balance remaining ` 48,00,000 after the reversal.

Ans: Accounts regularized near the Balance Sheet Date: The asset classification of borrower accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as NPA.

The auditor should check for sample transactions immediately before the closing of the financial year and immediately after the closing of the financial year to get a knowledge of the objective behind the transactions if they have any relation to each other in the borrower accounts or if any/some transactions are being reversed during the first few days after closing which might show an arrangement to prevent the Borrower account(s) from slipping into the NPA category.

In the given case of Sidharth Industries, a payment of ₹10,00,000 was made on March 29, 2024 reducing the outstanding loan balance to ₹40,00,000. and subsequently reversed by ₹8,00,000 on April 4, 2024. Thus, Mahavir and Associates should carefully assess the classification of Sidharth Industries' Account, and determine if the payment and reversal transactions indicate an attempt to prevent the account from slipping into the NPA category. If yes, the account should be classified as an NPA in compliance with regulatory guidelines.

RTP MAY 2024

Ques-46 While verifying provisions of advances of a branch of MCO Bank as part of statutory branch audit, CA Z notices that credit facilities consisting of term loan to KRT Enterprises have been classified under doubtful asset (D1) category. The outstanding balance in above term loan account as on 31.3.2023 is ₹50 lakhs. Value of security held in account is ₹40 lakhs. The branch has made provision of ₹7.50 lakhs. Is provision made by branch proper? Discuss

The provision for advances falling in D1 category is required @ 25% of secured portion and 100% of unsecured portion. Therefore, provision in above case is arrived as under: -

Outstanding balance as on 31.3.23	50 lakhs
Less: Value of security	40 lakhs

Unsecured portion	10 lakhs
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Therefore, outstanding balance of ₹50 lakhs is secured to the tune of ₹40 lakhs and balance ₹10 lakhs is unsecured.

Provision calculation

25% of secured part i.e., 25% of ₹40 lakhs	₹10 lakhs
100% of unsecured part i.e., 100% of ₹10 lakhs	₹10 lakhs

Required provision	₹20 lakhs
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Therefore, provision made by branch is not proper. It should have made provision of ₹20 lakhs instead of ₹7.50 lakhs.

RTP JAN 2025

Ques-56 Agrim, a CA student, is part of an engagement team conducting audit of Madurai branch of ARB Bank. CA Bhuvan, engagement partner, has asked him to verify provision made by branch as on March 31st, 2024 in respect of the following non-performing assets: -

Name of Account	NPA classification	Outstanding amount as on March 31st, 2024 (In ₹ lakhs)	Amount of provision made (In ₹ lakhs)
AK Industries	Doubtful (D1)	10.00	5.00
Jupiter Traders	Substandard asset	50.00	7.50
VT & Co.	Doubtful (D2)	30.00	30.00
ASD & Sons	Loss	1.00	1.00

The engagement partner has already verified NPA classification. Outstanding amounts as on March 31st, 2024, relating to each NPA account listed above (except ASD & Sons) are fully secured. However, only personal guarantee of proprietor (Net worth of proprietor ₹50 lakhs) is available in account of ASD & Sons. Comment on the correctness of the above provisions.

Agrim is in dilemma regarding classification of above accounts as NPA although these are fully secured or guaranteed. Guide him.

Ans: The auditor is required to ensure that provision for NPA is made as per its classification in different categories which are given as under:

Categories of Non- Performing Assets:	Provision required
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From the above provision, it can be concluded that in case of:

AK Industries- It has been classified as Doubtful (D1) category. Therefore, it requires provision of 25% of secured amount. That is provision of Rs 2.50 lakh (i.e 25% of ` 10 lakh) should be made instead of ` 5 lakh.

Jupiter Traders- It has been classified as Substandard asset. It requires provision of 15% of outstanding amount (i.e 15% of ` 50 lakhs) which comes to ` 7.50 lakh. Therefore, provision made by the branch is correct.

VT & Co.- It has been classified as Doubtful (D2) category. It requires provision of 40% of secured amount. That is provision of ` 12.00 lakh (40% of ` 30 lakhs) should be made instead of ` 30 lakh.

ASD & Sons- It has been classified as a loss asset which requires provision of 100% of outstanding amount. Therefore, the provision made by the branch is correct.

Classification as NPA should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise. Hence, these accounts have been classified as NPA on the record of recovery although these are fully secured or guaranteed.

Chapter - 10

Ethics & Terms of Audit Engagement

STUDY MATERIAL NEW

Ques-1 Briefly outline how principles-based approach differs from rules-based approach to ethics.

Ans: Ethical guidance may follow principles-based approach or rules-based approach. The essence of principles-based approach to ethics is that it requires compliance with spirit of ethics. It requires accountants to exercise professional judgment in every situation based upon their professional knowledge, skill and expertise. It requires that accountants should use professional judgment to evaluate every situation to arrive at conclusions.

However, rules-based approach to ethics strictly follows clearly established rules. It may lead to a narrow outlook and spirit of ethics may be overlooked while strictly adhering to rules. Further, rules-based approach is somewhat rigid as it may not be possible to deal with every practical situation relying upon rules.

Therefore, it is necessary that spirit of code is followed.

STUDY MATERIAL OLD

Ques-5 "The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats". Explain

Ans. Threats to Independence:

The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. These are:

- 1. Self-interest threats**, which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. **Examples include**
 - (i) direct financial interest or materially significant indirect financial interest in a client,
 - (ii) loan or guarantee to or from the concerned client,
 - (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement,
 - (iv) close business relationship with an audit client,
 - (v) potential employment with the client, and
 - (vi) contingent fees for the audit engagement. Like, in case an audit firm unduly relies on fees from a client, it may result in threat to self-interest of auditor and he may not work objectively for the fear of losing client.
- 2. Self-review threats**, which occur when during a review of any judgment or conclusion reached in a previous audit or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. **Instances where such threats come into play are**
 - (i) when an auditor is having recently been a director or senior officer of the company, and
 - (ii) when auditors perform services that are themselves subject matters of audit.
- 3. Advocacy threats**, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes. In such situations, auditor can be perceived as backing and championing causes of auditee client and it may lead to belief that auditor is not acting and working objectively. Remember that auditor has not only to be independent but also appear to be acting so.
- 4. Familiarity threats** are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. **This can occur in many ways:**
 - (i) close relative of the audit team working in a senior position in the client company,
 - (ii) former partner of the audit firm being a director or senior employee of the client,
 - (iii) long association between specific auditors and their specific client counterparts, and
 - (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees. Provisions in Companies Act, 2013 regarding rotation of auditors mainly address these very familiarity threats. Such

provisions prescribe that auditor is rotated after a certain number of years so that auditors do not become too familiar with their clients.

5. Intimidation threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees or being threatened with litigation. Such threats attempt to intimidate auditors to deter them from acting objectively.

EXAM MAY 19, MTP OCTOBER 20, RTP MAY 23

Ques-7 "Independence of mind and independence in appearance are interlinked perspectives of Independence of auditors". Explain.

Ans. "Independence" implies that the judgment of a person is not subordinate to the wishes or direction of another person who might have engaged him. The auditor should be independent of the entity subject to the audit. There are two interlinked perspective of independence of auditors, one independence of mind and two, independence in appearance. The Code of Ethics for Professional Accountants issued by International Federation of Accountants (IFAC) defines the term "Independence" as comprising both-

(a) Independence of mind :-the state of mind that permits the provision of an opinion without being affected by influences allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and
(b) Independence in appearance:-the avoidance of facts and circumstances that are so significant that a third party would reasonably conclude an auditor's integrity, objectivity or professional skepticism had been compromised." Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons.

MTP MARCH 2024

Ques-10 CA Tripad (engagement partner) based at New Delhi is external auditor of Lap of Nature, a firm, since last three years. The firm is engaged in business of providing tourism services including holiday packages to its club members. It has also provided auditor including his team members free holiday for a week every year in one of its premium resorts in Ooty in the State of Tamil Nadu. The company has also booked free air travel for engagement team members during all these years. Discuss why Chartered Accountant is not acting ethically. How are familiarity threats created in above situation?

Ans: The firm is providing free hospitality to engagement team members including engagement partner. In such circumstances, fundamental principles governing professional ethics are violated. Such acts of free hospitality are capable of impairing objectivity of auditor.

The situation given in the question signifies that auditors have formed relationships with client where they may end up being too sympathetic to the client's interests. Due to free hospitality enjoyed by engagement team members, they may take a sympathetic view to issues which may have arisen during course of audit. In this way, familiarity threats are created in the situation.

RTP JAN 2025

Ques-12 CA Sudhakar has been appointed as the auditor of AMRO Ltd. Before accepting the appointment, he learns that his cousin, who held shares in the company and recently passed away without children, named him as the nominee for these shares, which have substantial value. Although holding such shares through a distant relative does not violate legal provisions or affect his independence, this unexpected inheritance places him in a dilemma. Advise CA Sudhakar on how he should deal with this situation and safeguard his independence.

Ans: In the given situation, holding shares by CA Sudhakar involves financial interest in the company and is in nature of self-interest threat. Though he has come to hold shares due to nomination made by his distant relative before accepting the appointment.

Chartered Accountants have a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to address the threats.

Safeguards are actions, individually or in combination, that the professional accountant takes that effectively reduce threats to comply with the fundamental principles to an acceptable level.

To address the issue, the following guiding principles are to be applied: -

- ✦ For the public to have confidence in the quality of audit, it is essential that auditors should always be and appear to be independent of the entities that they are auditing.
- ✦ Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.
- ✦ When such threats exist, the auditor should either desist from the task or eliminate the threat or at the very least, put in place safeguards which reduce the threats to an acceptable level. All such safeguard measures need to be recorded in a form that can serve as evidence of compliance with due process.
- ✦ If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

Considering above, holding of shares of the same company for which he is offered appointment as auditor constitutes threat to his independence. Therefore, CA Sudhakar should take steps to eliminate the threat by selling shares immediately before accepting the appointment and in the absence of same, he should not accept the appointment as an auditor..

Chapter-11

Standards on Auditing

SA-200

RTP NOV 20

Ques-3 Professional skepticism refers to an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated. Explain giving examples.

Ans. The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated.

Professional skepticism includes being alert to, for example:

- Audit evidence that contradicts other audit evidence obtained.
- Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
- Conditions that may indicate possible fraud.
- Circumstances that suggest the need for audit procedures in addition to those required by the SAs.
- Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:
- Overlooking unusual circumstances.
- Over generalizing when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

MTP OCT 20

Ques-4 "Professional judgment is essential to the proper conduct of an audit." Discuss.

Professional judgment is essential to the proper conduct of an audit. This is because interpretation of relevant ethical requirements and the SAs and the informed decisions required throughout the audit cannot be made without the application of relevant knowledge and experience to the facts and circumstances. Professional judgment is necessary in particular regarding decisions about:

- (i) Materiality and audit risk.
- (ii) The nature, timing, and extent of audit procedures used to meet the requirements of the SAs and gather audit evidence.
- (iii) Evaluating whether sufficient appropriate audit evidence has been obtained, and whether more needs to be done to achieve the objectives of the SAs and thereby, the overall objectives of the auditor.
- (iv) The evaluation of management's judgments in applying the entity's applicable financial reporting framework.
- (v) The drawing of conclusions based on the audit evidence obtained, for example, assessing the reasonableness of the estimates made by management in preparing the financial statements.

SA-210

RTP NOV 2019/ EXAM NOV 2022

Ques-4. An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so. Explain stating the factors based on which client can request the auditor to change the engagement.

Ans. An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

A request from the client for the auditor to change the engagement may result from -

1. A change in circumstances affecting the need for the service,
2. A misunderstanding as to the nature of an audit or related service originally requested.
3. A restriction on the scope of the engagement, whether imposed by management or caused by circumstances.

SA-220

RTP NOV 19, RTP NOV 20, MTP OCT 22, MTP MARCH 23

Ques-3 The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements. Explain in the above context the purpose of monitoring compliance with quality control policies and procedures.

Ans. The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.

The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

- (a) Adherence to professional standards and regulatory and legal requirements;
- (b) Whether the quality control system has been appropriately designed and effectively implemented; and
- (c) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.

Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.

RTP NOV 21

Ques-5 The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles. Discuss the personnel issues addressed by such policies and procedures. Also explain how addressing the personnel issues would empower the firm.

Ans. The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.

Such policies and procedures address the following personnel issues:

- (a) Recruitment;
- (b) Performance evaluation;
- (c) Capabilities;
- (d) Competence;
- (e) Career development;
- (f) Promotion;
- (g) Compensation; and
- (h) Estimation of personnel needs.

Addressing these issues enables the firm to ascertain the number and characteristics of the individuals required for the firm's engagements. The firm's recruitment processes include procedures that help the firm select individuals of integrity as well as the capacity to develop the capabilities and competence necessary to perform the firm's work.

SQC-1

RTP NOV 2024

Ques-9 ABC & Associates, an audit firm, has been approached by a prospective company client that has been in business for about 10 years to conduct an audit of its financial statements. Before accepting the audit engagement, the firm wants to access the integrity of prospective client. With regard to the assessment of integrity, which matters should be considered by the audit firm?

Ans: With regard to the integrity of a client, matters that ABC & Associates should consider include, for example:

- The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.

RTP MAY 2024

Ques-20 Rajni, a CA student, has understood that SA 230 requires auditor to prepare audit documentation on a timely basis. While reading about SQC 1, she notices that time limit for completion of final audit file is ordinarily not more than 60 days after the date of auditor's report. She finds it to be puzzling. Unable to comprehend, she seeks your guidance. Guide her.

SA 230 requires that the auditor shall prepare audit documentation on a timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized.

SQC 1, however, requires auditor to complete assembly of final audit file in ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is only an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.

Therefore, auditor shall prepare documentation on a timely basis. However, for completion of assembly of final audit file which is an administrative process, time period of 60 days after the date of auditor's report has been required in SQC 1.

SA-230

PYQ JULY 2021

Ques-3 Documentation of audit plan serves as a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. What all activities in the planning phase should form part of auditor's documentation? State with examples

Ans: The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks.

Example

The following things should form part of auditor's documentation:

- A summary of discussions with the entity's key decision makers.
- Documentation of audit committee pre-approval of services, where required.
- Audit documentation access letters.
- Other communications or agreements with management or those charged with governance regarding the scope, or changes in scope, of our services.
- Auditor's report on the entity's financial statements.
- Other reports as specified in the engagement agreement (eg., debt covenant compliance letter).

MTP OCT 20

Ques-8 Give some examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment where the matters and judgments are significant.

Some examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant:

- ♦ The rationale for the auditor's conclusion when a requirement provides that the auditor 'shall consider' certain information or factors, and that consideration is significant in the context of the particular engagement.
- ♦ The basis for the auditor's conclusion on the reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates).
- ♦ The basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic..

RTP NOV 20

Ques-9 An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results. Explain stating clearly the examples of significant matters.

Ans. Judging the significance of a matter requires an objective analysis of the facts and circumstances.

Examples of significant matters include:

1. Matters that give rise to significant risks.
2. Results of audit procedures indicating
 - (a) that the financial statements could be materially misstated, or
 - (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
3. Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
4. Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter Paragraph in the auditor's report.

An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgement exercised in performing the work and evaluating the results.

Documentation of the professional judgements made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgement. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits, when reviewing matters of continuing significance (for example, when performing a retrospective review of accounting estimates).

RTP MAY 21

Ques-10 A new team member of GSR & Co., the auditors of Esteem Limited, was of the view that Audit Documentation would not serve any purpose at any stage of Audit. Explain.

Ans. The following are the purpose of Audit documentation:

1. Assisting the engagement team to plan and perform the audit.
2. Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.
3. Enabling the engagement team to be accountable for its work.
4. Retaining a record of matters of continuing significance to future audits.
5. Enabling the conduct of quality control reviews and inspections in accordance with SQC1
6. Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

From the above, it can be concluded that Audit documentation serves a number of purposes and hence it would be incorrect to say that audit documentation would not serve any purpose at any stage of audit.

MTP NOV 2024

Ques-3 CA Tanuj, the auditor of Kiran Ltd., completed the audit work and issued the auditor's report on 18th August 2024 for the financial year ended on 31st March 2024. During the final assembly of the audit file, he discarded some supporting schedules as same were outdated and corrected cross referencing errors of working papers. No new audit conclusions were drawn, and the final audit file was assembled on 10th October 2024.

On the basis of Standards on Auditing regarding audit documentation, comment on the action taken by CA Tanuj. As per SA 230, "Audit Documentation", the auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

- An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.
- Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature.
- After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.

In the given situation, the auditor CA Tanuj has issued the auditor's report on 18th August 2024 for the financial year ended on 31st March 2024. However, he discarded some supporting schedules and corrected cross-referencing errors of working papers during the final assembly of the audit file by 10th October 2024 which is under prescribed time-limit of 60 days from the issuance of auditors report. Further, no new audit conclusions were drawn. Thus, CA Tanuj can make said changes to the audit documentation during the final assembly process.

SA-260

STUDY MATERIAL NEW

Ques-1 In what ways an effective two-way communication between auditor and those charged with governance is important?

Ans: Communication from auditor is important with those charged with governance. An effective two-way communication is important in assisting: -

- (a) The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.
- (b) The auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and
- (c) Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements.

MTP MARCH 2025

Ques-2 Sigma Ltd. has approached CJK & Associates to appoint them as their auditor for a period of 5 years in accordance with provisions of the Companies Act, 2013. The prospective client company is new to audit firm. SQC 1 requires that a firm before accepting engagement should inquire vital information about the client which helps firm to decide about integrity of client. Apart from integrity, obtaining such vital information about client is helpful to audit firm in deciding about which other matters? Which matters would be considered by audit firm with regard to integrity of client?

Ans: A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about:

1. Integrity of Client
2. Competence (including capabilities, time and resources) to perform engagement
3. Compliance with ethical requirements

With regard to the integrity of a client, matters that the firm considers include, for example:

1. The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
2. The nature of the client's operations, including its business practices.
3. Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
4. Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
5. Indications of an inappropriate limitation in the scope of work.
6. Indications that the client might be involved in money laundering or other criminal activities.
7. The reasons for the proposed appointment of the firm and non- reappointment of the previous firm.

SA-265

MTP MARCH 2025

Ques-2 A deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance. Give examples of indicators of significant deficiencies in internal control.

Ans: Examples of indicators of significant deficiencies in internal control are as follows:

1. Evidence of ineffective aspects of the control environment, such as:
 Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.
 Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
 Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
2. Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
3. Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
4. Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
5. Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
6. Evidence of management's inability to oversee the preparation of the financial statements.

RTP MAY 2025

On reviewing internal control over inventories as part of statutory audit of a company, auditor finds that physical verification is not being conducted at regular intervals as stipulated by the management. The auditor finds it to be significant deficiency in internal control over inventories.

He points it out to the management in a one-liner as under: -

"Physical verification of inventories is not being conducted at regular intervals as stipulated by management."

Is above communication by auditor proper? Ignore statutory reporting requirements, if any in this regard.

Ans: As per SA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", while pointing out significant deficiencies in internal control, auditor has not only to communicate significant deficiencies giving their description but also explain the potential effects and sufficient information to those charged with governance and management to understand context of communication.

In the given situation, auditor noticed significant deficiency in internal control over inventories and he pointed out the same to management i.e. "Physical verification of inventories is not being conducted at regular intervals as stipulated by management."

Therefore, the above communication is not proper. Not only significant deficiency has to be communicated, it should also be explained to management the potential effects of not carrying out physical verification of inventories at regular intervals as stipulated by management. It should explain that such a significant deficiency can lead to misstatement of inventories impacting profits of the company. Highlighting the importance of such a control, it should be stated that responsibility be fixed for concerned person(s) for adhering to such an important control.

SA-299

RTP MAY 20

Ques-2 Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should identify division of audit areas and common audit areas. Explain stating the other relevant considerations in this regard.

Ans. Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:

- (a) identify division of audit areas and common audit areas;
- (b) ascertain the reporting objectives of the engagement;
- (c) consider and communicate among all joint auditors the factors that are significant
- (d) in directing the engagement team's efforts;
- (e) Consider the results of preliminary engagement activities, or similar engagements performed earlier.
- (f) Ascertain the nature, timing and extent of resources necessary to accomplish the engagement.

SA-300

STUDY MATERIAL, RTP NOV 19, RTP MAY 21

Ques-6 Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after the completion of the previous audit and continues until the completion of the current audit engagement. Planning includes the need to consider certain matters prior to the auditor's identification and assessment of the risks of material misstatement. Explain clearly stating those matters also.

Ans. In the context of recurring audits, as per SA-300, "Planning an Audit of Financial Statements", Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:

1. The analytical procedures to be applied as risk assessment procedures.
2. Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
3. The determination of materiality.
4. The involvement of experts.
5. The performance of other risk assessment procedures.

STUDY MATERIAL, MTP MAY 20, RTP NOV 20, RTP NOV 21

Ques-8 The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors. Explain giving examples.

Ans. The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work.

The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:

1. The size and complexity of the entity.
2. The area of the audit.
3. The assessed risks of material misstatement

Example

An increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work.

5. The capabilities and competence of the individual team members performing the audit work.

Example

We may have identified a problem related to the production process that raised concerns about inventory obsolescence. After obtaining an understanding of the entity's process that raised concerns about inventory obsolescence (which we had identified as a significant class of transactions), we concluded that additional tests of details were required. Therefore, the senior will likely take part, along with the team, in the discussions with management about the provision for obsolescence and examine related documentation supporting the provision, rather than just reading the memo on file. These procedures should be completed as the work is being performed rather than as an after the fact review. The extent of the senior's involvement requires judgement, taking into consideration the complexity of the area and the experience of the team.

EXAM NOV 2018, RTP Nov 19, RTP NOV 21, MTP MARCH 2023

Ques-15 "An adequate planning benefits the audit of financial statements." Discuss

OR

Engagement partner of Audit Firm MKC AND COMPANY thinks that planning an audit would involve establishing the overall audit strategy for the engagement and developing an audit plan. Also, Adequate planning would benefit the audit of financial statements in several ways. Analyse explaining the benefits of adequate planning. (

OR

Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways. Explain such benefits of planning in the audit of financial statements.

Ans. Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:

1. Helping the auditor to devote appropriate attention to important areas of the audit.
2. Helping the auditor identify and resolve potential problems on a timely basis.
3. Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
4. Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
5. Facilitating the direction and supervision of engagement team members and the review of their work.
6. Assisting, where applicable, in coordination of work done by auditors of components and experts.

RTP MAY 2024

Ques-26 Preliminary engagement activities include certain activities to be performed by an auditor while planning an audit. Discuss such activities briefly. How performing such activities assists an auditor?

Preliminary engagement activities

Preliminary engagement activities include following activities: -

- Performing procedures regarding the continuance of the client relationship
- Evaluating compliance with ethical requirements, including independence
- Establishing an understanding of terms of engagement

Performing preliminary engagement activities assists auditor in identifying and evaluating events or circumstances that may affect auditor's ability to plan and perform audit engagement.

SA-315

PYQ JULY 2021

Ques-3 CA L is in the process of finalizing his Risk Assessment Procedures of Effluent Limited which includes observation and inspection that may support inquiries of management and others. Discuss few examples of audit procedures which include observation or inspection of the entity's operations

Ans: Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment.

Examples of audit procedures which include observation or inspection of the entity's operations are:

- (1) Documents (such as business plans and strategies), records, and internal control manuals.
- (2) Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of director's meetings)
- (3) The entity's premises and plant facilities.

RTP MAY 20

Ques-4 Knowledge of the Client's business is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework. Substantiate with the help of examples.

Ans. Examples are:

- The competitive environment, including demand, capacity, product and price competition as well as cyclical or seasonal activity.
- Supplier and customer relationships, such as types of suppliers and customers (e.g., related parties, unified buying groups) and the related contracts with those entities.
- Technological developments, such as those related to the entity's products, Energy supply and cost.
- The effect of regulation on entity operations.

RTP NOV 21/ MTP OCT 22/ EXAM MAY 23

Ques-10 Significant risks often relate to significant non- routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty.

In context of significant risk, explain the factors to be considered by the auditor in exercising judgment as to which risks are significant risks.

Ans. As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

- (a) Whether the risk is a risk of fraud;
- (b) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;
- (c) The complexity of transactions;
- (d) Whether the risk involves significant transactions with related parties;
- (e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- (f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

SA-320

STUDY MATERIAL NEW

Ques-1 Is materiality required to be documented by the auditor? What factors have to be considered this regard?

Ans. The audit documentation shall include the following amounts and the factors considered in their determination:

- (a) Materiality for the financial statements as a whole
- (b) If applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures
- (c) Performance materiality and
- (d) Any revision of (a)-(c) as the audit progressed

STUDY MATERIAL/ RTP MAY 22/ EXAM MAY 23

Ques-2 "Determining materiality involves the exercise of professional judgment". Discuss stating the factors that may affect the identification of an appropriate benchmark. Also give example.

Ans. "Determining materiality involves the exercise of professional judgment". A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements: Assets, liabilities, equity, revenue, expenses;
- Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused
- The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates; The entity's ownership structure and the way it is financed and
- The relative volatility of the benchmark.

SA-450

MTP MARCH 24

Ques-2 Up and High Private Limited has started its export business during the year 2023-24. The company was catering to domestic market only in past years. CA H, statutory auditor of the company, is of the view that the company has understated its revenue by ₹ 50.00 lacs in the year 2023-24 by not complying with requirements of AS 9 relating to revenue recognition.

(i) Discuss responsibilities of statutory auditor to communicate with management in the above situation in accordance with SA 450. Also explain the usefulness of such communication.

(ii) If management refuses to correct misstatement as communicated by the statutory auditor, how should he proceed?

Ans: The above situation is an example of misstatement relating to non-compliance with requirements of AS 9 identified during audit. In accordance with requirements of SA 450, the auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation. The auditor shall request management to correct those misstatements. Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the items are misstatements, inform the auditor if it disagrees and take action as necessary. The correction by management of all misstatements, including those communicated by the auditor, enables management to maintain accurate accounting books and records and reduces the risks of material misstatement of future financial statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods. If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement.

SA-500

STUDY MATERIAL NEW

Ques-2 Maintaining accounts using accounting software having a feature of recording audit trail can be useful for an auditor. Discuss some of the advantages for such a feature in accounting software for auditors.

- ✦ An audit trail is a documented flow of a transaction. It is used to investigate how a source document was translated into an account entry and from there it was inserted into financial statement of an entity.
- ✦ It is used as audit evidence to establish authentication and integrity of a transaction.
- ✦ Audit trails help in maintaining record of system and user activity. Like, in case of banks, there is an audit trail keeping track of log-on activity detailing record of log-on attempts and device used.
- ✦ It is a step-by-step record by which accounting, trade details, or other financial data can be traced to their source.
- ✦ Audit trails are used to verify and track many types of transactions including accounting and financial transactions.
- ✦ Audit trails (or audit logs) act as record-keepers that document evidence of certain events, procedures or operations, because their purpose is to reduce fraud, material errors, and unauthorized use.
- ✦ Audit trails help to enhance internal controls and data security.
- ✦ Audit trails can help in fixing responsibility, rebuilding events and in thorough analysis of problem areas
- ✦ Audit trail analysis can specify reason of the problem. It can also help in ensuring operation of system as intended. In this way, audit trails can help entities in their regular system operations.

However, audit trails involve costs. The cost is not only in terms of system expenditure but also in terms of time involved in analysing data made available by audit trails. However, use of automated tools can be made to analyse large volume of data thrown up by audit trails

RTP MAY 22, MTP MARCH 2025

Ques-11 While conducting the audit of Pummy Limited, the statutory auditors collected written representations from the Management. The audit was finalized in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, state the importance of inquiry as one of the methods of collecting Audit Evidence.

Ans. Inquiry: As per SA 500 Audit Evidence: -

- (i) Inquiry consists of seeking information of knowledgeable persons, financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
- (ii) Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.
- (iii) Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and Management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.
- (iv) In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

MTP NOV 2024

Ques-14 The reliability of audit evidence depends on its source, nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance. Although exceptions may exist, few generalisations can be made about reliability of audit evidence. Considering above discuss such generalisations that can be made about the reliability of audit evidence.

Ans: While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:

- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally
- Audit evidence obtained as original documents is more reliable than audit evidence obtained as photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form because in these cases the reliability of which may depend on the controls over their preparation and maintenance.

MTP APRIL 2025

Identify and explain briefly the audit procedure used by the auditor to obtain audit evidence in following situations:

- While auditing the books of accounts of ANT Limited for the financial year 2023-24, the auditor checked the complete documents and records of the company in detail to obtain audit evidence.
- Mr. M, auditor of company, looks at the process of inventory counting by the entity's personnel and of the performance of control activities.
- XYZ Ltd. is engaged in export of goods to Europe. The sales invoices raised in Euros are converted into Indian rupees as per applicable norms. The auditor wants to verify whether conversion of foreign currency into Indian rupees is proper or not.
- CA Isha is appointed as auditor of TUV Ltd., during the initial stage of audit, she reviewed the Gross Profit Ratio of the company. She also compared GP ratio of TUV Ltd. with the other companies operating in similar industry.

Ans:(i) The audit procedure used by auditor of ANT Limited is known as Inspection because inspection is an audit procedure in which complete documents and records of a company are checked in detail for the purpose of obtaining audit evidence.

(ii) Mr. M is using Observation as audit procedure as Observation consists of looking at a process or procedure being performed by others.

(iii) The audit procedure used by auditor is Recalculation. Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

(iv) CA Isha is using Analytical Procedure to obtain audit evidence. Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

SA-501

STUDY MATERIAL NEW

Ques-1 Explain clearly the examples of matters relevant in planning attendance at physical inventory counting.

Ans: Matters relevant in planning attendance at physical inventory counting include, for example:

- (a) Nature of inventory.
- (b) Stages of completion of work in progress.
- (c) The risks of material misstatement related to inventory.
- (d) The nature of the internal control related to inventory.
- (e) Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- (f) The timing of physical inventory counting.
- (g) Whether the entity maintains a perpetual inventory system.
- (h) The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate
- (i) Whether the assistance of an auditor's expert is needed.

SA-505

PYQ JULY 2021

Ques-2 CA Rohit is appointed as an auditor of Grace Ltd., he wants to design a suitable confirmation request letter for a few debtors of Grace Ltd. As a senior auditor of the firm, explain to him with reference to SA 505 "External Confirmation" all the conditions that should be present to use Negative Confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level.

Ans: **Negative confirmations** is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative information provide less persuasive audit evidence than positive confirmations. Accordingly, CA Rohit, Auditor of Grace Ltd, shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

- (a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
- (b) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions,
- (c) A very low exception rate is expected; and
- (d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

MTP MARCH 2025

CA T, the statutory auditor of a company, is in the process of designing external confirmation requests to be sent to trade receivables outstanding as of March 31, 2024. As properly designed confirmation requests are essential to ensure the reliability and effectiveness of the audit evidence obtained. Further, well-structured requests help in reducing the risk of misstatements, non- responses, or misunderstandings by the recipients. In this context, explain why designing a proper confirmation request is necessary and discuss the key factors an auditor should consider when designing confirmation requests.

Ans: The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses. Therefore, designing a proper confirmation request by auditor is necessary.

Factors to be considered when designing confirmation requests include:

- (i) The assertions being addressed.
- (ii) Specific identified risks of material misstatement, including fraud risks.
- (iii) The layout and presentation of the confirmation request.

SA-510

STUDY MATERIAL NEW

Ques-2 Discuss the objective of Auditor with respect to Opening balances in conducting an initial audit engagement.

Ans. Objective of Auditor with respect to Opening Balances-in conducting an Initial Audit Engagement

In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

- (a) Opening balances contain misstatements that materially affect the current period's financial statements; and
- (b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

STUDY MATERIAL NEW/ EXAM MAY 2022, MTP APRIL 2023

Ques-3 M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore he is not required to verify them. Is CA Pankaj correct in his approach?

Ans. Initial audit engagement is an engagement in which either:

- (i) The financial statements for the prior period were not audited; or
- (ii) The financial statements for the prior period were audited by a predecessor auditor.

From the above, it is quite clear that CA Pankaj is not correct in his approach and therefore would be required to follow the initial audit engagement and also apply audit procedures regarding opening balances.

Audit Procedures regarding Opening Balances: The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.

The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

- (a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;
- (b) Determining whether the opening balances reflect the application of appropriate accounting policies; and
- (c) Performing one or more of the following:
 - (i) Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;
 - (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
 - (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

MTP APRIL 2024

Ques-5 In an initial audit engagement, in the case of inventories, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, in such a case, additional audit procedures become necessary so that auditor may obtain sufficient appropriate audit evidence. Discuss those additional audit procedures.

Ans: In an initial audit engagement, in the case of inventories, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:

- Observing a current physical inventory count and reconciling it to the opening inventory quantities.
- Performing audit procedures on the valuation of the opening inventory items.
- Performing audit procedures on gross profit and cut-off.

SA-520

STUDY MATERIAL NEW/ RTP NOV 20

Ques-1 Explain how a statutory auditor of a company can apply analytical procedures at the planning phase of audit.

Ans. Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase.

Analytical Procedures in Planning the Audit

In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non- financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.

For example, analytical procedures may help the auditor during the planning stage to determine the nature, timing and extent of audit procedures that will be used to obtain audit evidence for specific account balances or classes of transactions.

STUDY MATERIAL NEW/ PYQ JAN 21

Ques-2 While applying the Substantive Analytical Procedures what techniques can be used by the statutory auditor of a company to obtain sufficient and appropriate audit evidence?

Ans. While applying the Substantive Analytical Procedures the statutory auditor of a company may use the following techniques to obtain sufficient and appropriate audit evidence

Trend analysis - Trend analysis is a commonly used technique. It is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. We evaluate whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.

Ratio analysis - Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry.

Reasonableness tests - Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts. In other words these tests are made by reviewing the relationship of certain account balances to other balances for reasonableness of amounts.

Structural modelling - A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression).

The statutory auditor may use any of the above mentioned techniques while applying substantive analytical procedures depending upon the availability of data and requirements of the case.

STUDY MATERIAL NEW/ EXAM NOV 19/ EXAM MAY 23

Ques-4 What are the factors that determine the extent of reliance that the auditor places on results of analytical procedures? Explain with reference to SA-520 on "Analytical procedures".

Ans. The following are the relevant points while determining whether data is reliable for purposes of designing substantive analytical procedures:

- Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity.
- Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products.

- iii. Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved.
- iv. Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

EXAM NOV 20

Ques-9 With respect to SA 520 "Analytical procedures ". Explain the following factors to be considered by the auditor for substantive audit procedures.

- (i) Account type
- (ii) Predictability
- (iii) Nature of Assertion.

Ans. The auditor should consider the following factors for Substantive Audit Procedures:

Account Type - Substantive analytical procedures are more useful for certain types of accounts than for others. Income statement accounts tend to be more predictable because they reflect accumulated transactions over a period whereas balance sheet accounts represent the net effect of transactions at a point in time or are subject to greater management judgment.

Predictability - Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable (e.g., between sales and cost of sales or between trade receivables and cash receipts). A predictable relationship is one that may reasonably be expected to exist and continue over time.

Nature of Assertion - Substantive analytical procedures may be more effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations). Predictive analytical procedures using data analytics can be used to address completeness, valuation/ measurement and occurrence.

SA-530

STUDY MATERIAL NEW

Ques-2 With reference to Standard on Auditing 530, state the requirements relating to audit sampling, sample design, sample size and selection of items for testing.

Ans. Audit Sampling: As per SA 530 on "Audit Sampling", the meaning of the term Audit Sampling is - the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The requirements relating to sample design, sample size and selection of items for testing are explained below-
Sample design - When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.

Sample Size- The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

Selection of Items for Testing- The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

STUDY MATERIAL NEW

Ques-3 While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind?

Ans. Risk Factors while applying Sampling Techniques: As per SA 530 "Audit Sampling", sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions-

(i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

(ii) In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

STUDY MATERIAL NEW/ MTP OCTOBER 20/ RTP MAY 2022

Ques-4 Write short notes on the following:

(a) Advantages of Statistical sampling in Auditing.

(a) The advantages of statistical sampling may be summarized as follows -

(1) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.

(2) The sample selection is more objective and thereby more defensible.

(3) The method provides a means of estimating the minimum sample size associated with a specified risk and precision.

(4) It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.

(5) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.

(6) It is widely accepted way of sampling as it is more scientific, without personal bias and the result of sample can be evaluated and projected in more reliable way.

EXAM DEC 21

Ques-19 With reference to SA 530 "Audit Sampling", explain briefly the following factors that the auditor may consider when determining the sample size for the Test of Details -

(i) The desired level of assurance

(ii) Stratification of the population.

Ans. Examples of factors influencing Sample Size for Test of Details:

(i) Desired Level of Assurance: An increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population will increase the sample size. Hence, greater the level of assurance that the auditor requires that the results of the sample are in fact indicative of the actual amount of misstatement in the population, the larger the sample size needs to be.

(ii) Stratification of population: When stratification of the population is appropriate then sample size will decrease as when there is a wide range (variability) in the monetary size of items in the population, it may be useful to stratify the population. When a population can be appropriately stratified, the aggregate of the sample sizes from the strata generally will be less than the sample size that would have been required to attain a given level of sampling risk, had one sample been drawn from the whole population.

SA-550

STUDY MATERIAL NEW

Ques-1 Many related party transactions are in the normal course of business. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Give few examples of such areas.

Ans. Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties.

However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties

FOR EXAMPLE

(A) Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.

(B) Information systems may be ineffective at identifying or summarising transactions and outstanding balances between an entity and its related parties.

(C) Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.

SA-560

RTP MAY 19

Ques-2 The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. Explain.

Ans. Audit Procedure Regarding Events Occurring Between the Date Of The Financial Statements and the Date of the Auditor's Report

The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.

The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment which shall include the following:

- (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- (b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- (c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- (d) Reading the entity's latest subsequent interim financial statements, if any.

MTP MARCH 2025

CA Yash is conducting audit of a company for year 2023-24. The company is engaged in export of ethnic rugs to buyers in Europe. The audit is nearing completion in month of July 2024. However, it becomes known to the auditor that one of overseas buyers has made a legal claim against the company on 1st June 2024 for injury caused to a customer of one European buyer due to sub-standard dyes used in rugs of one lot of order shipped in August, 2023. The management of company has decided to agree to an out of court settlement of ` 5 crore to protect its reputation. The financial statements of the company are silent on this issue. Discuss, how, **CA Yash** should proceed to deal with above issue.

Ans: In the given case, the auditor has come to know of legal claim against the company before issue of audit report. It has also come to his knowledge that management of the company has agreed to an out of court settlement of Rs.5 crore. It is an example of subsequent event between the date of the financial statements and the date of the auditor's report as per SA 560.

Auditor's responsibilities regarding subsequent events between the date of the financial statements and the date of the auditor's report are as under:

1. Perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.
2. If such subsequent events that require adjustment of, or disclosure in, the financial statements have been identified, it shall be determined whether each such event is appropriately reflected in those financial statements.
3. Obtain a written representation from management or those charged with governance that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed

SA-570

STUDY MATERIAL NEW

Ques-1 The auditor of a company is having concerns about following of going concern basis of accounting followed by management for preparation of financial statements. It asks the management to justify preparation of financial statements. However, management is not willing to make its assessment and share with auditor. What are implications for auditor's report in such a scenario?

Ans: **Management unwilling to make or extend its assessment**

If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the implications for the auditor's report. In such a situation, **a qualified opinion or a disclaimer of opinion** in the auditor's report may be appropriate, because it may not be possible for the auditor to obtain sufficient appropriate audit evidence regarding management's use of the going concern basis of accounting in the preparation of the financial statements

RTP MAY 19, RTP Nov 19, RTP MAY 21, MTP APRIL 2022

Ques-3 (a) On the basis of which assumption the financial statements of a company are prepared. Explain. Also describe the objectives of the auditor regarding going concern.

Or

When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. Explain stating also the objective of the auditor regarding going concern.

Or

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. Explain. Also discuss the objectives of an auditor regarding Going concern as per relevant standard on auditing.

Ans. The auditor's responsibilities are:

(1) to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and (2) to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

However, as described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

MTP MARCH 2024

Ques-6 Mention any four financial events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as going concern.

Ans: Financial events or conditions that may cast significant doubt on the entity's ability to continue as going concern:

- i. Net liability or net current liability position.
- ii. Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short term borrowings to finance long term assets.
- iii. Indications of withdrawal of financial support by trade payables.
- iv. Negative operating cash flows indicated by historical or prospective financial statements.
- v. Adverse key financial ratios.
- vi. Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- vii. Arrears or discontinuance of dividends.
- viii. Inability to pay trade payables on due dates.
- ix. Inability to comply with terms of loan agreements.
- x. Change from credit to cash-on-delivery transactions with suppliers.

Inability to obtain financing for essential new product development or other essential investments.

SA-580

RTP NOV 19

Ques-1 Explain clearly objective of the auditor regarding written representation.

Ans. Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

Objectives of the auditor regarding going concern The objectives of the auditor are:

- (a) To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
- (b) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and
- (c) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

MTP MARCH 2023

Ques-4 Akash & Associates are the statutory auditors of Deluxe Ltd. for the FY 2020 -21. During the course of audit, CA Akash, the engagement partner requested the management of the company to provide written representation with respect to valuation of a transaction. The management, however does not provide the same to CA Akash. What course of action should CA Akash follow in such situation?

Ans. If management of Deluxe Ltd. does not provide one or more of the requested written representations, CA Akash should:

- (a) Discuss the matter with management;
- (b) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- (c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705.

SA-610

RTP MAY 19

Ques-3 CA Z is appointed as statutory auditor of BETA Private Limited for the year 2023-24. There exists an internal audit function in the company headed by its Chief Internal Auditor, CA K. Valuation of trade receivables of company is assessed as area of higher risk by statutory auditor. He wants to take direct assistance of Chief Internal Auditor in respect of above matter. Discuss along with reasons whether it would be proper for statutory auditor to: -

(i) assign checking of accuracy of aging of trade receivables to Chief Internal Auditor?

(ii) assign evaluation of adequacy of provision based on aging of trade receivables to Chief Internal Auditor?

In accordance with SA 610, the external auditor shall not use internal auditors to provide direct assistance to perform procedures that relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited.

In the given situation, valuation of trade receivables is assigned as an area of higher risk by statutory auditor. Judgment required in checking of accuracy of aging of trade receivables is limited. Therefore, external auditor can assign the checking of the accuracy of the aging to Chief Internal Auditor providing direct assistance as it involves limited judgment.

However, because the evaluation of the adequacy of the provision based on the aging would involve more than limited judgment, it would not be appropriate to assign that latter procedure to Chief Internal Auditor providing direct assistance.