

GET YOUR VIVITSU REVIEWER TODAY



15% OFF

CODE : "COMBO"

on purchase of full set or a group

EXTRA 5%

CODE : BULKDISCOUNT

On purchase of more than 1 qty

Reviewer v/s ICAI Compilation

| | REVIEWER | ICAI COMPILATION |
|--|-------------------------------------|---------------------------------|
| Questions | Includes RTP, MTP and PYP Questions | Only includes ICAI SM questions |
| Quick recap summary | ✓ | ✗ |
| LDR questions | ✓ | ✗ |
| Easy to Difficult flow | ✓ | ✗ |
| Exam insights | ✓ | ✗ |
| Chapter's ranked as A,B or C as importance | ✓ | ✗ |



Vivitsu Website

Available on



YouTube

Subscribe to our



Channel

Telegram

Join the



Community

Instagram

Follow us on



WhatsApp

Chat with us on



Table of Contents

| Sr. | Particulars | PAGE NO. |
|-----|---|-----------|
| 1 | Nature, Objective and Scope of Audit | 5 – 15 |
| 2 | Audit Strategy, Audit Planning and Audit Programme | 16 – 26 |
| 3 | Risk Assessment and Internal Control | 27 – 43 |
| 4 | Audit Evidence | 44 – 74 |
| 5 | Audit of Items of Financial Statements | 75 – 92 |
| 6 | Audit Documentation | 93 – 99 |
| 7 | Completion and Review | 100 – 109 |
| 8 | Audit Report | 110 – 131 |
| 9 | Special Features of Audit of Different Type of Entities | 132 – 152 |
| 10 | Audit of Banks | 153 – 164 |
| 11 | Ethics and Terms of Audit Engagements | 165 – 174 |
| 12 | Case Scenarios | 175 – 193 |

ICAI Study Material Questions As Free

Audit & Ethics

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Reading this along with Vivitsu Reviewers ?



Save time by reading only unique questions →

Practical Questions Answer

Question 4
XYZ Ltd., with a turnover of ₹ 50 crores during previous year and borrowings of ₹ 1 crore during any time in the previous year, wants to avail the exemptions available in adoption of Accounting Standards applicable to companies for the year ended 31.3.20X1. Advise the management on the exemptions that are available as per the Companies (Accounting Standards) Rules, 2021.

Answer 4
The question deals with the issue of Applicability of Accounting Standards for corporate entities. The companies can be classified under two categories viz SMCs and Non SMCs under the Companies (Accounting Standards) Rules, 2021. As per the Companies (Accounting Standards) Rules, 2021, criteria for above classification as SMCs, are:
"Small and Medium Sized Company" (SMC) means, a company-
• whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
• which is not a bank, financial institution or an insurance company;
• whose turnover (excluding other income) does not exceed rupees two- fifty crores in the immediately preceding accounting year;
• which does not have borrowings (including public deposits) in excess of rupees fifty crores at any time during the immediately preceding accounting year; and
• which is not a holding or subsidiary company of a company which is not a small and medium-sized company.
Since, XYZ Ltd.'s turnover was ₹ 50 crores which does not exceed ₹ 250 crores and borrowings of ₹ 1 crore are less than ₹ 50 crores, it is a small and medium sized company (SMC).

Question 5
A company was classified as Non-SMC in 20X1-X2. In 20X2-X3, it has been classified as SMC. The management desires to avail the exemptions or relaxations available for SMCs in 20X2-X3. However, the accountant of the company does not agree with the same. Comment.

Answer 5
As per Companies (Accounting Standards) Rules, 2021, an existing company, which was previously not a SMC and subsequently becomes a SMC, should not be qualified for exemption or relaxation in respect of accounting standards available to a SMC until the company remains a SMC for two consecutive accounting periods. Therefore, the management of the company cannot avail the exemptions/ relaxations available to the SMCs for the FY 20X2-X3.

Blue = Skip

The questions highlighted in blue are already covered in your Vivitsu Reviewer.

So when you're solving ICAI SM questions, feel free to skip the blue ones — and save time.

Black = Solve

These haven't been covered in your Vivitsu Reviewer.

So just focus on these, and you'll complete the entire ICAI SM — no extra effort, maximum results.

SMCs, are-
"Small and Medium Sized Company" (SMC) means, a company-
• whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
• which is not a bank, financial institution or an insurance company;
• whose turnover (excluding other income) does not exceed rupees two- fifty crores in the immediately preceding accounting year;
• which does not have borrowings (including public deposits) in excess of rupees fifty crores at any time during the immediately preceding accounting year; and
• which is not a holding or subsidiary company of a company which is not a small and medium-sized company.
Since, XYZ Ltd.'s turnover was ₹ 50 crores which does not exceed ₹ 250 crores and borrowings of ₹ 1 crore are less than ₹ 50 crores, it is a small and medium sized company (SMC).

Question 5
A company was classified as Non-SMC in 20X1-X2. In 20X2-X3, it has been classified as SMC. The management desires to avail the exemptions or relaxations available for SMCs in 20X2-X3. However, the accountant of the company does not agree with the same. Comment.

Answer 5
As per Companies (Accounting Standards) Rules, 2021, an existing company, which was previously not a SMC and subsequently becomes a SMC, should not be qualified for exemption or relaxation in respect of accounting standards available to a SMC until the company remains a SMC for two consecutive accounting periods. Therefore, the management of the company cannot avail the exemptions/ relaxations available to the SMCs for the FY 20X2-X3.

Nature, Objective and Scope of Audit

Test Your Understanding

Question 1

Lalji Bhai has purchased shares of a company listed on NSE. The audited financial statements of the company provide picture of healthy financial performance having robust turnover, low debt and good profits. On above basis, he is absolutely satisfied that money invested by him is safe and there is no chance of losing his money. Do audited results and audit reports of companies provide such assurance to investors like Lalji Bhai? Is thinking of Lalji Bhai correct?

Answer 1

An audit does not provide assurance to investor in shares regarding safety of his money. Share prices of securities are affected by range of factors. An audit only provides reasonable assurance that financial statements are free from material misstatement whether due to fraud or error. Hence, thinking of Lalji Bhai is not correct.

Question 2

Good deeds Limited is engaged in business of recycling of wastes from dumping grounds of municipal corporation of Indore to usable manure. It is, in this way, also, helping to make the city clean.

During course of audit by Zoha & Zoha, a firm of auditors, it is observed by auditors that company has received a notice from Central Bench of National Green Tribunal for not following certain environmental regulations involving imposition of hefty monetary penalty on the company. The company is yet to reply to the notice. The auditors point out that same is not stated in notes to accounts in financial statements. The company points out that auditors are going beyond scope of their work. Does such a matter fall within scope of audit?

Answer 2

Proper disclosure of financial information is well within scope of audit.

Question 3

A huge fire broke out in NOIDA plant of KT Limited. Plant assets comprising building, machinery and inventories were insured from branch of a public sector insurance company. Apart from an insurance surveyor who was deputed for assessing loss, the regional office of insurance PSU also appointed a CA for verification of books of accounts/ financial records

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

of the company and circumstances surrounding the loss. He was also requested to submit an early report. Would the report by CA in nature of audit report?

Answer 3

Appointment of CA for verification of books of accounts/financial records and circumstances surrounding the loss is for a specific objective to determine genuineness of loss and any issue affecting liability of insurance company. It is an investigation and not in nature of audit report.

Question 4

Zeeba Products is a partnership firm engaged in trading of designer dresses. The firm has appointed JJ & Co, Chartered accountants to audit their accounts for a year. The auditors were satisfied with control systems of firm, carried out required procedures and necessary verifications. In particular, they carried out sample checking of purchases, traced purchase bills to GST portal and also made confirmations from suppliers. They were satisfied with audit evidence obtained by them as part of audit exercise. An audit report was submitted to the firm giving an opinion that financial statements reflected true and fair view of state of affairs of the firm.

However, later on, it was discovered that purchase manager responsible for procuring dresses from one location was also booking fake purchases of small values by colluding with unethical dealers. Payments to these dealers were also made in connivance with accountant through banking channel.

The partners of firm blame auditors for futile audit exercise. Are partners of firm correct in their view point? Imagine any probable reason for such a situation.

Answer 4

It is example of failure of internal controls of the firm. The internal control has not operated due to collusion between employees which is a limitation of internal control itself. The auditor has relied upon internal controls. It is very nature of financial reporting that management is responsible for devising suitable internal controls. This is an inherent limitation of audit.

Question 5

The management of Exotic Tours and Travels Limited requests its auditor Raja & Co.to provide an assurance report on the financial information for first quarter of a year by skipping required detailed procedures.

Can Raja & Co. provide such a report? What would be nature of such a report? Would it be necessary for them to obtain sufficient appropriate evidence in such a case?

Answer 5

Such report would be in nature of "review". However, auditors would have to obtain sufficient appropriate evidence.

Question 6

CA. P Babu is conducting audit of financial statements of Quick Buy Private Limited. He was not able to obtain external confirmations from certain debtors due to practical difficulties

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

and peculiar circumstances. However, such a procedure is mandated under one of Standards on Auditing.

Unable to obtain external confirmations from these debtors, he relied upon sale details to these parties, e-invoices, e-way bills and also traced payments from these parties in bank accounts of the company. He was reasonably satisfied with audit evidence obtained. Is there any other reporting duty cast upon him relating to not following a mandated procedure in one of Standards on Auditing?

Answer 6

He is required to document how alternative procedures performed achieve the purpose of required procedure. Reason for departure has to be documented unless it is clear. His report should draw attention to such departure.

CASE STUDY-1

Rohit, Gurpreet, Ali and Goreti are friends since their school days based in Mumbai. They have cleared CA foundation exams in the same attempt and now plan to appear for CA Intermediate exams. All of them are avid news listeners and regularly keep track of business news even on social media.

They are trying to understand new subjects including auditing. Rohit, Gurpreet and Ali have also started attending Live Coaching Classes (LCC) being conducted by Board of studies of ICAI. Goreti has not been able to join Live Coaching Classes yet as she was away on a holiday with her parents. However, she plans to catch it up with her friends very soon. Ali had also joined the classes but he had skipped some lectures.

During one informal get together, their discussions centred around new subject of auditing. They discussed many things regarding its nature, scope, benefits and other general practical issues. Goreti was regular in keeping track of audited results of companies being published in leading newspapers. Her view was that audited financial statements of companies give 100% guarantee to different stake holders. It is the main reason behind so much reliance upon auditing. But she could not understand why wrong doings in financial matters are being discovered after many years have gone by.

Ali also concurred with her view and added that when financial statements are audited, each and every transaction appearing in books of accounts is verified. However, he could not give clarity to Goreti.

Gurpreet was of the opinion that audit was conducted on the basis of sample checking. He was also of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of the companies.

Not to be left behind, Rohit also jumped in the fray. He supported Gurpreet and also added something of his own.

Based on above, answer the following questions: -

1. Gurpreet was of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of companies. What kind of assurance

| Get Vivitsu Reviewers | Want Lectures? | Test yourself with Test Series |
|---|--|--|
| Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs | Get Vivitsu Recommended lectures at the lowest price | Test yourself Chapter-wise for a better pass percentage |
| www.thevivitsu.com/ca_inter | www.thevivitsu.com/marketplace | www.thevivitsu.com/test_series?id=18 |

does audit of financial statements provide?

- (a) It provides reasonable assurance meaning a moderate level of assurance.
- (b) It provides reasonable assurance meaning a low level of assurance.
- (c) It provides reasonable assurance meaning a high level of assurance.
- (d) It provides reasonable assurance meaning an absolute level of assurance.

Ans: (c)

2. Rohit added that auditor can force an employee of the company to provide him required information and documents. Can he do so?

- (a) Yes, he can do so. It is necessary to obtain audit evidence.
- (b) Yes, he can do so. There are express rights given to him in this respect.
- (c) No, he cannot do so. He can only request for providing him with necessary information and documents. But it cannot be forced by him.
- (d) No, he cannot do so. He has no right of seeking information and documents. Therefore, question of forcing does not arise.

Ans: (c)

3. Ali had listened in one of the classes that audit covers all aspects of an entity and concluded that each and every transaction of entity is verified by auditor. Goreti also seemed to be in agreement with him but she was of the view that besides this, it also meant that audit should be so organized to cover all areas of an entity. Which of following statements is appropriate in this regard?

- (a) Only view of Ali is correct.
- (b) Only view of Goreti is correct.
- (c) Views of both Ali and Goreti are correct.
- (d) Views of both Ali and Goreti are incorrect.

Ans: (d)

4. All of them also discussed about benefits of auditing. Which of the following is not a likely benefit of auditing?

- (a) Since auditing is connected to future events, audited information can be easily relied upon by users.
- (b) Errors or frauds may be discovered during audit.
- (c) Government authorities can make use of audited accounts for different purposes.
- (d) It can help in bringing out deficiencies in maintenance of financial records.

Ans: (a)

5. Goreti told her friends that she had read a news report about how a company had misled its auditors by producing some fabricated documents. Which of following statements seems to be appropriate in this regard?

- (a) It was wrong on the part of auditor to rely upon fabricated documents. He must have discovered it as the same falls within the scope of his duties.
- (b) Although it was wrong on the part of auditor to rely upon fabricated documents, he cannot do anything in the matter. He has to report on the basis of documents provided to him. He has no duty in this regard.
- (c) Auditor has to conduct audit by exercising professional skill. But he is not an expert in discovering genuineness of documents. Hence, management consisting of dishonest persons may have led him to rely upon fabricated documents deliberately.
- (d) Management cannot mislead auditor due to high level of knowledge and expertise possessed by him. The above is an outlier case-one of the rare odd cases.

Ans: (c)

CASE STUDY-2

Me and You Private Limited has been newly incorporated. The plant of the company has recently started production with the help of funds provided by a bank for purchase and installation of machinery. Further, the company is also utilizing working capital credit facilities from the same bank for meeting its day to day working capital requirements like for purchase of raw materials, labour payment etc. However, just within six months of its operations, the management feels that working capital funds are inadequate and situation is creating liquidity issues in the company.

The management of the company has approached its bankers and requested for enhancement in working capital credit facilities. The bank manager is insisting upon financial statements of the company for half year along with report providing assurance in this respect duly signed by Chartered Accountant as audit is far away. It also requires projected financial statements for coming years along with a report from CA providing assurance regarding these projections to consider request of management.

The management approaches CA P, who has qualified recently and started practising. Reports providing assurance for half yearly results and projected financial statements are sought from CA P. The Management provides necessary information and records to him in this regard.

Assume, in above case, the company only provides trial balance, financial statements in draft/preliminary form along with accompanying records for the relevant half year to CA P and requests him to provide duly signed financial statements with a report for mutually agreed professional fees.

Based on above, answer the following questions: -

1. The management of company has engaged CA P to issue a duly signed report for half year. Which of the following standards, if any, issued by ICAI are relevant for CA P?
 - (a) Standards on Review Engagements
 - (b) Standards on Auditing
 - (c) Standards on Related Services

ICAI Study Material Questions As Free

Audit & Ethics

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (d) There are no standards for issuing report in such situation.

Ans: (c)

2. Which of the following statements is MOST APPROPRIATE in given case situation?

- (a) CA P can assist management in preparation of financial statements of the company. However, issue of a report in such a case is outside the scope of work.
- (b) CA P can assist management in preparation of financial statements of the company and he can issue an audit report.
- (c) CA P can assist management in preparation of financial statements of the company and he can issue a compilation report in this respect.
- (d) The responsibility of preparation of financial statement is of company's management. CA P cannot assist management in preparation of financial statements of the company. However, he can issue a review report.

Ans: (c)

3. In the above said scenario for issuance of signed financial statements for half year by CA P, as discussed in last para of Case Study, identify the MOST APPROPRIATE statement: -

- (a) Standard on Quality control (SQC 1) is not applicable as CA P cannot issue audit report.
- (b) Standard on Quality Control (SQC 1) is not applicable as CA P cannot issue review report.
- (c) Standard on Quality Control (SQC 1) is applicable in such type of engagement.
- (d) Standard on Quality Control (SQC 1) is not applicable as CA P is barred from issuing any report in such type of engagement.

Ans: (c)

4. The banker of company has also requested for projected financial statements for coming years along with a report from CA regarding these projections to consider request of management. Which of the following standards issued by ICAI are relevant for CA P in such a situation, if any?

- (a) Standards on Review Engagements
- (b) There are no standards for issuing such type of reports.
- (c) Standards on Related Services
- (d) Standards on Assurance Engagements

Ans: (d)

5. Suppose CA P also accepts work of issuing projected financial statements with a report to be signed by him. The management has projected turnover of ₹ 100 crore for the next year, ₹ 150 crore & ₹ 200 crore for following years respectively as compared to present turnover of ₹ 25 crore in current half year. Identify the MOST APPROPRIATE statement in this situation: -

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (a) CA P has to satisfy himself regarding arithmetical accuracy of projected data.
- (b) CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover and its consistency with actuals.
- (c) CA P has to satisfy himself regarding arithmetical accuracy of data along with its proper presentation to banker.
- (d) CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover, its consistency with actuals, disclosure and presentation.

Ans: (d)

Test Your Knowledge

Multiple Choice Questions (MCQs)

1. Which of the following is not an advantage of audit?

- (a) It provides high quality financial information.
- (b) It acts as a moral check on employees.
- (c) It enhances risk of management bias.
- (d) It helps in safeguarding interests of shareholders.

Ans: (c)

2. Which of the following is NOT TRUE about an assurance engagement?

- (a) It relates to providing assurance about historical financial information only.
- (b) The practitioner obtains sufficient appropriate evidence.
- (c) There is some information to be examined by practitioner.
- (d) A written assurance report in appropriate form is issued by practitioner.

Ans: (a)

3. Which of the following is TRUE about Engagement Standards?

- (a) Engagement standards ensure proper rights to practitioners in course of performance of their duties.
- (b) Engagement standards ensure preparation and presentation of financial statements in a standardized manner.
- (c) Engagement standards ensure uniformity by practitioners in course of performance of their duties.
- (d) Engagement standards ensure savings in resources of clients.

Ans: (c)

4. Consider following statements in relation to “Limited assurance engagement”:-

Statement I - It involves obtaining sufficient appropriate evidence to draw reasonable conclusions.

Statement II - Review of interim financial information of a company is an example of limited assurance engagement.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (a) Statement I is correct. Statement II is incorrect.
- (b) Both Statements I and II are correct.
- (c) Both Statements I and II are incorrect.
- (d) Statement I is incorrect. Statement II is correct.

Ans: (d)

5. Which of the following is TRUE about Standards on auditing?

- (a) These deal mainly with voluntary responsibilities of auditors.
- (b) These deal mainly with mandatory responsibilities of auditors.
- (c) Their sole purpose is to help government authorities in augmenting revenues.
- (d) These deal mainly in carrying out audit according to legal provisions.

Ans: (b)

Correct /Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

- (i) The basic objective of audit does not change with reference to nature, size or form of an entity.**

Ans: Correct: An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.

- (ii) The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.**

Ans: Correct: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

- (iii) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.**

Ans: Correct: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

Theoretical Questions Answer

Question 1

"Choosing of appropriate accounting policies in relation to accounting issues is responsibility of management". Do you agree? Discuss duty of auditor, if any, in relation to accounting policies.

Answer 1

Choosing of appropriate accounting policies is responsibility of management. The role of auditor lies in evaluating selection and consistent application of accounting policies by management- Refer to scope of audit- what it includes.

(1) Coverage of all aspects of entity

Audit of financial statements should be organized adequately to cover all aspects of the entity relevant to the financial statements being audited.

(2) Reliability and sufficiency of financial information

The auditor should be reasonably satisfied that information contained in underlying accounting records and other source data (like bills, vouchers, documents etc.) is reliable and sufficient basis for preparation of financial statements.

The auditor makes a judgment of reliability and sufficiency of financial information by making a study and assessment of accounting systems and internal controls and by carrying out appropriate tests, enquiries and procedures.

(3) Proper disclosure of financial information

The auditor should also decide whether relevant information is properly disclosed in the financial statements. He should also keep in mind applicable statutory requirements in this regard.

It is done by ensuring that financial statements properly summarize transactions and events recorded therein and by considering the judgments made by management in preparation of financial statements.

The management responsible for preparation and presentation of financial statements makes many judgments in this process of preparing and presenting financial statements. For example, choosing of appropriate accounting policies in relation to various accounting issues like choosing method of charging depreciation on fixed assets or choosing appropriate method for valuation of inventories.

The auditor evaluates selection and consistent application of accounting policies by management; whether such a selection is proper and whether chosen policy has been applied consistently on a period-to-period basis.

Understand that financial statements of an entity are prepared on historical financial information basis. "Historical financial information" means information expressed in financial

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

terms in relation to a particular entity, derived primarily from that entity's accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Question 2

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

Answer 2

Assurance engagement" means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

It means that the practitioner gives an opinion about specific information due to which users of information are able to make confident decisions knowing well that chance of information being incorrect is diminished.

Question 3

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

Answer 3

Following elements comprise an assurance engagement: -

1. **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.
2. **An appropriate subject matter**
 It refers to the information to be examined by the practitioner. For example, financial information contained in financial statements while conducting audit of financial statements.
3. **Suitable criteria**
 These refer to benchmarks used to evaluate the subject matter like standards, guidance, laws, rules and regulations.
4. **Sufficient appropriate evidence**
 The practitioner performs an assurance engagement to obtain sufficient appropriate evidence. It is on the basis of evidence that conclusions are arrived and an opinion is formed by auditor.
 "Sufficient" relates to quantity of evidence obtained by auditor. "Appropriate" relates to

| Get Vivitsu Reviewers | Want Lectures? | Test yourself with Test Series |
|---|--|--|
| Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs | Get Vivitsu Recommended lectures at the lowest price | Test yourself Chapter-wise for a better pass percentage |
| www.thevivitsu.com/ca_inter | www.thevivitsu.com/marketplace | www.thevivitsu.com/test_series?id=18 |

quality of evidence obtained by auditor. One evidence may be providing more comfort to auditor than the other evidence. The evidence providing more comfort is qualitative and, therefore, appropriate. Evidence should be both sufficient and appropriate.

5. A written assurance report in appropriate form

A written report is provided containing conclusion that conveys the assurance about the subject matter. A written assurance report is the outcome of an assurance engagement.

Question 4

A Chartered Accountant is specifically asked to check accounts whether fraud exists. State with reasons whether it is an example of reasonable assurance engagement.

Answer 4

It is not a reasonable assurance engagement. It is in nature of investigation.

Question 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.

Answer 5

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.

We have already discussed under section on scope of audit that an auditor is not an expert in authentication of documents. Therefore, he may be led to accept invalid audit evidence on the basis of unauthentic documents.

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.

| Get Vivitsu Reviewers | Want Lectures? | Test yourself with Test Series |
|---|--|--|
| Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs | Get Vivitsu Recommended lectures at the lowest price | Test yourself Chapter-wise for a better pass percentage |
| www.thevivitsu.com/ca_inter | www.thevivitsu.com/marketplace | www.thevivitsu.com/test_series?id=18 |

Audit Strategy, Audit Planning and Audit Programme

ILLUSTRATION

Question 1 (Illustration)

The auditor T of Hand Fab Ltd is worried as to management of key resources to be employed to conduct audit.

Required: How the audit strategy would be helpful to the auditor?

Answer 1

(A) Establishing the overall audit strategy- Assistance for the auditor

Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.

The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

Factors to be taken into consideration by auditor for establishing audit strategy

The auditor shall take following factors into consideration while establishing audit strategy:

(a) Identify the characteristics of the engagement that define its scope

It is important for auditor to identify scope of the engagement. Only a well identified scope can lead to establishment of a sound audit strategy. There are many characteristics of engagement defining its scope. Some of characteristics are as under: -

- Applicable financial reporting framework applicable to the entity
- Nature of business segments to be audited including the need for specialized knowledge
- Industry specific reporting requirements required by industry regulators
- Expected use of audit evidence obtained in previous audits

(b) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required.

- The ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications. Some of the instances are given under: - The entity's timetable for reporting
- Organization of meetings to discuss of nature, timing and extent of audit work with management
- Discussion with management regarding the expected type and timing of reports to be issued including the auditor's report

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- Discussion with management regarding the expected communications on the status of audit work throughout the engagement.
- Expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed.

(c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts

The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant. Preliminary identification of material classes of transactions, account balances and disclosures help auditor in establishing overall audit strategy. More energies need to be devoted to significant matters to obtain desired outcomes. Few examples are listed as under: -

- Volume of transactions which may determine whether it is more efficient for the auditor to rely on internal control
- Significant industry developments such as changes in industry regulations and new reporting requirements.
- Significant changes in the financial reporting framework, such as changes in accounting standards.
- Other significant relevant developments, such as changes in the legal environment affecting the entity.

(d) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant

Considering results of preliminary engagement activities and knowledge gained from similar engagements goes a long way in establishing sound audit strategy. Examples are listed as under: -

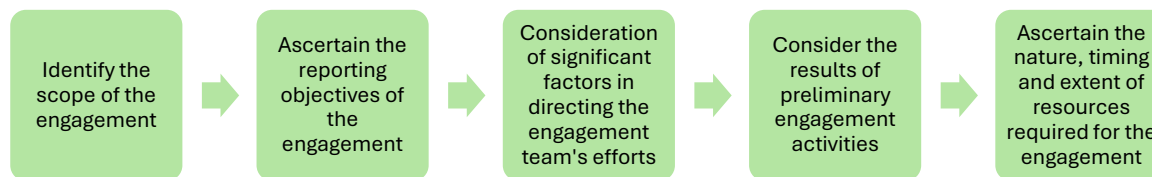
- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them.
- The manner in which the auditor emphasizes to engagement team members the need to maintain a questioning mind and to exercise professional skepticism in gathering and evaluating audit evidence.

(e) Ascertain the nature, timing and extent of resources necessary to perform the engagement.

Selection of engagement team and assignment of audit work to team members is a significant factor in establishing overall audit strategy. Experienced team members may be assigned in areas where there is higher risk of material misstatement. Similarly, engagement budgeting and devotion of more time to areas of higher risk of material misstatement are to be kept in mind.

| Get Vivitsu Reviewers | Want Lectures? | Test yourself with Test Series |
|---|--|--|
| Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs | Get Vivitsu Recommended lectures at the lowest price | Test yourself Chapter-wise for a better pass percentage |
| www.thevivitsu.com/ca_inter | www.thevivitsu.com/marketplace | www.thevivitsu.com/test_series?id=18 |

In establishing the overall audit strategy, the auditor shall:



Question 2 (Illustration)

W, the auditor of SKM Ltd. asks its finance and audit head to prepare audit strategy for conducting audit of SKM Ltd. W also insists him to draw detailed audit procedures. On the request of auditor W completes audit strategy as well as audit procedures as prepared by finance head of the company. Subsequently, auditor realizes that effectiveness of the audit is compromised and it was his responsibility to prepare the overall audit strategy. Comment.

Answer 2

The overall audit strategy and the audit plan remain the auditor's responsibility. It is the auditor who is responsible for establishing overall audit strategy and developing audit plan. However, as discussed earlier, auditor may discuss elements of planning with entity's management without compromising effectiveness of audit.

Accordingly, approach of W was wrong and he should have prepared overall audit strategy and detailed audit procedures.

Test Your Understanding

Question 1

MG & Co, a firm of auditors, having a standing of 30 years is appointed as a statutory auditor of company engaged in manufacturing of defence equipment. Due to opening of defence sector by government to private players in recent times, many new companies have entered the fray to manufacture sophisticated defence equipment. Considering technical and complex nature of operations, the auditors recognize that involvement of experts in the audit is required. Does consideration for involvement of experts by auditors fall in the domain of planning audit?

Answer 1

Consideration for involvement of experts by auditors falls within domain of planning. While planning an audit, auditor would have to consider whether involvement of experts is necessary. In the stated case, company is involved in technical and complex operations. Therefore, while planning an audit, auditors would have to consider whether involvement of expert is necessary.

Question 2

CA Kartik is planning for audit of a company engaged in manufacturing of cosmetics. Considering nature of operations of the company, he had planned to include testing of

| Get Vivitsu Reviewers | Want Lectures? | Test yourself with Test Series |
|---|--|--|
| Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs | Get Vivitsu Recommended lectures at the lowest price | Test yourself Chapter-wise for a better pass percentage |
| www.thevivitsu.com/ca_inter | www.thevivitsu.com/marketplace | www.thevivitsu.com/test_series?id=18 |

controls of the company over purchases, sales and inventories. One fine day, he reaches the corporate office and asks for manuals and required documentation to ensure surprise element in testing. He had never shared with management his intention to carry out above procedures. Is approach of CA Kartik proper?

Answer 2

In the case, CA Kartik has reached office of the company without sharing with management his intention to test the controls. The auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement without compromising effectiveness of audit. Sharing details of visit to test controls does not compromise effectiveness of audit. It is for the better facilitation and conduct of audit. Therefore, approach of CA Kartik is not proper.

Question 3

CA Mary, while planning audit of a company, feels that she would inquire from in-house legal counsel of the company status of pending litigation matters against the company to identify and assess risks of material misstatements. Considering above description, are you able to identify said procedures? Where these identified procedures are included in planning in accordance with SA-300?

Answer 3

These are planned risk assessment procedures to identify and assess risk of material misstatement. The objective of planned inquiry of in-house legal counsel is to identify and assess risk of material misstatement. Such planned risk assessment procedures are included in audit plan in accordance with SA-300.

Question 4

CA Shubhendu is statutory auditor of a social media company. Due to change in information technology regulations by government, it has become mandatory for such companies to constitute "grievance redressal mechanism" for users of social media platform of the company. Failure to comply with regulations can potentially lead to civil and criminal liabilities against the company. Is above factor to be considered by auditor while framing audit strategy?

Answer 4

Changes in laws and regulations affecting the company is a factor to be considered while establishing overall audit strategy. There has been change in information technology regulations applicable to the company. Non-compliance of the same can have implications in form of civil and criminal liabilities. Such an important matter concerning changes in laws and regulations is to be considered by auditor while establishing overall audit strategy.

Question 5

Rohit, undergoing practical training, is part of an engagement team conducting audit of a company engaged in manufacturing of paints. He has been provided with audit programme

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

pertaining to sales. It lists out various items to be checked and verified by him including invoices, rate lists, posting in debtors accounts, correlation of invoices with e-way bills on sample basis etc.

During verification, he notices that many e-way bills have been cancelled by the company within 24 hours of their generation in month of March. There is no specific instruction in audit programme in this regard. He keeps mum. Is attitude of Rohit proper?

Answer 5

Attitude of Rohit is not proper. The assistants should observe matters objectively and bring significant matters to the notice of supervisor/principal. Reasons for cancellation of many e-way bills in month of March need to be looked into. Matter should be informed to engagement partner.

CASE STUDY 1

Kaur & Associates, a sole proprietor firm of Simran Kaur, is offered appointment as auditor of a company engaged in manufacturing of automobile components for the first time. She is fact checking about the integrity of promoters of the company and key managerial persons. Matters such as competence of staff to perform the engagement are also considered by her. The appointment is subsequently accepted by her.

She is also taking into account number and location of branches of the company, requirements of Schedule III of Companies Act, 2013 and expected time by which audit has to be completed keeping in view statutory requirements. Initially, she has thought it proper to inquire key employees of the company in procurement and marketing departments and planned for the same. She has also planned to visit three plants of the company. The purpose of planned inquiry and visit is to identify and assess risk of material misstatements.

A detailed set of instructions has been prepared by her office and it has been handed over to assistants in engagement team. These set of instructions include details of extent of checking and nature of audit procedures to be performed regarding purchases, sales, items of income, items of expenditure etc. During the course of execution of above set of instructions, it has been brought to her notice that company is also producing substantial quantities of scrap generated during manufacturing process. However, no instructions have been given to engagement team in this regard.

Based on above, answer following questions:

1. Auditor is fact checking about promoters and key managerial persons. She is also considering competence of staff to perform engagement. What is she trying to do?
 - (a) She is establishing audit strategy.
 - (b) She is conducting preliminary engagement activities.
 - (c) She is designing audit plan.
 - (d) She is checking her compliance of ethical requirements.

Ans: (b)

ICAI Study Material Questions As Free

Audit & Ethics

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

2. **Consideration of number and location of branches, requirements of financial reporting framework and expected time of completion are relevant factors primarily for which of the following -**

- (a) Developing audit plan
- (b) Establishing overall audit strategy
- (c) Designing audit programme
- (d) Designing risk assessment procedures

Ans: (b)

3. **Taking into account description of planned inquiry and visit, which of the following statements is TRUE?**

- (a) Planned inquiry and visit fall in area of audit strategy.
- (b) Planned inquiry and visit are planned risk assessment procedures and fall in field of audit plan.
- (c) The said description is not related to audit planning.
- (d) Planned inquiry and visit fall in scope of audit programme.

Ans: (b)

4. **What is detailed set of instructions given to assistants in engagement team known as?**

- (a) Audit guidelines
- (b) Audit plan
- (c) Audit Programme
- (d) Audit Procedures

Ans: (c)

5. **The issue of generation of scrap has been overlooked in detailed set of instructions given to engagement team. What should be proper course of action by CA Simran Kaur?**

- (a) She should ignore this information as audit has already begun.
- (b) She should modify earlier set of instructions.
- (c) She should leave the matter to wisdom of engagement team.
- (d) She should put the ball in court of management as she was not provided with complete information earlier.

Ans: (b)

Test Your Knowledge

Multiple Choice Questions

1. **Which of the following is not considered in planning an audit generally?**

- (a) Understanding of legal and regulatory framework of an entity
- (b) Need to consider determination of materiality
- (c) Evaluating audit evidence
- (d) Need to consider involvement of expert

ICAI Study Material Questions As Free

Audit & Ethics

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Ans: (c)

2. Which of the following is true about audit plan?

- (a) Once an audit plan has been finalized for an engagement, changes cannot be made to it.
- (b) Audit plan includes scope, timing and direction of planned risk assessment procedures.
- (c) Changes in audit plan cannot lead to change in audit strategy.
- (d) Audit plan has to be documented by auditor.

Ans: (d)

3. Which of the following is not included in an audit programme normally?

- (a) Extent of checking
- (b) Date of checking
- (c) Nature or type of procedure
- (d) Planning of risk assessment procedures

Ans: (d)

4. Which of the following is not an advantage of an audit programme?

- (a) It acts as a guide for audit of coming years.
- (b) It fixes responsibility of assistants.
- (c) It serves as a shelter for assistants.
- (d) It serves a proof of work done by auditor.

Ans: (c)

5. Which of the following is most important principle for formulating an audit plan?

- (a) Gaining knowledge of client's workforce
- (b) Gaining knowledge of client's business
- (c) Gaining knowledge of client's vendors
- (d) Gaining knowledge of tax laws applicable to client

Ans: (b)

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

Question 1

The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes but are closely inter-related since changes in one may result in consequential changes to the other.

Answer 1

Correct: Once the overall audit strategy has been established, an audit plan can be developed to achieve the audit objectives through the efficient use of the auditor's resources. The establishment of the overall audit strategy and the detailed audit plan are not necessarily

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.

Question 2

Establishing an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan is prerogative of the management.

Answer 2

Incorrect: The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

Question 3

Planning is a discrete phase of an audit.

Answer 3

Incorrect: Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begin 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.

Question 4

A detailed Audit Programme once prepared for a business can be used for all business under all circumstances.

Answer 4

Incorrect: 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.

Question 5

The audit plan is more detailed than the overall audit strategy.

Answer 5

Correct: The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Theoretical Questions Answer

Question 1

Discuss how performing preliminary engagement activities as part of planning an audit assists auditor.

Answer 1

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

The auditor considers whether relationship with client should be continued and whether ethical requirements including independence continue to be complied with. It includes: -

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

Question 2

Discuss how an engagement partner ensures that firm complies with relevant ethical requirements including independence in relation to client.

Answer 2

The auditor shall continuously evaluate compliance with ethical requirements including independence. "Independence" means that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.

Throughout the audit engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team. If matters come to the engagement partner's attention that indicate that members of the engagement team have not complied with relevant ethical requirements, the engagement partner, in consultation with others in the firm, shall determine the appropriate action.

The engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, the engagement partner shall:

- (i) Obtain relevant information from the firm to identify and evaluate circumstances and relationships that create threats to independence
- (ii) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement and
- (iii) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Besides, consideration for client continuance and compliance with ethical requirements,

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

preliminary engagements activities also include establishing an understanding of terms of engagement.

Question 3

“Purported disadvantages of an audit programme can be overcome”. Do you agree?

Answer 3

Purported disadvantages of audit programme 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.

The disadvantages are: -

- 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.
- 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.
- 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.
- 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.

Question 4

An auditor of a company fails to document audit strategy and audit plan. Briefly outline consequences of such failure.

Answer 4

The auditor shall document: -

- the overall audit strategy
- the audit plan and
- any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team.

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. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit.

Question 5

SA 300 states that auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. Discuss few factors affecting such supervision and review of work of engagement team members.

Answer 5

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

ICAI Study Material Questions As Free

Audit & Ethics

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Chapter 3

Risk Assessment and Internal Control

27

ILLUSTRATION

Question 1 (Illustration)

XYZ Ltd is engaged in the business and running several stores dealing in variety of items such as ready made garments for all seasons, shoes, gift items, watches etc. There are security tags on each and every item. Moreover, inventory records are physically verified on monthly basis.

Discuss the types of inherent, control and detection risks as perceived by the auditor.

Answer 1

Inherent Risk: Because items may have been misappropriated by employees, therefore, risk to the auditor is that inventory records would be inaccurate.

Control Risk: There is a security tag on each item displayed. Moreover, inventory records are physically verified on monthly basis. Despite various controls being implemented at the stores, still collusion among employees may be there and risk to auditor would again be that inventory records would be inaccurate.

Detection Risk: Auditor checks the efficiency and effectiveness of various control systems in place. He would do that by making observation, inspection, enquiry, etc. In addition to these, the auditor would also employ sampling techniques to check few sales transactions from beginning to end. However, despite all these procedures, the auditor may not detect the items which have been stolen or misappropriated.

Question 2 (Illustration)

A Partnership Firm of Chartered Accountants HT and Associates was appointed to audit the books of accounts of Wind and Ice Limited for the financial year 2020 -21. There was a risk that HT and Associates would give an inappropriate audit opinion if the financial statements of Wind and Ice Limited are materially misstated. State the Risk mentioned in the question

Answer 2

The risk mentioned in the question is known as Audit Risk, because risk that auditor of a company will give an inappropriate audit opinion if the financial statements of that company are materially misstated is known as Audit Risk.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 3 (Illustration)

One of the team members of auditors of Highly Capable Limited was of the view that Materiality and Audit Risk are only considered at planning stage of an audit. Comment as an auditor

Answer 3

The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

Question 4 (Illustration)

The auditor of ABC Textiles Ltd chalks out an audit plan without understanding the entity's business. Since he has carried out many audits of textile companies, there is no need to understand the nature of business of ABC Ltd. Advise the auditor how he should proceed.

Answer 4

Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The auditor should proceed accordingly.

Question 5 (Illustration)

While auditing the books of accounts of Heavy Material Limited for the financial year 2022-23, a team member of the auditor of Heavy Material Limited showed no inclination towards understanding the business and the business environment of the above mentioned company. Is the approach of team member of the auditor of Heavy Material Limited correct or incorrect? Also give reason for your answer.

Answer 5

The approach of team member of the auditor of Heavy Material Limited is incorrect because understanding the business and the business environment of company whose audit is to be conducted is very important, as it helps in planning the audit and identifying areas requiring special attention during the course of audit of that company.

Question 6 (Illustration)

Prince Blankets is engaged in business of blankets. Its major portion of sales is taking place through internet. Advise the auditor how he would proceed in this regard as to understanding the entity and its environment.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 6

While understanding entity and its environment, internet sales is being perceived as risky area by the auditor and thereby would be spending substantial time and extensive audit procedures on this particular area.

Question 7 (Illustration)

Auditor GR and Associates, appointed for audit of PNG Ltd, a manufacturing company engaged in manufacturing of various food items. While planning an audit, the auditor does not think that it would be necessary to understand internal controls. Advise the auditor in this regard.

Answer 7

The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit.

Question 8 (Illustration)

The team member of the auditor of Simple and Easy Limited was of the view that understanding the internal control of the company would not help them in any manner in relation to audit procedures to be applied while conducting the audit.

Answer 8

The view of the team member of the auditor is incorrect because understanding the internal control of the company would help the auditor and his team members in designing the nature, timing and extent of audit procedures to be applied while conducting the audit of the company.

Question 9 (Illustration)

Mr. Y, one of the team member of the auditors of What and Where Limited was very keen in knowing whether the internal control of the company would safeguard the company's assets. Advise Mr. Y.

Answer 9

The review of internal controls will enable the auditors to know whether the controls adequately safeguard the assets.

Question 10 (Illustration)

Mr. H, a team member of the auditor of There and Here Limited was of the view that evaluation of internal control of the company would help in identifying the areas where internal control is weak. Advise

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 10

The review of internal controls will enable the auditor to know what are the areas where control is weak and where it is excessive.

Question 11 (Illustration)

In order to evaluate the Internal Control of Your and My Limited, a team member of the auditors used a method according to which, number of questions relating to internal control of the company were required to be answered by the employees of the company. After obtaining the answers there was a discussion relating to those answers between team member of the auditor and employees of the company for a clear picture. State the method of evaluation of internal control as discussed above.

Answer 11

The method of evaluation of internal control used in the above question is known as Internal Control Questionnaire because in questionnaire method, a number of questions relating to internal control of a company are required to be answered by employees of that company and when answers to the questions are obtained, there is a discussion relating to those answers between team members of the auditors and employees of that company for a clear picture.

Question 12 (Illustration)

Healthy and Useful Limited is into small manufacturing as well as trading business. For the purpose of evaluating the internal control of Healthy and Useful Limited, a team member of the auditors of the company used a method according to which the whole description of internal control that was operating in the said company was to be recorded. Identify the method of evaluation of internal control as mentioned above.

Answer 12

The method of evaluation of internal control referred above is known as Narrative Record because in Narrative Record method, a whole description of internal control operating in an entity is recorded. Narrative Record method is also appropriate for small manufacturing as well as trading business as is mentioned in the question above case.

Test Your Understanding
Question 1

Wear & Tear Private Limited is a “start-up” engaged in providing holistic solutions to problem of paddy stubble burning mainly catering to needs of farmers of North western India. Due to importance given by governments to this issue, companies have entered in the market in past few years. Many of these companies have not been successful and have gone bust. As an auditor of the company, can you spot the component of risks of material misstatement involved in above?

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 1

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 is “inherent risk.”

Question 2

A company has devised a control that its inventory of perishable goods is stored in appropriate conditions- in a controlled environment to prevent any damages to inventory. Responsibility is fixed on two persons to monitor environment using sensors and to report on deviations. Identify the component of risks of material misstatement involved as an auditor of the company.

Answer 2

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 is “control risk”.

Question 3

Shree Foods Private Limited is engaged in manufacturing of garlic bread. The auditors of 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. Which risk is being alluded to?

Answer 3

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”.

Question 4

Jo Jo Limited is planning to list on Bombay Stock Exchange next year. As an auditor of Jo Jo Limited, identify any one reason of increased audit risk due to listing of the company next year.

Answer 4

Jo Jo Limited is planning to list on Bombay Stock Exchange next year. There is a greater chance of misstatements in the financial statements due to planned listing next year. There could be a possibility of intentional manipulation of financial statements so that good response is received to proposed issue. Therefore, there is increased audit risk i.e., risk of expressing inappropriate opinion by the auditor when financial statements are materially misstated.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 5

On perusing financial statements of Jo Jo Limited put up for audit, it is observed by the auditor that current ratio has improved from 1.20:1 (in preceding year) to 1.75:1 (in current year). Identify what kind of risk assessment procedures are being performed by auditor? Has it any relation with listing of the company next year on Bombay Stock Exchange?

Answer 5

It is noticed by the auditor that current ratio has improved from 1.20:1 (in preceding year) to 1.75:1 (in current year). The auditor is using “analytical procedures” as risk assessment procedures. Current ratio has improved from previous year. There could be a possibility of misstatement in current assets and current liabilities. It is possible that improvement in current ratio is artificial due to misstatements and has been done to secure good response to the proposed issue of company next year.

Question 6

CA A. Raja is auditor of Build Well Forgings Private Limited having a revenue of ₹ 25 crore. The company has been sanctioned a term loan of ₹ 50 lacs from a bank. However, as at end of the year, only ₹ 1 lac was availed due to delay in procurement of asset. The financial statements of the company do not disclose nature of security against which loan has been taken. Schedule III of Companies Act, 2013 requires disclosure in this respect. Discuss, whether, non-disclosure of nature of security is material for auditor.

Answer 6

If there is any statutory requirement of disclosure, it is to be considered material. Schedule III mandates disclosure of nature of security in relation to loan. The amount involved is irrelevant.

Question 7

CA Smriti is auditor of a company. As part of audit, she is going through company policies and practices regarding employee recruitment, training, orientation and related matters. She seems to be very much interested in finding out whether company hires best candidates from applicant pool. Identify what she is trying to do? How gaining knowledge about this aspect is useful to her as an auditor?

Answer 7

The study of company policies and practices regarding employee recruitment, training, orientation and related matters including hiring of best candidates is part of understanding HR function of the company. It, in turn, helps in understanding control environment of the company. By gaining such a knowledge, she can better understand internal control of the company.

Question 8

During the audit of same company, CA Smriti is keen to find out whether there exists a proper system of segregation of duties in the company. She wants to be sure that a person

| Get Vivitsu Reviewers | Want Lectures? | Test yourself with Test Series |
|---|--|--|
| Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs | Get Vivitsu Recommended lectures at the lowest price | Test yourself Chapter-wise for a better pass percentage |
| www.thevivitsu.com/ca_inter | www.thevivitsu.com/marketplace | www.thevivitsu.com/test_series?id=18 |

responsible for recording a transaction is different from the person authorising it. Discuss what she is trying to do and how its understanding is significant to her as an auditor.

Answer 8

She is keen to find out whether there exists a proper system of segregation of duties in the company. She is gaining an understanding of internal control of the company. In particular, she is understanding "control activities". When a person recording a transaction is different from one authorizing it, she gains confidence that there exists a system for preventing misstatements. It helps her in gaining insight into the internal control system of the company.

Question 9

Zomba Products Private limited is a small company. The control systems in the company are rudimentary. How, you as an auditor of the company, would proceed to evaluate internal control of the company?

Answer 9

In a small company, control systems are basic and not formalized. Therefore, auditor should proceed to evaluate internal control using narrative record.

Question 10

A Chartered accountant during course of audit of a company finds that cash is not deposited into bank frequently although concerned staff of company was required to do so. Further, the official responsible for ensuring performance of above function, has also not paid any attention to it. Discuss what does it represent from auditor's perspective.

Answer 10

Cash is not deposited into bank frequently, although, concerned staff of company was required to do so. Further, the official responsible for ensuring performance of above function, has also not paid any attention to it. It means that control is not working as planned. It would not be able to prevent misstatement and very purpose of control is defeated. It represents a "control deficiency".

CASE STUDY-1

CA Paritosh is auditor of a company. The financial statements of the company have just been received for audit. Following issues have been flagged pertaining to the financial statements of the company for purpose of risk assessment: -

- (i) The revenue of company has fallen from ₹ 50 crore in last year to ₹ 5 crore in current year (for which financial statements have been received for audit) due to lack of demand in the market for company's products.
- (ii) Due to advent of new products in the market, company's products are fast becoming outdated.
- (iii) A large customer having an outstanding balance of ₹ 5 crore has failed to pay to the company despite efforts made by the company.
- (iv) Inventory holding period has increased from 30 days in last year to 90 days.
- (v) The company also gets carried out job operations from third parties. Therefore, parts of

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

inventories are lying with third parties.

Based on above, answer the following questions: -

1. Regarding drastic fall in revenue of the company, which of the following is an audit risk?

- (a) Fall in revenue would result in fall of profits for the company.
- (b) Drastic fall in revenue may imply that company is not able to carry out its operations in foreseeable future due to lack of demand in the market for company's products. There is a risk that going concern disclosure is omitted to be made in financial statements.
- (c) The company can explore some new line of activity, if demand of its products is falling.
- (d) Fall in revenue would mean lower tax liabilities for the company.

Ans: (b)

2. The company's products are getting outdated in the market. Which of the following is an audit risk?

- (a) The company should devise strategies to sell products in the market.
- (b) Inventories may be understated in such a scenario.
- (c) Inventories may be overstated in such a scenario.
- (d) The company should launch a 1+1 free offer for its customers.

Ans: (c)

3. A large customer has failed to pay to the company. Identify audit risk from below:

- (a) Receivables may be misstated if irrecoverable debt is not written off.
- (b) Receivables may be overstated if irrecoverable debt is not written off.
- (c) Writing off irrecoverable debt would impact profits of company adversely.
- (d) Failure to recover outstanding debt would impact cash flows of company adversely.

Ans: (b)

4. Identify audit risk involved when inventory holding period has increased from 30 days to 90 days.

- (a) There is a risk of overstatement of inventories.
- (b) There is a risk relating to existence of inventories.
- (c) There is a risk that slow movement of stocks would increase tax liability when GST rates are increased.
- (d) There is a risk relating to holding and storage cost of inventories.

Ans: (a)

5. Part of inventories are lying with third parties. Identify audit risk involved.

- (a) There is a risk that third parties do not manufacture according to specifications of the company.
- (b) There is a risk that by getting job work done from third parties, company is increasing its costs.
- (c) There is a risk that sufficient and appropriate evidence would not be available in respect of quantity and condition of inventories lying with third parties.
- (d) There is a risk that sufficient and appropriate evidence would not be available for quality control in respect of inventories lying with third parties.

Ans: (c)

CASE STUDY-2

CA Piyush is understanding internal controls as part of audit exercise of a company. It is a new client. He has studied controls in place in various operational areas of the company. After studying and gaining an understanding of such controls, he has decided to test few controls to actually see whether these are operating as intended by the management. Till now, he has studied controls over inventories and bank. Few of such controls are listed below: -

| Nature of Control | Control description |
|------------------------------|---|
| Control over inventories | Inventories of the company lying at each location should be insured. |
| Control over inventories | There should be inventory counts on a regular basis for each location of the company. |
| Control over Bank operations | Bank reconciliations are to be performed at regular intervals. |

1. Which of the following most appropriately describes test of control regarding insurance of inventories?

- (a) Inspect insurance policies to verify that inventories at each location are insured for fire and burglary. The sum insured and period of validity of policy are not relevant.
- (b) Inspect insurance policies to verify that inventories at each location are comprehensively insured. Ensure adequacy of sum insured by comparing it with value of inventories. Also ensure policy period has not expired.
- (c) Inspect insurance policies to verify that inventories at each location are comprehensively insured. Ensure policy period has not expired.
- (d) Inspect insurance policies to verify that inventories at each location are insured for fire and burglary. Ensure policy period has not expired.

Ans: (b)

2. Which of the following most appropriately describes test of control regarding inventory counts?

- (a) Obtain detail of inventory counting procedure and ensure that inventory count is

carried out according to laid down procedure.

- (b) Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure. Attend inventory count.
- (c) Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure. Attend inventory count and perform test count.
- (d) Attend inventory count and perform test count.

Ans: (c)

3. While testing control over bank reconciliations, it has been noticed that bank reconciliations are not being performed at regular intervals. Identify the most appropriate description of “control deficiency” in this regard: -

- (a) Bank reconciliations are not being performed regularly as concerned staff is overburdened.
- (b) Bank reconciliations are not being performed regularly as concerned staff is overburdened. It could result in errors.
- (c) Bank reconciliations are not being performed regularly as concerned staff is overburdened. It could result in errors. It may result in misstatement of cash and bank balance in financial statements.
- (d) Bank reconciliations are not being performed regularly as concerned staff is overburdened. These should be performed monthly and reviewed by senior accountant.

Ans: (c)

4. Since the company is a new client, which of the following statements is most appropriate?

- (a) There is reduced detection risk.
- (b) There is increased detection risk.
- (c) There is no effect on detection risk.
- (d) Detection risk should be increased to lower audit risk.

Ans: (b)

5. Which of the following statements is most appropriate regarding auditor’s response to assessed risk of a new client?

- (a) More substantive procedures would require to be performed.
- (b) Less substantive procedures would require to be performed.
- (c) There is no effect on substantive procedures.
- (d) There is no effect on substantive procedures as audit risk is low.

Ans: (a)

Test Your Knowledge

Multiple Choice Questions

1. Which of the following is true regarding materiality?

- (a) It is unaffected by nature of an item.
- (b) It is unaffected by requirements of law or regulations.
- (c) It is not a matter of professional judgment.
- (d) It is not always a matter of relative size.

Ans: (d)

2. The operations of a company are automated substantially. Which of the following statements is most appropriate in this respect?

- (a) It results in complex business environment.
- (b) It results in simple business environment and easier audit.
- (c) Automation has no relationship with complexity of business environment.
- (d) It results in simple business environment. However, it increases complexity of audit.

Ans: (a)

3. Who is responsible for maintaining effective internal financial controls?

- (a) Statutory auditor
- (b) Audit Committee
- (c) Management
- (d) Shareholders

Ans: (c)

4. Which of the following is not a risk to a company's internal control due to its IT environment?

- (a) Potential loss of data
- (b) Inability to access data when required
- (c) Unauthorized access to data
- (d) Processing of large volumes of data

Ans: (d)

5. Which of the following is not an example of "General IT controls"?

- (a) Controls pertaining to Disaster recovery plan
- (b) Controls pertaining to batch preparation
- (c) Controls pertaining to data security
- (d) Controls pertaining to validation of input data in an application

Ans: (d)

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

Question 1

There is direct relationship between materiality and the degree of audit risk.

Answer 1

Incorrect: There is an inverse relationship between materiality and the degree of audit risk. The higher the materiality level, the lower the audit risk and vice versa. For example, the risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low but the risk that it could be misstated by an extremely small amount might be very high.

Question 2

Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

Answer 2

Incorrect: Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls. Control risk, on the other hand is the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

Question 3

Tests of control are performed to obtain audit evidence about the effectiveness of Internal Controls Systems.

Answer 3

Correct: Tests of Control are performed to obtain audit evidence about the effectiveness of:

- the design of the accounting and internal control systems that is whether, they are suitably designed to prevent or detect or correct material misstatements and
- the operation of the internal controls throughout the period.

Question 4

Maintenance of Internal Control System is the responsibility of the Statutory Auditor.

Answer 4

Incorrect: The management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

business. Maintenance of Internal Control System is responsibility of management because the internal control is the process designed, implemented and maintained by those charged with governance/management to provide reasonable assurance about the achievement of entity's objectives.

Theoretical Questions Answer

Question 1

Discuss how “analytical procedures” performed as “risk assessment procedures” can be useful to an auditor.

Answer 1

Analytical Procedures: Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, relationship between sales and square footage of selling space or volume of goods sold.

Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud. However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures.

Question 2

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

Answer 2

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

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

Question 3

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Discuss relationship between “General IT controls” and “application controls” in an automated environment.

Answer 3

These two categories of control over IT systems are interrelated.

The relationship between the application controls and the General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems.

Question 4

A company functions in an automated environment. Discuss in what areas data analytics can be useful for auditor of the company.

Answer 4

The tools and techniques that auditors use in applying the principles of data analytics are known as Computer Assisted Auditing Techniques or CAATs in short. Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialized audit tools viz., IDEA and ACL to perform the following:

- Check completeness of data and population that is used in either test of controls or substantive audit tests.
- Selection of audit samples – random sampling, systematic sampling.
- Re-computation of balances – reconstruction of trial balance from transaction data.
- Reperformance of mathematical calculations – depreciation, bank interest calculation.
- Analysis of journal entries Fraud investigation.
- Evaluating impact of control deficiencies.

Question 5

What is understood by “non-routine” transactions? Briefly outline why risks of material misstatement is greater for such transactions.

Answer 5

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. Significant risks are inherent risks with both a higher likelihood of occurrence and a higher magnitude of potential misstatement. The auditor assesses assertions affected by a significant risk as higher inherent risk. The following are always significant risks:

- Risks of material misstatement due to fraud
- Significant transactions with related parties that are outside the normal course of business for the entity

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 6

The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting” Explain.

Answer 6

The auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting. Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It helps in assessing the effectiveness of controls on a timely basis. It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions. It includes considering whether controls are operating as intended and that they are modified as appropriate for change in conditions. Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.

Management’s monitoring activities may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.

Question 7

“Risk of material misstatement consists of two components” Explain clearly defining risk of material misstatement.

Answer 7

The risk of material misstatement at assertion level comprises of two components i.e., inherent risk and control risk. Both inherent risk and control risk are the entity’s risks and they exist independently of the audit of financial statements. Inherent risk and control risk are influenced by the client. These are entity’s risks and are not influenced by the auditor.

Inherent risk

Inherent risk is the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements before consideration of any related controls as described in SA-200. There is always a risk that before considering any existence of internal control in an entity, a particular transaction, balance of an account or a disclosure required to be made in the financial statements of an entity have a chance of being misstated and such misstatement can be material. This risk is known as inherent risk.

Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations.

Inherent risk factors are considered while designing tests of controls and substantive procedures. Category of auditor’s assessment lower or higher, each category covers a range of degrees of inherent risk. Auditor may assess the inherent risk of two different assertions as lower while recognizing that one assertion has less inherent risk than the other, although both

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

have been assessed as lower.

It is important to consider the reason for each identified inherent risk even if the risk is lower, when auditor designs tests of controls and substantive procedures.

External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete. Factors in the entity and its environment may also influence the inherent risk related to a specific assertion.

Control Risk

In accordance with SA-200, control risk is the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

Control risk is a risk that internal control existing and operating in an entity would not be efficient enough to stop from happening, or find and then rectify in an appropriate time, any material misstatement relating to a transaction, balance of an account or disclosure required to be made in the financial statements of that entity. Therefore, in a way, it can be said that there exists an inverse relation between control risk and efficiency of internal control of an entity. When efficiency of internal control of an entity is high, the control risk is low and when efficiency of internal control of that entity is low, the control risk is high.

Question 8

"The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement"" Explain

Answer 8

Standards on auditing do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

Audit risk = Risks of material misstatement × Detection risk

It can be concluded from the above that: -

Since risks of material misstatement is a function of inherent risk and control risk,

it can also be shown as: - Audit risk = Inherent risk × Control risk × Detection risk

Question 9

"The auditor shall obtain an understanding of the control environment" Explain stating what is included in control environment.

Answer 9

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

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (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.

Question 10

Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. Explain stating clearly the objectives of Internal Control.

Answer 10

Objectives of Internal Control

Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. The auditor's consideration of such controls is generally limited to those relevant to the reliability of financial reporting. For example, use of access controls, such as passwords, that limit access to the data and programs that process cash disbursements may be relevant to a financial statement audit. Conversely, safeguarding controls relating to operations objectives, such as controls to prevent the excessive use of materials in production, generally are not relevant to a financial statement audit.

Objectives of Internal Control are:

- (i) transactions are executed in accordance with managements general or specific authorization;
- (ii) all transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;
- (iii) assets are safeguarded from unauthorized access, use or disposition; and
- (iv) the recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

ILLUSTRATION**Question 1 (Illustration)**

The auditor of JPJ Limited explained to the audit team members about the relationship between Audit Evidence and Opinion of Auditor. Explain what relationship exists between Audit Evidence and Opinion of Auditor.

Answer 1

There exists a very important relationship between Audit Evidence and opinion of the Auditor. While conducting an audit of a company, the auditor obtains audit evidence and with the help of that audit evidence obtained, the auditor forms an audit opinion on the financial statements of that company.

Question 2 (Illustration)

An audit team member of the auditors of Genuine Limited was of the view that audit evidence obtained internally from within the company under audit are more appropriate from the reliability point of view as compared to audit evidence obtained externally as evidence obtained internally are obtained from the company whose audit is being conducted.

Give your views as auditor of Genuine Limited.

Answer 2

Audit evidence obtained externally is more appropriate from reliability point of view as compared to those which are obtained internally. The reason that audit evidence obtained externally is more appropriate from the point of view of reliability is that there is a very low risk that they can be altered or changed.

Question 3 (Illustration)

There was a Partnership Firm of Chartered Accountants VM and Associates. Mr. M, one of the partners of VM and Associates, while explaining to his audit team members about importance of audit evidence informed them about sufficiency and appropriateness of audit evidence. Mr. A, one of the members of audit team of VM and Associates was of the view that sufficiency of audit evidence means simplicity of audit evidence and appropriateness of audit evidence means ease of obtaining audit evidence. Explain whether sufficiency and appropriateness of audit evidence mean simplicity and ease of obtaining audit evidence.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 3

Sufficiency and Appropriateness of audit evidence does not mean simplicity and ease of obtaining audit evidence rather sufficiency of audit evidence is related to the quantity of audit evidence and appropriateness of audit evidence is related to quality of audit evidence.

Question 4 (Illustration)

While auditing the books of accounts of AB Limited for the financial year 2022-23, the auditor of the company used an audit procedure according to which complete documents and records of the company were checked in detail in order to obtain audit evidence. Explain the audit procedure used by the auditor of Extremely Distinct Limited

Answer 4

The audit procedure used by auditor of AB 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.

Question 5 (Illustration)

JK Exports Ltd is a manufacturer exporter having its own production capacity and also gets the job work done through various job workers. The auditor of JK Exports Ltd. Considers that inventory held with job workers is material to the financial statements. Required: Suggest the audit procedures in the given case.

Answer 5

When inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

- Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
- Perform inspection or other audit procedures appropriate in the circumstances.

Question 6 (Illustration)

Parag India Ltd is a manufacturer of various FMCG (fast moving consumable goods) range of products. The company is having several cases of litigation pending in courts. The auditor wanted to identify litigation and claims resulting to risk of material misstatements.

Required

Suggest the auditor with reference to SAs.

Answer 6

The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

- Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
- Reviewing minutes of meetings of those charged with governance and correspondence

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- between the entity and its external legal counsel; and
- (c) Reviewing legal expense accounts.
- If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel.

Question 7 (Illustration)

During the financial year 2022-23, the auditor of Healthy and Wealthy Limited asked a Trade Receivable to respond directly to the auditor whether or not the amount they were required to pay to Healthy and Wealthy Limited was ₹ 1,23,000. That trade receivable confirmed to the auditor of Healthy and Wealthy Limited, that they were required to pay an amount of ₹ 1,23,000 to Healthy and Wealthy Limited. State and explain the type of Confirmation Request as required by the auditor.

Answer 7

The above-mentioned situation is an example of Positive Confirmation Request because in Positive Confirmation Request the party confirms the auditor of a company whether such party agrees or whether such party disagrees with the information for which the confirmation is required by auditor of that company.

Question 8 (Illustration)

While conducting the audit of AB Ltd, the auditor K of KLM and Associates, Chartered Accountants observes that there are large number of Trade payables and receivables standing in the books of accounts as on 31st March. The auditor wanted to send confirmation request to few trade receivables, but the management refused the auditor to send confirmation request.

Required - How would the auditor proceed?

Answer 8

If management refuses to allow the auditor to send a confirmation request, the auditor shall:

- Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;
- Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and
- Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705.

Question 9 (Illustration)

CA Aarav wants to verify the payments made by XYZ Ltd. on account of building rent during the FY 2022-23. The rent amounts to ₹50,000/- per month for the year. The monthly rent payments are consistent with the rent agreement. However, the other companies in the similar industry are paying rent of ₹ 10,000/- per month for a similar location. How will applying the analytical procedures impact the verification process of such rental payments by XYZ Ltd.?

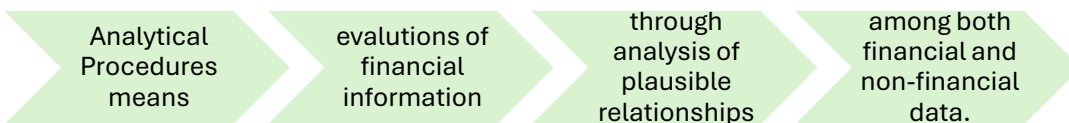
Answer 9

If CA Aarav checks in detail the monthly rent payments, he may find that such payments are consistent with the rent agreement i.e. XYZ Ltd. paid ₹ 50,000/- per month as rent and the same is getting reflected in the rent agreement. Here, CA Aarav may not be able to find out the inconsistency in the rent payment with respect to rent payment prevalent in the similar industry for rent of the similar location.

If CA Aarav applies analytical procedure i.e. compares the rent payment by XYZ Ltd. with the similar payments made by companies in similar industry and similar area, he will notice an inconsistency in such rent payments as the other companies are paying a very less monthly rent in similar industry for similar area.

However, if CA Aarav does not make such comparison and only checks the monthly payments and rent agreement of XYZ Ltd., he would not have found such inconsistency and as such the misstatement may remain undetected.

Meaning of Analytical Procedures. As per the Standard on Auditing (SA) 520 "Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ



from expected values by a significant amount.

Question 10 (Illustration)

Analytical procedure involves analysis of relationship among financial and non- financial data. Explain with the help of an example as to how, the statutory auditor of ABC Ltd. will analyse such relationship with respect to the total wages paid by ABC Ltd. during the FY 2022-23.

Answer 10

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

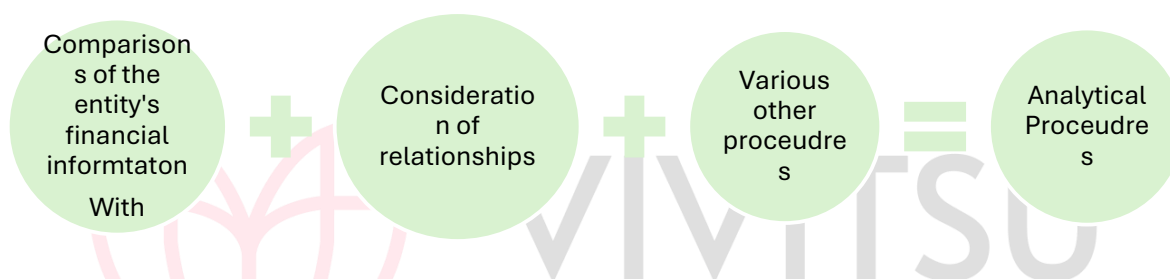
As per SA 520, Analytical Procedures means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. The following example explains the analysis of relationship between financial and non-financial data while applying analytical procedures.

The statutory auditor of ABC Ltd. has to verify the total wages paid by the company having factories in various states. He can verify the same by analyzing the relationship between wages per worker and total number of workers across all the factories.

i.e. Total wages = Wages per worker x Total number of workers.

Here wages per worker is financial data i.e. in ₹ and total number of workers is a number which is a non financial data. Thus, the statutory auditor of ABC Ltd. is evaluating financial information i.e. total wages paid (in ₹) by analyzing the relationship between wages per worker (in ₹) which is financial data and number of workers which is a non financial data.

Analytical procedures include the consideration of comparisons of the entity's financial information with as well as consideration of relationships.



Question 11 and Answer (Illustration)

| Particulars | Client | | Industry | |
|--------------------|---------|---------|----------|---------|
| Year | 2021-22 | 2022-23 | 2021-22 | 2022-23 |
| Inventory Turnover | 2.8 | 2.9 | 3.1 | 2.8 |
| Gross Margin | 22.5% | 22.7% | 23.6% | 22.2% |

- Various methods may be used to perform analytical procedures.
- These methods range from performing simple comparisons to performing complex analyses using advanced statistical techniques.
- Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

Thus, we can say that Analytical Procedures may be segregated into the following major types:

- as comparison of client and industry data,
- comparison of client data with similar prior period data,
- comparison of client data with client-determined expected results,
- comparison of client data with auditor-determined expected results and
- comparison of client data with expected results, using non financial data.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Test Your Understanding

Question 1

On perusal of financial statements of a company, auditor of company finds that notes to accounts contain aging of trade payables in accordance with requirements of Schedule III of Companies Act, 2013. The accountant of company is responsible for ensuring proper aging of trade payables included in notes to accounts. The auditor wants to verify whether aging of trade payables made in financial statements is proper or not. Identify what he is trying to do.

Answer 1

The auditor is verifying aging of trade payables. He is “reperforming” the control which was mandated by the management.

Question 2

CA Sooryagaythri is conducting audit of an entity. During the course of audit, she has made oral inquiries from head accountant regarding preparing of bank reconciliations every month as has been laid down by the management. Discuss, whether inquiries as stated above would provide satisfaction to her that controls in respect of preparing bank reconciliations statements have operated effectively.

Answer 2

Inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls. Mere inquiry does not lead to obtaining of sufficient appropriate audit evidence. In the instant case, CA Sooryagaythri should verify whether proper bank reconciliations have been carried out monthly as stipulated by management. Only then, she can be satisfied about operating effectiveness of controls in this regard.

Question 3

A company has stipulated a control that reconciliations of its records showing quantitative details of its property, plant and equipment are carried out at regular intervals with physical verification of such items. The auditor has found that such reconciliations are being carried out as stipulated. Discuss, whether above factor, increases reliability of other internally generated evidence within the company relating to existence of such items.

Answer 3

The management is carrying out reconciliations of items contained in Property, Plant and Equipment records with physical verification of such items at regular intervals. It means that controls in this regard have operated effectively. 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.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 4

A company has stipulated a control through its automated software that interest @ 12% p.a. is charged in case of those customers who fail to make payment within a month of a sales transaction. The internal auditor of the company finds that during a certain period, software has failed to charge interest due to certain technical glitches. Does reporting of above situation fall in domain of internal auditor's work?

Answer 4

One of the functions of internal auditor includes responsibility for reviewing controls, evaluating their operation, and recommending improvements thereto. In the given case, internal auditor has found that controls relating to levying of interest have not operated. The system has not levied stipulated interest in respect of a certain period. It can result in loss of income for the company and improper financial reporting. Such a matter, definitely, falls in the domain of reporting by internal auditor.

Question 5

CA Sukesh is external auditor of an entity. He comes to know that there is also an internal auditor in the entity. However, he finds that internal auditor is not reporting directly to higher echelons of the management. CA Sukesh has also assessed risk of material misstatement to be high. Discuss, whether it would be proper for CA Sukesh to rely upon work of internal auditor extensively in above situation.

Answer 5

In the given case, the organizational status of internal audit function is not commensurate with his duties. He is not reporting directly to higher echelons of management. It shows that such a function is not given its due importance in entity. Since risk of material misstatements has also been assessed as high by CA Sukesh, both the above factors suggest that he should not rely upon work of internal auditor extensively.

Question 6

An auditor, while conducting audit of an entity, has selected samples based upon his personal experience and knowledge. Later on, it turns out that selected samples were not representative and it has led to faulty selection of samples. The auditor contends that samples were selected based upon his personal experience and knowledge. Can auditor escape from his responsibility in this regard?

Answer 6

In the provided situation, the auditor has selected samples based upon his personal experience and knowledge. It, is a case of non-statistical sampling approach adopted by the auditor. Whatever may be the approach non- statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The auditor cannot escape his responsibility in this regard.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 7

The audit procedures performed so far by auditor of a company indicate that there is a possibility that company has not disclosed all material litigation cases involving the company. Does such a situation warrant direct communication by auditor with external lawyer of the company?

Answer 7

As per requirements of SA-501, If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, seek direct communication with the entity's external legal counsel. The above situation warrants direct communication with company's standing external lawyer.

Question 8

CA Jignesh Desai is in midst of audit of a company. The company is fairly large one and has a well -functioning internal audit department. While considering sending out external confirmation requests to trade receivables outstanding as on date of financial statements, he has delegated the process of choosing trade receivables, designing requests and receiving responses from customers to internal audit department. The responses are also received on the mail id of internal audit department. Is approach of CA Jignesh Desai proper?

Answer 8

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

- Determining the information to be confirmed or requested;
- Selecting the appropriate confirming party;
- Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
- Sending the requests, including follow-up requests when applicable, to the confirming party.

In the given case, it appears that external auditor has delegated entire work of sending out external confirmation requests to internal audit department over which he has no control. Further, responses to external confirmation requests are received on mail id of internal audit department. All these acts are not in line with requirements under SA 505.

Question 9

On reviewing schedule of trade receivables of a company, CA Mary finds that in respect of one outstanding balance, the CFO of the company is not willing to allow her to send external confirmation request due to the reason that sending out such request could spoil precariously placed business relations with the customer. On further inquiry, she finds out that there is a dispute going on with the company relating to some quality issues of goods sent to the customer and matter is sub judice. Efforts are also being made by the company

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

for out of court settlement. Reviewing correspondence with the customer, she finds that issue is near resolution and no fraud risk factors exist. Is unwillingness of CFO justifiable?

Answer 9

In terms of requirements of SA 505, if management refuses to allow the auditor to send a confirmation request, the auditor shall inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness.

A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. Further, fraud risk factors do not exist. Keeping in view, unwillingness of CFO is justifiable.

Question 10

An auditor of a company intends to apply analytical procedures for verifying revenue. Discuss any two analytical procedures which may be performed by auditor relating to revenues.

Answer 10

Analytical procedures in relation to revenue can include:-

- (i) Comparing revenue of current year with previous year and investigating significant fluctuations
- (ii) Comparing revenue of current year with budgeted targets and investigating significant fluctuations.

CASE STUDY 1 Case Scenario

CA Drishti Khandelwal is conducting audit of a company engaged in manufacturing of towels and bedspreads. The company is having its own manufacturing set-up. However, it also gets some manufacturing processes outsourced from third parties. The company has three locations having substantial quantities of inventories in the same city. Besides, due to outsourcing of some processes, inventories are also held in premises of third parties in the same city. As part of audit procedures, she is performing many audit procedures required by different Standards on Auditing.

In particular, she is attending physical inventory count process of the company at year end in accordance with requirements of SA 501. The inventory of the company includes raw materials consisting mainly of natural and dyed yarns, work in process in different stages of manufacturing and finished stocks of towels and bedspreads.

She is also planning sending confirmations to parties to whom the company has sold goods. On reviewing trade receivables list, she finds that the list also contains large number of parties having small balances. She further finds that these receivables have arisen due to sale of bedspreads to small time retailers and possibility of difference in balances as per company's records and as per records of these small-time retailers is low. Risk of misstatements in relation to trade receivables has been assessed as low. Besides, there is nothing to suggest that small-time retailers would disregard such requests.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

While conducting audit, she is testing controls operating in the company. She is also conducting tests of various items of income and expenditure as well as balances appearing in balance sheet. She intends to rely upon sampling extensively.

Based on above, answer the following questions: -

1. Which of the following statements is most appropriate regarding inventory count by auditor in accordance with SA 501? 4.4

- (a) She should inspect the inventory to ascertain its existence and condition at all locations, observe how company personnel are carrying out count procedures and perform test counting.
- (b) She should inspect the inventory to ascertain its existence at all locations, observe how company personnel are carrying out count procedures and perform test counting. The matter of condition of inventories falls in domain of expert.
- (c) She should inspect the inventory to ascertain its existence at selected location, observe how company personnel are carrying out count procedures and perform test counting. The matter of condition of inventories falls in domain of expert.
- (d) She should inspect the inventory to ascertain its existence and condition at all locations and perform counting of each and every item.

Ans: (a)

2. As regards inventories lying with third parties, which of following statements meets requirements of SA 501? 4.4

- (a) She should request confirmation from third parties regarding quantity and condition of inventories held on behalf of the company as well as request third parties to allow her to inspect inventories held by them. Both requirements are necessary to be complied with.
- (b) She should request confirmation from third parties regarding quantity and condition of inventories held on behalf of the company or request third parties to allow her to inspect inventories held by them. Compliance of any one of these or both is required for purposes of SA 501.
- (c) There is no obligation cast upon an auditor in respect of inventories lying with third parties.
- (d) She should request confirmation from third parties regarding quantity, condition and value of inventories held on behalf of the company or request third parties to allow her to inspect inventories held by them. Compliance of any one of these is sufficient for purposes of SA 501.

Ans: (b)

3. Keeping in view description regarding trade receivables, identify the most appropriate statement in context of SA 505? 4.5

- (a) She should not plan and design confirmation requests for large number of parties having small balances.

- (b) She should plan and design positive confirmation requests for large number of parties having small balances.
- (c) She should plan and design positive confirmation requests for large number of parties having small balances and meticulously analyse exception rate
- (d) She should plan and design negative confirmation requests for large number of parties having small balances.

Ans: (d)

4. As regards sampling, which of the following statements is most appropriate in terms of requirements of SA 530? 4.3

- (a) Sampling is used in tests of transactions as well as tests of controls.
- (b) Sampling is used in tests of balances as well as tests of controls.
- (c) Sampling is used in tests of details.
- (d) Sampling is used in tests of details as well as tests of controls.

Ans: (d)

5. Since she intends to rely upon sampling extensively, which of the following statements is true about sampling risk? 4.3

- (a) Sampling risk can be eliminated.
- (b) Increase in sampling risk would lead to decrease in detection risk.
- (c) Decrease in sampling risk would lead to increase in detection risk.
- (d) Sampling risk will always be in existence.

Ans: (d)

CASE STUDY 2 Case Scenario

Financial statements of a firm have been put up for audit before CA Manushi. Ongoing through financial statements, she wants to verify assertions contained in financial statements and has planned certain procedures for carrying out detailed checking.

- (A) She plans to verify some major bills debited in “Machinery repair” account. The purpose of it is to ensure that bills are entered correctly and their classification is proper.
- (B) She plans to verify that all balances appearing under trade payables are genuine and not fake.
- (C) She plans to compare amount of wages paid in current year and last year. It is also planned to verify relationship between the number of employees and wages paid in both years.
- (D) She is of the view that it is necessary to examine title deeds of “land” appearing in financial statements of the firm.
- (E) The firm is engaged in export of goods to Europe. The sales invoices raised in Euros are converted into Indian rupees as per applicable norms.

1. As regards description given regarding verification of bills debited in “Machinery

repair” account, identify what she intends to perform? 4.1

- (a) Tests of Controls
- (b) Tests of transactions
- (c) Tests of balances
- (d) Risk assessment procedures

Ans: (b)

2. Identify which type of assertion she intends to focus when she wants to ensure genuineness of trade payables. 4.1

- (a) Occurrence
- (b) Cut-off
- (c) Existence
- (d) Accuracy

Ans: (c)

3. As regards comparison of wages of current year and last year and comparison of relationship between the number of employees and wages paid in both years, identify what she is trying to do? 4.1

- (a) She is intending to perform tests of details.
- (b) She is intending to perform tests of transactions.
- (c) She is intending to perform tests of balances.
- (d) She is intending to perform substantive analytical procedures.

Ans: (d)

4. In case of examination of title deeds of “land”, which of the following fits into most appropriate description of such an audit procedure? 4.1

- (a) Observation
- (b) Inspection
- (c) External confirmation
- (d) Enquiry

Ans: (b)

5. She wants to verify whether conversion of foreign currency into Indian rupees is proper or not. Identify what she is trying to do? 4.1

- (a) Performance
- (b) Recalculation
- (c) Observation
- (d) Inspection

Ans: (b)

Test Your Knowledge

1. Which of the following is not one of functions of internal auditor of an organization?

- (a) Performing assurance activities
- (b) Performing consulting activities to improve governance of organization
- (c) Performing risk management activities
- (d) Expressing independent opinion on financial statements of organization

Ans: (d)

2. An auditor finds during course of an audit that the entity has entered into many related party transactions. Which of the following statements is true? 4.7

- (a) The risk that management may override controls in respect of related party transactions is lower.
- (b) The risk that management may override controls in respect of related party transactions is higher.
- (c) There is no effect on the risk that management may override controls in respect of related party transactions.
- (d) Risk of overriding of controls by management has no relationship at all with related party transactions.

Ans: (b)

3. Which of the following is not an objective of a company's policies for ensuring "internal financial controls"? 4.1

- (a) Efficient conduct of business
- (b) Safeguarding of assets
- (c) Prevention and detection of frauds and errors
- (d) Assessing audit risk

Ans: (d)

4. Which of the following is not an advantage of statistical sampling? 4.3

- (a) Sample size does not increase in proportion to size of area tested.
- (b) Sample selection is more objective.
- (c) It provides a means of deriving a calculated risk and corresponding precision.
- (d) In case of verifying compliance with specific legal requirements, it is suitable.

Ans: (d)

5. A company auditor receives external confirmation from an entity to whom company has sold goods. The said amount is properly classified in financial statements of company. Which of the following statements is not true in this regard? 4.5

- (a) It shows that said trade receivable exists.
- (b) It shows that said trade receivable is properly valued.
- (c) It shows that company has a right to said trade receivable.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (d) It shows that amount of said trade receivable has been recorded in proper account.
Ans: (b)

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

Question 1

Purchase invoice is an example of internal evidence.

Answer 1

Incorrect: Internal evidence is the evidence that originates within the client's organisation. Since purchase invoice originates outside the client's organisation, therefore, it is an example of external evidence.

Question 2

Sufficiency is the measure of the quality of audit evidence.

Answer 2

Incorrect: Sufficiency is the measure of the quantity of audit evidence. On the other hand, appropriateness is the measure of the quality of audit evidence.

Question 3

Inquiry alone is sufficient to test the operating effectiveness of controls.

Answer 3

Incorrect: Inquiry along with other audit procedures (for example observation, inspection, external confirmation etc.) would only enable the auditor to test the operating effectiveness of controls. Inquiry alone is not sufficient to test the operating effectiveness of controls.

Question 4

When auditor inquires the management as part of the audit procedures it should be formal written form only and not informal oral inquiries.

Answer 4

Incorrect: When auditor inquires the management as part of audit procedures such inquiries may range from formal written inquiries to informal oral inquiries.

Question 5

Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur.

Answer 5

Incorrect: Assertions refer to representations by management that are embodied in the financial statements as used by the auditor to consider the different types of the potential misstatements that may occur.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 6

The method which involves dividing the population into groups of items is known as block sampling.

Answer 6

Incorrect: The method which involves dividing the population into groups of items is known as cluster sampling whereas block sampling involves the selection of a defined block of consecutive items.

Question 7

Universe refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

Answer 7

Incorrect: Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

Question 8

Non-Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.

Answer 8

Incorrect: Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.

Question 9

Sample need not be representative.

Answer 9

Incorrect: Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

Question 10

The objective of stratification is to increase the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

Answer 10

Incorrect: The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 11

When statistical sampling is used to select a sample, sample need not be representative because the statistical sampling takes care of the representation.

Answer 11

Incorrect: Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

Question 12

Stratified Sampling is used for homogeneous population.

Answer 12

Incorrect: Stratified sampling is used when the population is diversified i.e heterogeneous. The population is divided into sub population having similar characteristics. Sample are then chosen from these sub populations which are called as Stratum. Therefore, stratified sampling is not useful in case of homogeneous population.

Question 13

Non statistical sampling is considered to be more scientific than the statistical sampling.

Answer 13

Incorrect: Statistical sampling uses scientific method of choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non-statistical sampling, auditors' judgment and past experience is used to choose samples without any scientific method.

Question 14

In case of Statistical sampling, auditor's bias in choosing sample is involved.

Answer 14

Incorrect: Statistical sampling uses scientific method choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non statistical sampling, auditor's judgment and past experience is used to choose samples without and scientific method. Hence, personal bias is involved in Non statistical sampling and not Statistical.

Question 15

In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population.

Answer 15

Incorrect: In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

effect of misstatement or deviation. Hence the samples are used to derive conclusion only on the respective stratum from where they are drawn and not the whole population.

Question 16

Low acceptable sampling risk requires larger sample size.

Answer 16

Correct: Sampling risk arises from possibility that the auditor's conclusion based upon sample may be different from conclusion that would have been reached if same audit procedures were applied on the entire population. If acceptable sampling risk is low, large sample size is needed.

Question 17

As per the Standard on Auditing (SA) 520 "Analytical Procedures" 'the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among financial data only.

Answer 17

Incorrect: As per the Standard on Auditing (SA) 520 "Analytical Procedures" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non- financial data.

Question 18

Auditor can depend on routine checks to disclose all the mistakes or manipulation that may exist in accounts.

Answer 18

Incorrect: Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis in addition to reasonable tests.

Question 19

Only purpose of analytical procedures is to obtain relevant and reliable audit evidence when using substantive analytical procedures.

Answer 19

Incorrect: Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Analytical procedures are used for the following purposes:

- (i) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
- (ii) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 20

Analytical Procedures are required in the planning phase only.

Answer 20

Incorrect. 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.

Question 21

Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time.

Answer 21

Incorrect. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.

Question 22

Ratio analysis is useful in analyzing revenue and expense account only.

Answer 22

Incorrect: Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts

Question 23

Reasonableness test rely only on the events of the prior period like other analytical procedures.

Answer 23

Incorrect: Unlike trend analysis, Reasonableness test does not rely on events of prior periods, but upon non-financial data for the audit period under consideration.

Question 24

The statutory auditor of the company can apply analytical procedures to the standalone financial statements of a company only and not to the consolidated financial statements.

Answer 24

Incorrect: Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

Theoretical Questions Answer

Question 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.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 1
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.

Question 2

An auditor is appointed for the first time for audit of accounts of an entity. The accounts of previous year were unaudited. He is unable to obtain sufficient appropriate audit evidence regarding the opening balances. What is his responsibility in this regard?

Answer 2

If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.

Question 3

Discuss some of circumstances when work of the internal auditor cannot be used by external auditor.

Answer 3

The external auditor shall not use the work of the internal audit function if the external auditor determines that:

- (a) The function's organizational status and relevant policies and procedures do not adequately support the objectivity of internal auditors;
- (b) The function lacks sufficient competence; or
- (c) The function does not apply a systematic and disciplined approach, including quality control.

Question 4

Discuss what is understood by "appropriateness" of audit evidence.

Answer 4

Appropriateness: The auditor will need to determine that the population from which the sample is drawn is appropriate for the specific audit objective. Appropriate means population from which the samples are drawn shall be relevant for the specific objective under audit. This is because when the samples are drawn, the audit procedures are applied on the sample and the conclusions are projected on the population.

It is important for the auditor to ensure that the population is appropriate to the objective of the audit procedure, which will include consideration of the direction of testing.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Example

If the auditor's objective were to test for overstatement of accounts receivable, the population could be defined as the accounts receivable listing. On the other hand, when testing for understatement of accounts payable, the population would not be the accounts payable listing, but rather subsequent disbursements, unpaid invoices, suppliers' statements, unmatched receiving reports, or other populations that would provide audit evidence of understatement of accounts payable.

Question 5

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.

Answer 5

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. For example, audit trails can track activities of users thus fixing responsibility for users. These can also be used to rebuild events upon occurring of some problem. 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.

Systems which have a feature of audit trail inspires confidence in auditors. It helps auditors in verifying whether controls devised by the management were operating effectively or not. It aids in verification whether a transaction was indeed performed by a person authorised to do it. Since audit trails also enhance data security, these can be used by auditor while performing audit procedures thus increasing reliability of audit evidence obtained.

Question 6

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

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 6

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.

Question 7

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

Answer 7

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.

Question 8

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?

Answer 8

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.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

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.

Question 9

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?

Answer 9

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.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

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.

Question 10

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. Explain with the help of at least three examples.

Answer 10

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.

Example

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

Question 11

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including sending the requests, including follow-up requests when applicable, to the confirming party. Explain the other points as to when using external confirmation procedures, the auditor would be required to maintain control over external confirmation requests.

Answer 11

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including:

- (a) Determining the information to be confirmed or requested;
- (b) Selecting the appropriate confirming party;
- (c) Designing the confirmation requests, including determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor; and
- (d) Sending the requests, including follow-up requests when applicable, to the confirming party.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 12

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

Answer 12

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.

Question 13

The statutory auditor of MNO Ltd., CA Kishore identifies certain inconsistencies while applying analytical procedures to the financial and non financial data of MNO Ltd. What should CA Kishore do in this case with reference to SA 520 on "Analytical Procedures"?

Answer 13

As per SA 520- "Analytical Procedures" If while applying analytical procedures in accordance with SA 520, the statutory auditor identifies fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

- (i) **Inquiring of management and obtaining appropriate audit evidence relevant to management's responses:** Audit evidence relevant to management's responses may be obtained by evaluating those responses taking into account the auditor's understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit.
- (ii) **Performing other audit procedures as necessary in the circumstances:** The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management's response, is not considered adequate.

In the present case, CA Kishore identifies certain inconsistencies while applying analytical procedures to the financial and non financial data of MNO Ltd. CA Kishore should inquire the management of MNO Ltd. and obtain sufficient and appropriate audit evidence relevant to management response. Further, CA Kishore should also perform other audit procedures if

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

required in the circumstances of the case to obtain further sufficient and appropriate audit evidence.

Question 14

Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain

Answer 14

Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management's expert. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence.

Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

As explained in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. The sufficiency and appropriateness of audit evidence are interrelated.

Question 15

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".

Answer 15

The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:

- (i) Source of the information available. For example, information may be more reliable when it is

| Get Vivitsu Reviewers | Want Lectures? | Test yourself with Test Series |
|---|--|--|
| Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs | Get Vivitsu Recommended lectures at the lowest price | Test yourself Chapter-wise for a better pass percentage |
| www.thevivitsu.com/ca_inter | www.thevivitsu.com/marketplace | www.thevivitsu.com/test_series?id=18 |

obtained from independent sources outside the entity;

- (ii) 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 specialised 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; and
- (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.

The auditor may consider testing the operating effectiveness of controls, if any, over the entity's preparation of information used by the auditor in performing substantive analytical procedures in response to assessed risks. When such controls are effective, the auditor generally has greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The operating effectiveness of controls over non-financial information may often be tested in conjunction with other tests of controls.

Question 16

Define Analytical Procedures.

Answer 16

Meaning of Analytical Procedures: As per the Standard on Auditing (SA) 520 "Analytical Procedures" "the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Thus, analytical procedures include the consideration of comparisons of the entity's financial information with as well as consideration of relationships.

Question 17

M/s PQR and associates are the statutory auditors of TUV Ltd. for the FY 2022-23-. They have been appointed as statutory auditors of TUV Ltd. for the first time. What is the objective of the engagement partner in terms of SA 510?

Answer 17

As per SA 510, "**Initial Engagement- Opening balances**" the objective of the auditor with respect to the opening balances is to obtain sufficient and 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

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

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.

Question 18

What is meant by sufficiency of Audit Evidence? Explain the factors affecting the auditor's judgement as to the sufficiency of audit evidence.

Answer 18

Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality.

Following are the factors affecting the auditor's judgement as to the sufficiency of audit evidence:

- (a) **Materiality:** It may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements. Less evidence would be required in case assertions are less material to users of the financial statements. But on the other hand if assertions are more material to the users of the financial statements, more evidence would be required.
- (b) **Risk of material misstatement:** It may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components described as follows at the assertion level:
 - **Inherent risk**—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.
 - **Control risk**—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control.

Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand, if assertions have a higher risk of material misstatement, more evidence would be required.
- (c) **Size of a population:** It refers to the number of items included in the population. Less evidence would be required in case of smaller, more homogeneous population but on the other hand in case of larger, more heterogeneous populations, more evidence would be required.

Question 19

What is the meaning of Sampling? Also discuss the methods of Sampling. Explain in the light of SA 530 "Audit Sampling".

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 19

Meaning of Audit Sampling: “Audit Sampling” means 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 objective of the auditor when using audit sampling is to provide a reasonable basis for the auditor to draw conclusions about the population from which the sample is selected.

Some of the important methods of selecting the sample are discussed below

- (1) **Random Sampling:** Random selection ensures that all items in the population or within each stratum have a known chance of selection. It may involve use of random number tables. Random sampling includes two very popular methods which are discussed below–

(i) **Simple Random Sampling:** Under this method each unit of the whole population e.g. purchase or sales invoice has an equal chance of being selected. It is considered that random number tables are simple and easy to use and also provide assurance that the auditors’ bias does not affect the selection. *Each item in a population is selected by use of random number table either with a help of computer or picking up a number in a random way (may be randomly from a drum).* Today random numbers are also generated using various applications on the cellphones like the random number generator. This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e. it is suitable for a homogeneous population having a similar range.

(ii) **Stratified Sampling:** This method involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratum. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgment.

- (2) **Interval Sampling or Systematic Sampling:** Systematic selection is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected. Although the starting point may be determined haphazardly, the sample is more likely to be truly random if it is determined by use of a computerized random number generator or random number tables.

When using systematic selection, the auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval corresponds with a particular pattern in the population.

To minimise the effect of the possible known buyers through a pattern in the population, more than one starting point may be taken. The multiple random starting point is taken because it minimises the risk of interval sampling pattern with that of the population being sampled.

- (3) **Monetary Unit Sampling:** It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.
- (4) **Haphazard sampling:** Haphazard selection, in which the auditor selects the sample without

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability **(for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page)** and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.

- (5) **Block Sampling:** This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample. Usually, a range of continuous transaction shall have similar characteristics, therefore, selection of a group at one time will not give a reasonable basis for opinion on the overall population as different types of transactions and unusual transactions may not be covered in the group taken all at once. Further, if the client has the idea of the block selection pattern of the auditor, then material misstatements and deviations can be easily overlooked by management's practice of recording them.

Question 20

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

Answer 20

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.

Question 21

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

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 21

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.

Question 22

Write short notes on the following:

- (a) **Advantages of Statistical sampling in Auditing.**
- (b) **Stratified sampling**

Answer 22

(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.

(b) **Stratified Sampling:** This method involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratum. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgment.

Example

In the above case, trade receivables balances may be divided into four groups as follows:-

- (a) balances in excess of ₹ 10,00,000;

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (b) balances in the range of ₹ 7,75,001 to ₹ 10,00,000;
- (c) balances in the range of ₹ 5,50,001 to ₹ 7,75,000;
- (d) balances in the range of ₹ 2,25,001 to ₹ 5,50,000; and
- (e) balances ₹ 2,25,000 and below.

From these above groups the auditor may pick up different percentage of items from each of the group. From the top group i.e. balances in excess of ₹ 10,00,000, the auditor may examine all the items; from the second group 25 per cent of the items; from the third group 10 per cent of the items; and from the lowest group 2 per cent of the items may be selected.

Random sample is chosen from each stratum using random number tables.

The reasoning behind the stratified sampling is that for a highly diversified population, weights should be allocated to reflect these differences. This is achieved by selecting different proportions from each strata. It can be seen that the stratified sampling is simply an extension of simple random sampling.

Therefore, we can say that random selection method is applied through random number generators, for example, random number tables.

Question 23

What precautions should be taken by the auditor while applying test check techniques?

Answer 23

Precautions to be taken while applying test check techniques are

- Thorough study of accounting system should be done before adopting sampling.
- Proper study of internal control systems.
- Areas which are not suitable for sampling should be carefully considered. Eg: compliance with statutory provisions, transactions of unusual nature etc.
- Proper planning for Sampling methods to be used and explaining the staff,
- Transactions and balances have to be properly classified (stratified)
- Sample size should be appropriately determined.
- Sample should be chosen in unbiased way,

Errors located in the sample should be analysed properly.

Question 24

Explain the factors to be considered while determining the extent of checking on a sampling plan.

Answer 24

The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:

- (i) Size of the organisation under audit.
- (ii) State of the internal control.
- (iii) Adequacy and reliability of books and records.
- (iv) Tolerable error range.
- (v) Degree of the desired confidence.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Audit of Items of Financial Statements

Test Your Understanding

Question 1

A company is engaged in manufacturing of fabrics from yarn purchased from different suppliers. Occasionally, it also manufactures fabrics tailor made in accordance with requirements of certain mills from yarn received from these mills. The company raises bill of its labour charges only on mills for converting yarn into fabrics. The auditor of company tries to ensure that stocks of the company as at year end do not include stocks pertaining to these mills. Which assertion auditor tries to verify in above situation? How he can ensure that?

Answer 1

The auditor is trying to verify assertion relating to “Rights and Obligations”. He is verifying that the company owns or controls the inventory recorded in the financial statements. Any inventory held by the company on behalf of another entity has not been recognized as part of inventory of the company.

This can be achieved by verifying stock records pertaining to goods received from mills and sent back to mills after carrying out necessary operations. Besides, agreements with such mills may also be verified.

Question 2

A company has availed cash credit facility of ₹ 2 crore (O/s balance ₹ 2 crore as at year end) from a bank for meeting its working capital requirements against security of stocks and debtors and guaranteed by directors of the company. Discuss, how the above cash credit facility, would be classified and disclosed in financial statements of company.

Answer 2

It shall be shown under the head “Borrowings” and classified as Short-term secured borrowings specifying nature of security. The above said outstanding amount shall be further sub-classified under heading “Loans repayable on Demand” from Banks. As per requirements of Schedule III of Companies Act, 2013, where loans have been guaranteed by directors or others, aggregate amount of such loans under each head shall be disclosed.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 3

Various ratios of current year and preceding year are disclosed in financial statements of a company in accordance with requirements of Schedule III of Companies Act, 2013. Discuss requirements of law in this regard (Do not list out names of ratios).

Answer 3

A company has to disclose various ratios in its financial statements in accordance with requirements of Schedule III of Companies Act, 2013. The company shall also explain the terms included in numerator and denominator for computing the above ratios. Further explanation shall be provided for any change in the ratio by more than 25% as compared to the preceding year.

Question 4

An auditor of a company is focusing upon revenues of a company. In this regard, besides performing usual detailed checking of sales, he wants to perform substantive analytical procedures in respect of sales. Discuss how he can perform such procedures.

Answer 4

Substantive analytical procedures in respect of sales will consist of sales trend analysis, comparison with previous accounting period, category-wise sales analysis, any analysis the auditor may find relevant and most important of all, building a sales expectation and comparing that with the client's sales records. The auditor will need to know the sales prices of the products or services over the year, monthly average sales price per product or service, discount policy.

Question 5

While verifying depreciation charged to statement of profit and loss account of a company, it is noticed by auditor that one new machinery was purchased and installed in month of April. The necessary trials were carried out and machinery was ready for use in April itself. However, owing to lack of orders in the market, the said machinery was put into actual operation from 1st October. The company has, accordingly, provided depreciation in its books on this machinery w.e.f. 1st October. Is above recording of depreciation by company proper in its books?

Answer 5

Depreciation of an asset begins when it is available for use i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by the management. Depreciation on asset is charged on asset from the date when it is ready for use and not from date of actual usage.

Hence, recording of depreciation by company w.e.f. 1st October is not proper.

CASE STUDY 1

Sunsteel Ltd. is a company engaged in the manufacture of variety of stainless steel household items ranging from hot pot, pressure cooker, cutlery set, bottles, to serving trays.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

The company has its corporate office in Delhi and its plant in Raigarh, a city in the state of Chhattisgarh. The company is planning to expand its manufacturing activities by setting up two new plants in the Raipur district of the state. For this purpose, the company also raised funds by making a follow-on public offer during the financial year 2022-23. R K Maheshwari & Associates are the statutory auditors of the company since the year 2020 -21. The engagement team consisted of 5 members, with CA Raman as the engagement partner, CA Madhu as the senior associate and three articled trainees namely, Aman, Chetanya and Depesh.

The company raised fresh capital of ₹ 5 Cr during the FY 2022-23. The shares with the nominal value of ₹ 10 per share were issued at a premium of ₹ 5 per share.

The company has the Reserves and Surplus totaling to ₹ 2 Cr, comprising of securities premium and general reserve.

CA Raman directed CA Madhu to verify the issue of the share capital in detail giving special consideration to the utilization of the securities premium amount.

The audit engagement team discussed with the management about the performance of the company during the year under consideration. To this, the management told the engagement team that the company is performing very well and the company has doubled its revenue during the year as compared to the last year. The management of the company also told the auditors that during the year the company has made majority of its sales on credit basis to its customers.

CA Raman directed Mr. Aman to send balance confirmation requests to debtors having balance in excess of ₹ 1 lakh.

During the course of audit, CA Raman, Chetanya and Depesh also visited the power plants in Raigarh to get a detailed understanding of the manufacturing process. The team performed analytical procedures to obtain audit evidence with respect to the overall reasonableness of purchase quantity and price of inventory. More specifically, Chetanya collected the reports from the management for composition of stock i.e. raw materials as a percentage of total stock and compared the same with the data of the previous year. CA Raman and Chetanya thereafter, discussed the reasons for the variations with the management.

Also, while considering the presentation and disclosure requirements as per Schedule III to the Companies Act, 2013 CA Madhu discussed with CA Raman the disclosure with respect to the following account balances:

- Current maturities to long term borrowings
- Long term maturities of finance lease obligations
- Interest accrued but not due on borrowings
- Interest accrued and due on borrowings

Based on above, answer the following questions: -

1. Which of the following is not correct with respect to shares issued at premium and securities premium account in terms of Section 52 of the Companies Act, 2013?

- (a) Where a company issues shares at a premium, whether for cash or otherwise, a sum

equal to the aggregate amount of the premium received on those shares shall be transferred to a securities premium account.

- (b) The securities premium account can be applied by the company in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares.
- (c) The securities premium account cannot be applied by the company in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company.
- (d) The securities premium account can be applied by the company for the purchase of its own shares or securities under section 68.

Ans: (c)

2. Which of the following is not an example of capital reserve?

- (a) Revaluation reserve arising from revaluation of fixed assets
- (b) Securities Premium
- (c) Capital redemption reserve
- (d) General reserve

Ans: (d)

3. Statement 1: Confirmations as well as undelivered letters should be given/ returned to the auditor and not to the client.

Statement 2: When no reply is received, the auditor should perform alternate procedures regarding the balances.

- (a) Only statement 1 is correct
- (b) Only statement 2 is correct
- (c) Both statements 1 & 2 are correct
- (d) Both statements 1 & 2 are incorrect

Ans: (c)

4. Mr. Chetanya performed which of the following analytical procedures to obtain the audit evidence with respect to the overall reasonableness of purchase quantity and price of raw material?

- (a) Consumption Analysis
- (b) Stock Composition Analysis
- (c) Reasonableness test
- (d) Ratio analysis

Ans: (b)

5. Which of the following is not correct with respect to the disclosure requirements of Schedule III to the Companies Act 2013?

- (a) Current maturities of long term borrowings is to be disclosed under the head long

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- term borrowings
- (b) Long term maturities of finance lease obligations is to be disclosed under the head long term borrowings
 - (c) Interest accrued but not due on borrowings is to be disclosed under the head Other Current Liabilities
 - (d) Interest accrued and due on borrowings is to be disclosed under the head Other Current Liabilities

Ans: (a)

Test Your Knowledge

Multiple Choice Questions

1. An auditor is verifying purchases to ensure their genuineness. Consequently, he is also trying to verify that no fake “trade payables” are present in financial statements. Which assertions concerning purchase transactions and trade payables respectively are being verified by auditor?

- (a) Occurrence; Existence
- (b) Occurrence; Completeness
- (c) Existence; Occurrence
- (d) Completeness; Occurrence

Ans: (a)

2. Which of the following statement is most appropriate as regards to disclosure of goods in transit in financial statements of a company?

- (a) No separate disclosure of goods in transit is required.
- (b) Disclosure of total goods in transit under head of inventories is required.
- (c) Disclosure of goods in transit under each sub-head of inventories is required.
- (d) Disclosure of goods in transit for raw material and finished goods is required.

Ans: (c)

3. Sweat Equity shares are issued by a company at a discount or for consideration other than cash to its:-

- (a) Directors only
- (b) Clients only
- (c) Directors or employees
- (d) Auditors only

Ans: (c)

4. Which of the following is not an element of cost of an item of machinery included under head “Property, Plant and Equipment”?

- (a) Installation costs
- (b) Freight cost of bringing the item to its location

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (c) Inaugural costs
- (d) Employee benefit cost for making such an item suitable for production

Ans: (c)

5. Which of the classification is not required by a company in respect of its “Cash and cash equivalents?”

- (a) Balance with Banks
- (b) Balance with scheduled banks
- (c) Cash on hand
- (d) Cheques on hand

Ans: (b)

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

Question 1

Employee benefits expenses represent the sum an entity pays to its employees for their labour/ efforts only.

Answer 1

Incorrect: Employee benefits expenses, commonly called payroll expenses, represent the aggregate sum an entity pays to its employees for their labour/ efforts, as well as associated expenses such as perquisites/ benefits, post- employment benefits like gratuity, superannuation, leave encashment, provident fund contribution etc. as well as towards their hiring, their welfare and training.

Question 2

Dividends are recognised in the statement of profit and loss only when the entity’s right to receive payment of the dividend is established.

Answer 2

Incorrect: Dividends are recognised in the statement of profit and loss only when:

- (i) the entity’s right to receive payment of the dividend is established;
- (ii) it is probable that the economic benefits associated with the dividend will flow to the entity; and
- (iii) the amount of the dividend can be measured reliably.

Question 3

“Sweat Equity Shares” means equity shares issued by the company to employees or directors at a premium 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.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 3

Incorrect: “Sweat Equity Shares” means 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.

Question 4

Capital reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose.

Answer 4

Incorrect: Revenue reserves represent profits that are available for distribution to shareholders.

Question 5

A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised.

Answer 5

Correct: A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised. But the amount of share premium or capital redemption reserve account can be utilised only for the purpose specified in Sections 52 and 55 respectively of the Companies Act, 2013.

Question 6

If Company X’s balance sheet shows building with carrying amount of ₹ 100 lakh, the auditor shall assume only one point that the management has only asserted that the building recognized in the balance sheet exists as at the period-end.

Answer 6

Incorrect: If Company X’s balance sheet shows building with carrying amount of ₹ 100 lakh, the auditor shall assume that the management has claimed/ asserted that:

- The building recognized in the balance sheet exists as at the period- end (existence assertion);
- Company X owns and controls such building (Rights and obligations assertion);
- The building has been valued accurately in accordance with the measurement principles (Valuation assertion);
- All buildings owned and controlled by Company X are included within the carrying amount of ₹ 100 lakh (Completeness assertion).

Question 7

The securities premium account may only be applied by the Company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 7

Incorrect: The securities premium account may be applied by the Company:

- (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- (b) in writing off the preliminary expenses of the Company;
- (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- (e) for the purchase of its own shares or other securities under section 68.

Question 8

Material and wages are considered to be revenue expenditure when incurred for construction of building.

Answer 8

Incorrect: Material and Wages incurred on construction of building qualify to be capital expenditure as per AS 10 "Property, Plant and Equipment". Therefore, these have to be added to the cost of the asset i.e building and shall not be expensed off to Statement of Profit and Loss.

Question 9

PPE are depreciated when the asset is actually put to active use.

Answer 9

Incorrect: Depreciation is a fall in value of asset due to obsolescence, usage and effluxion of time. Therefore, depreciation is charged when the asset is ready for use. Active use of asset is not a mandatory criteria for charge of depreciation.

Question 10

Increase in authorised capital of the company requires special resolution to be passed at the general meeting.

Answer 10

Incorrect: Increase in Authorised capital requires alteration of capital clause of memorandum of Association. Therefore, ordinary resolution is passed for increase in authorised capital of the company as per the Companies Act, 2013.

Question 11

Capital redemption reserve can be used for distribution of dividends.

Answer 11

Incorrect: Capital Redemption reserve is not a free reserve. It is a restrictive reserve and can be used only for purposes given in the Act. Since it is not a free reserve, it cannot be utilised for payment of dividends. CRR can be used only for the purpose of issuing fully paid up bonus shares.

| Get Vivitsu Reviewers | Want Lectures? | Test yourself with Test Series |
|---|--|--|
| Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs | Get Vivitsu Recommended lectures at the lowest price | Test yourself Chapter-wise for a better pass percentage |
| www.thevivitsu.com/ca_inter | www.thevivitsu.com/marketplace | www.thevivitsu.com/test_series?id=18 |

Question 12

Dividends are recommended by the Board, and declared by the Shareholders.

Answer 12

Correct: The dividends are recommended by the Board of Directors by passing a resolution at the board meeting. The Shareholders declare the dividends at the AGM by passing an ordinary resolution. Declaration of dividend is an item of ordinary business. However, the shareholders can decrease the amount of dividends recommended by the board but cannot increase it.

Question 13

In verifying Trade Receivables balance, Direct Confirmation Procedure is one of the important audit activity

Answer 13

Correct: While auditing trade receivable balance, direct confirmations as per SA 505, is considered to be the most important audit activity. Direct confirmation can be sought from the debtors directly confirming their balance due. The replies to the confirmation can be then matched with the records maintained by the client. Any discrepancies so revealed, can be investigated and checked in detail for possibility of any risk of material misstatement. Auditor selects few debtors' balances and ask the client to prepare the confirmations properly addressed to the debtors. Auditor maintains strict control over this process.

THEORETICAL QUESTIONS ANSWER

Question 1

How will you vouch and/or verify the following:

- (a) **Goods sent out on Sale or Return Basis.**
- (b) **Borrowing from Banks.**

Answer 1

(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,

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

has been included in the closing inventory.

(b) Borrowing from Banks: Borrowing from banks may be either in the form of overdraft limits or term loans. In each case, the borrowings should be verified as follows-

- (i) Reconcile the balances in the overdrafts or loan accounts with that shown in the pass book(s) and confirm the last mentioned balance by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.
- (ii) Obtain independent balance confirmation from the bank showing balances, particulars of securities deposited with the bank as security for the loans or of the charge created on an asset and confirm that the same has been correctly disclosed and duly registered with Registrar of Companies and recorded in the Register of charges.
- (iii) Verify the authority under which the loan or draft has been raised. In the case of a company, only the Board of Directors is authorised to raise a loan or borrow from a bank.
- (iv) Confirm, in the case of a company, that the restraint contained in Section 180 of the Companies Act, 2013 as regards the maximum amount of loan that the company can raise has not been contravened.

Ascertain the purpose for which loan has been raised and the manner in which it has been utilised and that this has not prejudicially affected the entity.

Question 2

How will you vouch/verify the following:

- (a) Goods sent on consignment.
- (b) Foreign travel expenses.
- (c) Receipt of capital subsidy.
- (d) Provision for income tax.

Answer 2

(a) Goods Sent on Consignment:

- (i) Verify the accounts sales submitted by the consignee showing goods sold and inventory of goods in hand.
- (ii) Reconcile the figure of the goods on hand, as given in the last accounts sales, with the Performa invoices and accounts sales received during the year. If any consignment inventory was in the hands of the consignee at the beginning of the year, the same should be taken into account in the reconciliation.
- (iii) Obtain confirmation from the consignee for the goods held on consignment on the balance sheet date. Verify the terms of agreement between the consignor and the consignee to check the commission and other expenses debited to the consignment account and credited to the consignee's account. The accounts sales also must be correspondingly checked.
- (iv) Ensure that the quantity of goods in hand with the consignee has been valued at cost plus proportionate non-recurring expenses, e.g., freight, dock dues,

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

customs due, etc., unless the value is lower. In case net realisable value is lower, the inventory in hand of the consignee should be valued at net realisable value. Also see that the allowance has been made for damaged and obsolete goods in making the valuation.

- (v) See that goods in hand with the consignee have been shown separately under the head inventories.

(b) 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".

(c) Receipt of Capital Subsidy:

- (i) Check the application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.
- (ii) Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.
- (iii) Ensure that the conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.
- (iv) Check relevant entries for receipt of subsidy.
- (v) Check compliance with requirements of AS 12 on "Accounting for Government Grants" i.e. whether it relates to specific amount or in the form of promoters' contribution and accordingly accounted for as also compliance with the disclosure requirements.

(d) Provision for Income Tax:

- (i) Obtain the computation of income and income tax prepared by the entity and verify whether it is as per the Income-tax Act, 1961 and Rules made thereunder.
- (ii) Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (iii) Examine relevant records and documents pertaining to advance tax, self-assessment tax and other demands.
- (iv) Compute tax payable as per the latest applicable rates in the Finance Act.
- (v) Ensure that overall provisions on the date of the balance sheet is adequate having regard to current year provision, advance tax paid, assessment orders, etc.
- (vi) Ensure that the requirements of AS 22 on Accounting for Taxes on Income have been appropriately followed for the period under audit.

Question 3

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

Answer 3

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.

Question 4

How would you vouch/verify the following:

- (a) **Advertisement Expenses.**
- (b) **Sale of Scrap.**

Answer 4

(a) Advertisement Expenses:

- (i) Verify the bills/invoices from advertising agency to ensure that rates charged for different types of advertisement are as per the contract.
- (ii) See that the advertisement relates to client's business.
- (iii) Inspect the receipt issued by the agency.
- (iv) Ascertain the nature of expenditure – revenue or capital expenditure and see

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

that it has been recorded properly.

- (v) Ascertain the period for which payment is made and see that prepaid amount, if any, is carried to the balance sheet.
- (vi) See that all outstanding advertisement bills have been provided for.

(b) Sale of Scrap:

- (i) Review the internal control as regards generation, storage and disposal of scrap.
- (ii) Check whether the organization is maintaining reasonable record for generation of scrap.
- (iii) Analyze the raw material used, production and generation pattern of scrap and compare the same with figures of earlier year.
- (iv) Check the rates at which scrap has been sold and compare the rate with previous year.
- (v) Vouch sales, with invoices raised, advertisement for tender, rate contract with scrap dealers.
- (vi) Ensure that there exists a proper control procedure to identify scrap and good units and they are not mixed up and sold as scrap.
- (vii) Make an overall assessment of the value of realization from scrap as to its reasonableness.

Question 5

ABC Ltd. has issued shares for cash at a premium. Section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account. Advise the means in which the amount in the account can be applied.

Answer 5

Shares Issued at Premium: In case a company has issued shares at a premium, that is, at amount in excess of the nominal value of the shares, whether for cash or otherwise, section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account and state the means in which the amount in the account can be applied. As per the section, where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and the provisions of this Act relating to reduction of share capital of a company shall apply as if the securities premium account were the paid-up share capital of the company.

Application of securities premium account: The securities premium account may be applied by the Company:

- (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- (b) in writing off the preliminary expenses of the Company;
- (c) in writing off the expenses of, or the commission paid or discount allowed on, any

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- issue of shares or debentures of the company;
- (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- (e) for the purchase of its own shares or other securities under section 68. The auditor needs to verify whether the premium received on shares, if any, has been transferred to a “securities premium account” and whether the application of any amount out of the said “securities premium account” is only for the purposes mentioned above.

Question 6

The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Plant and Equipment) purchase invoices are in the name of the entity he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor.

Answer 6

In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor 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. For all additions to land, building in particular, the auditor should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.

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

Question 7

Write the audit Procedure for verification of existence of Trade Receivables.

Answer 7

For Verification of Existence of Trade Receivables, the auditor should check the following:

- Check whether there are controls in place to ensure that invoices cannot be recorded more than once and receivable balances are automatically recorded in the general ledger from the original invoice.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Ask for a period-end accounts receivable ageing report and trace the balance as per the report to the general ledger.

- ii. Check whether realization is recorded invoice-wise or not. If not, check that money received from debtors is adjusted chronologically invoice-wise and on FIFO basis i.e. previous bill is adjusted first.
- iii. If any large balance is due for a long time, auditor should ask for reasons and justification for the same.
- iv. A list of trade receivables selected for confirmation should be given to the entity for preparing request letters for confirmation which should be properly addressed.
- v. The auditor should maintain strict control to ensure the correctness and proper despatch of request letters. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client.
- vi. Any discrepancies revealed by the confirmations received or by the additional tests carried out by the auditor may have a bearing on other accounts not included in the original sample.
- vii. Where no reply is received, the auditor should perform alternate procedures regarding the balances.
- viii. Agreeing the balance to cash received subsequently;
- ix. Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred. (examination in depth for those balances)
- x. If there are any related party receivables, review them for collectability as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.
- xi. Check that receivables for other than sales or services are not included in the list.

Review a trend line of sales and accounts receivable, or a comparison of the two over time, to check if there are any unusual trends i.e. perform Analytical procedures. Make inquiries about reasons for changes in trends with the management and document the same in audit work papers.

Question 8

MNO & Associates are the statutory auditor of Venus Ltd. for the FY 2021 -22. During the course of audit, one of the audit team members, Mr. Viaan noticed that the company has made loans totaling to ₹ 50 lakhs to the promoters of the company, namely, Mr. Raj and Mr. Rajeev without specifying the period of repayment. Mr. Viaan discussed with Mr. Manik, the engagement partner, about the disclosure requirements with respect to such loans required by Schedule III to the Companies Act, 2013. What should Mr. Manik advise Mr. Viaan?

Answer 8

Mr. Manik should advise Mr. Viaan to consider whether the following disclosures as required by Schedule III to the Companies Act, 2013, has been made in respect of the loans granted to

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

promoters, namely, Mr. Raj and Mr. Rajeev, either severally or jointly with any other person, that are:

- (a) repayable on demand or
- (b) without specifying any terms or period of repayment

| Type of Borrower | Amount of loan or advance in the nature of loan outstanding | Percentage to the total Loans and Advances in the nature of loans |
|------------------|---|---|
| Promoters | | |
| Directors | | |
| KMPs | | |
| Related Parties | | |

Question 9

What are the disclosures requirements as per Part I of Schedule III to the Companies Act, 2013 with respect to the cash & cash equivalents held by a company?

Answer 9

The following are the disclosure requirements as per Schedule III to the Companies Act, 2013, with respect to the cash & cash equivalents held by the company:

Cash and cash equivalents

- (i) Cash and cash equivalents shall be classified as:
 - (a) Balances with banks;
 - (b) Cheques, drafts on hand;
 - (c) Cash on hand;
 - (d) 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.

Question 10

Mercury Ltd. is a company engaged in the manufacture of floor mats. The company sells its goods on credit. The debtors balance as on 31.03.2022 amounted to ₹ 20 cr. What is the disclosure requirement as per Schedule III to the Companies Act 2013, with respect to the ageing schedule of debtors of the company?

Answer 10

The following are the disclosure requirement as per Schedule III to the Companies Act 2013, with respect to the ageing schedule of debtors of the company:

Trade Receivables ageing schedule

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

| | | | | | (Amount in ₹) | |
|---|---|-------------------|-----------|-----------|-------------------|-------|
| Particulars | Outstanding for following periods from due date of payment# | | | | | |
| | Less than 6 months | 6 Months - 1 year | 1-2 years | 2-3 years | More than 3 years | Total |
| (i) Undisputed Trade receivables – considered good | | | | | | |
| (ii) Undisputed Trade Receivables – considered doubtful | | | | | | |
| (iii) Disputed Trade Receivables considered good | | | | | | |
| (iv) Disputed Trade Receivables considered doubtful | | | | | | |

similar information shall be given where no due date of payment is specified, in that case disclosure shall be from the date of the transaction.

Unbilled dues shall be disclosed separately.

Question 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?

Answer 11

Capital-Work-in Progress

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

CWIP ageing schedule

| (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**:

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

| (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.

Question 12

The auditor of Saturn Ltd. wants to verify whether the company has valid legal ownership rights over the inventories recorded in the balance sheet as on 31.03.2023. What audit procedures should the statutory auditor of the company perform?

Answer 12

The statutory auditor of Saturn Ltd. should perform the following audit procedures to verify if the company has valid legal ownership rights over the inventories recorded in the balance sheet as on 31.03.2023. The auditor should:

- vouch recorded purchases to underlying documentation (purchase requisition, purchase order, receiving report, vendor invoice and cancelled cheque or payment file).
- evaluate the consigned goods.
- examine client correspondence, sales and receivables records, purchase documents.
- determine existence of collateral agreements.
- review consignment agreements.
- review material purchase commitment agreements.
- examine invoices for evidence of ownership i.e. the invoices shall be in the name of the client.
- obtain confirmation for significant items of inventory.

For instances of inventory held by third party, the auditor should insist on obtaining declaration from the third party on its business letterhead and signed by an authorized personnel of that third party confirming that the items of inventory belong to the entity and are being held by such third party on behalf of and for the benefit of the entity under audit.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

ILLUSTRATION**Question 1 (Illustration)**

A new team member of the auditors of Extremely Vibrant Limited was of the view that Audit Documentation does not help in planning the audit of any company. Explain whether Audit Documentation has any relation with regard to planning the audit of a company.

Answer 1

Audit Documentation helps in planning the audit of a company in a proper manner and also helps in conducting the audit of that company in a more effective way.

Question 2 (Illustration)

While auditing the books of accounts of Very Careful Limited for the financial year 2020-21, a team member of the auditors of Very Careful Limited was of the view that with regard to audit of the company, no relation exists between Audit File and Audit Documentation. Explain the relationship between Audit File and Audit Documentation.

Answer 2

Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement. 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.

Question 3 (Illustration)

A director of Very Different Limited was of the view that Audit Documentation of a company is the property of that company. Comment on the contention of the director regarding the audit documentation of the company.

Answer 3

Audit Documentation of a company is not the property of the company rather Audit Documentation is the property of Auditor of that company.

Test Your Understanding**Question 1**

During the course of audit of a company, an issue arose relating to treatment of interest costs of company on its restructured loans taken from a bank. This important matter was

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

discussed with CFO of the company and was properly resolved. Is it necessary for the auditor to include in its working papers?

Answer 1

The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

In the instant case, an important matter regarding treatment of interest costs of company on its restructured loans taken from a bank directly impacting profits of the company was discussed. Although issue was resolved, it is necessary to document the same by including detail of the person with whom discussions took place along with date.

Question 2

CA Sonali Morarka has completed audit of a listed company. The audit report dated 15th July, 2022 has been issued. However, audit working papers including record of discussions with management, details of audit procedures performed to obtain audit evidence and conclusions reached by her have not been properly assembled. More than six months have elapsed after issue of audit report. Subsequently, she has received a letter from regulator in connection with audit of the company requesting her to share copy of audit file.

The letter has woken up her from deep slumber. She hurriedly assembled audit file and inserted some more papers which were necessary. However, she put current date on these inserted papers and the copy of audit file was sent to regulator. Discuss, the issues involved, in context of “audit documentation”.

Answer 2

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.

Further, 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. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

In the given case, even after passage of more than six months, she has not assembled audit file. Besides, she has put in some papers with current date which is not permissible at all. It shows that part of audit documentation has been prepared afterwards putting a question mark on quality of audit.

CASE STUDY

CA Rajan Pillai is heading the engagement team conducting audit of a company. While audit is in progress, consider following issues regarding audit documentation:-

(A) Audit programme was prepared assigning responsibilities for different types of works to be performed to team members. The engagement team consists of 4 members

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Mohit (CA final student), Rohit (CA final student), Shobhit (Paid CA) and CA Rajan Pillai (partner of audit firm).

- (B) The team has determined materiality for financial statements as a whole.**
- (C) The team has assessed risks of material misstatements to be low.**
- (D) CA Shobhit is responsible for attending inventory count process and putting down its documentation part.**
- (E) During the course of audit, many related party transactions have come to notice.**

Based on above, answer the following questions: -

- 1. Work relating to verification of revenue was assigned to Mohit in audit programme. However, it is being performed by Rohit actually. Verification of trade receivables was planned to be carried out by Rohit in audit programme. However, it being performed by CA Rajan Pillai due to last minute practical issues. Which of the following statements is most appropriate in this regard relating to audit documentation?**

- (a) Audit programme contains names of persons and work to be performed. It is immaterial whether work assigned to one person is performed by another person.
- (b) Audit programme was already prepared. Only persons assigned specific responsibilities can perform those duties.
- (c) It is necessary that audit programme be suitably updated or notes are given in working papers to this effect so that planned duties are in accordance with actual work performance.
- (d) Changes in audit programme or notes clarifying the matter are required only when a person not forming part of engagement team is deputed to perform a duty. Otherwise, this issue of inter-shuffling of team members is frivolous.

Ans: (c)

- 2. As regards materiality, which of the following statements is most appropriate in context of audit documentation?**

- (a) Materiality has already been determined. There is no need to put it into working papers.
- (b) Materiality depends upon professional judgment of auditor. Whatever amount has been determined can be documented in working papers.
- (c) Materiality arrived on basis of professional judgment along with factors considered in the determination has to be documented.
- (d) Materiality has been arrived upon professional judgment. It also depends upon professional judgment of auditor whether he wants to document it or not.

Ans: (c)

- 3. As regards team's assessment that risk of material misstatements is low, which of the following statements is odd one relating to documentation of risk?**

- (a) Discussion amongst engagement team members and detail of significant decisions reached has to be documented.

- (b) Details of risk assessment procedures have to be documented.
- (c) Details about how understanding of each component of internal control was obtained has to be documented.
- (d) Precise calculation of risk of material misstatements has to be documented.

Ans: (d)

4. CA Shobhit is responsible for attending physical inventory count of the company. Which of the following is not true in this regard relating to audit documentation?

- (a) Dates on which physical inventory count process was attended by him should be documented. It may also include photographs of that date showing his attendance of inventory counting process at a particular location.
- (b) Detail of test counting undertaken should form part of audit documentation.
- (c) Detail of obsolete goods found should form part of audit documentation.
- (d) Reports showing that stocks conform to quality control standards in accordance with law are essential part of audit documentation.

Ans: (d)

5. As regards related party transactions, which of the following should not be part of audit documentation?

- (a) Management representation letter in this regard
- (b) Related party transaction policy of the company
- (c) Documentation to show that such transactions are at arm's length basis
- (d) Documentation to show that such transactions are at close length basis

Ans: (d)

Test Your Knowledge

Multiple Choice Questions

1. Which of the following statement is appropriately suited to preparation of audit documentation?

- (a) Audit documentation has to be prepared simultaneously as audit progresses.
- (b) Audit documentation has to be prepared 60 days after date of audit report.
- (c) Audit documentation has to be prepared when information is required by regulator.
- (d) Audit documentation has to be prepared 60 days after completion of audit work.

Ans: (a)

2. Audit documentation is owned by: -

- (a) Client
- (b) Auditor
- (c) Team member responsible for documentation

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (d) Regulator

Ans: (b)

3. Which of the following is least likely to be included in audit documentation of a company engaged in manufacturing and export of goods?

- (a) Previous years audited financial statements
- (b) Projected cash flow statement for next twelve months provided by management in support of going concern assumption
- (c) Statements showing dispatch of overseas consignments in accordance with delivery schedules of overseas buyers
- (d) Statement showing verification of ageing of trade receivables as on date of balance sheet

Ans: (c)

4. Which of the following is false in relation to audit documentation when an external auditor relies upon work of internal auditor?

- (a) Evaluation of objectivity and competence of internal auditor has to be documented.
- (b) Nature of work used and reason for relying upon work used forms part of documentation.
- (c) Documentation on whether quality control is exercised in internal audit work forms part of audit documentation.
- (d) Documentation on what specific recommendations were given by internal auditor for risk assessment to external auditor forms part of audit documentation.

Ans: (d)

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

Question 1

As per SA 230 on "Audit Documentation", the working papers are not the property of the auditor.

Answer 1

Incorrect: As per SA 230 on "Audit Documentation" the working papers are the property of the auditor and the auditor has right to retain them. He may at his discretion can make available working papers to his client. The auditor should retain them long enough to meet the needs of his practice and legal or professional requirement.

Question 2

Mr. A is a statutory auditor of ABC Ltd. The branch of ABC Ltd. is audited by Mr. B, another Chartered Accountant. Mr. A requests for the photocopies of the audit documentation of Mr. B pertaining to the branch audit.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 2

Incorrect: SA 230 issued by ICAI on Audit Documentation, and “Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

Theoretical Questions Answer
Question 1

The form, content and extent of audit documentation depends upon number of factors. List out any four such factors.

Answer 1

The form, content and extent of audit documentation depend on factors such as:

1. The size and complexity of the entity.
2. The nature of the audit procedures to be performed.
3. The identified risks of material misstatement.
4. The significance of the audit evidence obtained.
5. The nature and extent of exceptions identified.
6. The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
7. The audit methodology and tools used.

Question 2

Discuss any two purposes of audit documentation.

Answer 2

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 SQC 1.
6. Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Question 3

Define audit documentation. Also give some examples.

ICAI Study Material Questions As Free
Audit & Ethics
Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 3

Audit Documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. (terms such as “working papers” or “work papers” are also sometimes used.)

Audit Documentation include:

- Audit programmes.
- Analyses.
- Issues memoranda.
- Summaries of significant matters.
- Letters of confirmation and representation.
- Checklists.
- Correspondence (including e-mail) concerning significant matters.

Question 4

“Audit documentation summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits”. Explain.

Answer 4

The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes-

- the significant matters identified during the audit and
- how they were addressed.

Such a summary may facilitate effective and efficient review and inspection of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist auditor’s consideration of the significant matters. It may also help the auditor to consider whether there is any individual relevant SA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Test Your Understanding**Question 1**

CA PK Jacob is conducting audit of a company for year 2021-22. The company is engaged in export of ethnic rugs to buyers in Europe. The audit is nearing completion in month of July 2022. However, it becomes known to the auditor that one of overseas buyers has made a legal claim against the company on 1st June 2022 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, 2021. The management of company has decided to agree to an out of court settlement of Rs.5 crore to protect its reputation. The financial statements of the company are silent on this issue. Discuss, how, CA PK Jacob should proceed to deal with above issue.

Answer 1

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 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. It provides evidence of conditions that existed at the date of the financial statements and requires adjustment in financial statements.

He should ask company management to make necessary adjustment to the financial statements. If adjustment is not made by management, he should consider impact on auditor's report.

Question 2

CA Chandni Khanna is going to complete audit of a company within next few days. She has performed necessary audit procedures like inquiry of management personnel, reading minutes of meetings held after date of financial statements, going through books of accounts after date of financial statements to make sure that all subsequent events before signing audit report have been considered by her. Still, she wants to be certain that no such events have been left out. What she should do in such a situation? Also, discuss the rationale of doing so.

Answer 2

She has already performed necessary audit procedures like inquiry of management personnel, reading minutes of meetings after date of financial statements and going through books after date of financial statements.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Now, she should request management and, where appropriate, those charged with governance, to provide a written representation in accordance with SA 580, “Written Representations” 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.

The rationale of obtaining written representations is that even after performing abovesaid procedures, she may not come to know all subsequent events. Therefore, it is necessary from an auditor’s point of view to obtain acknowledgment from management in the form of Written representations that all such events for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

Question 3

During course of audit of a company, CA. Varun Aggarwal notices that company is facing significant skilled labour shortages resulting in hampering of operations of company. The company’s manufacturing is dependent upon skilled labour coming from villages in certain districts of Eastern UP. However, due to job opportunities available near villages now, many are not interested in going out from their native villages.

Such a situation has led to company not being able to keep its commitments, losing out on orders and fall in its revenues. Fixed costs of the company remain at a high level. As a result, company is facing a liquidity crunch and is not able to pay its creditors on time. The bankers of company are also not willing to help the company to tide over liquidity crisis. The auditor is having doubts over going concern status of the company. How should management of the company try to address auditor’s concerns? What audit procedures may be performed by auditor in such a situation?

Answer 3

Significant shortage of skilled labour, inability to pay creditors on time and overall liquidity crisis faced by the company are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity’s ability to continue as a going concern. In such a situation, management should try to address auditor’s concerns by preparing its future plan of action including preparation of cash flow forecast showing inflow and outflow of cash. Such a cash flow forecast should address auditor’s concerns regarding liquidity crisis being faced by the company.

The auditor should perform audit procedures to evaluate the reliability of the underlying data to prepare the forecast and determining whether there is adequate support for the assumptions underlying the forecast. The auditor should also consider whether any additional facts or information have become available since the date on which management made its assessment.

Question 4

You are nearing completion of audit of a company. On going through your working papers, it is noticed that finished goods inventory was overvalued by Rs. 2 crore. It has also been

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

noticed that freight of Rs.10 lacs paid on import of machinery was charged to statement of profit and loss. Discuss, how you should, proceed and communicate in above situation before signing audit report.

Answer 4

The instances highlighted in above situation are examples of misstatements identified during the audit. Over valuation of inventory of finished goods by Rs. 2 crore and wrongly charging freight of Rs. 10 lacs paid on machinery to statement of profit and loss instead of capitalizing are examples of misstatements.

The auditor should communicate above identified misstatements to those charged with governance and request for correction of these misstatements. In case, these are not corrected, understand the reasons for not making the corrections and reassess materiality. It should also be considered whether uncorrected statements are material individually or in aggregate. Effect of uncorrected misstatements on the opinion in auditor's report should be communicated to those charged with governance.

Question 5

CA R Gurumurthy is about to complete audit of a company. Before completion, he asks management to provide him a written representation confirming that management has fulfilled its responsibilities regarding preparation of financial statements. He also wants management to confirm in writing about providing of all the necessary information and completeness of transactions to him. The management feels that auditor is seeking irrelevant documents near the completion of audit. Why view of management is not proper? What possible implications it may lead to?

Answer 5

The view of management is not proper. Audit evidence obtained during the audit that management has fulfilled its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities. This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities.

In case of refusal of management to provide such a confirmation, it may lead to disclaimer of opinion by the auditor.

Question 6

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: -

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

“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. 7.3 & Includes concepts of

Answer 6

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.

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 importance of such a control, it should be stated that responsibility be fixed for concerned persons for adhering to such an important control.

CASE STUDY Case Scenario

CA. Gaurav Gogoi is about to conclude audit of a company. It has been noticed during the course of audit that there is shortage of important raw material supplies being imported from China due to prevailing geo-political situation. The company has shared with him its plan to deal with the situation. He is satisfied with assessment of the company for dealing with the matter. The issue is disclosed in financial statements and considering management's assessment, it is felt that use of going concern assumption by company in preparation of financial statements is appropriate.

Besides, he also wants to be sure that all subsequent events till now have been considered and accounted for, where ever necessary, in financial statements.

Before concluding audit, he requests written representations from management regarding its responsibilities. However, it is noticed that such written representations provided by management use qualifying language.

He has also communicated significant findings from audit in writing with those charged with governance in the company and has retained copy of relevant mails. Besides, there are certain matters which were communicated by him orally from time to time during the course of audit to those charged with governance.

Based on above, answer the following questions: -

- 1. As regards description of matter above concerning issue of going concern, which of the following statements is most appropriate for auditor's report? 7.2**
 - (a) The auditor should express an unmodified opinion.
 - (b) The auditor should express a qualified opinion as material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (c) Besides expressing an unmodified opinion, the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" drawing attention to the note in which such disclosure is made in financial statements along with related matters.
- (d) Such an issue does not affect auditor's opinion.

Ans: (c)

2. As regards going concern basis of accounting is concerned, which of the following statements is true? 7.2

- (a) A company showing net loss in its financial statements is essentially not a going concern.
- (b) Following going concern assumption of accounting is primary duty of auditor.
- (c) In case, a company is not a going concern, its financial statements must be prepared on liquidation basis.
- (d) Audit procedure seeking confirmation from banker regarding outstanding balance relates to verification of going concern assumption.

Ans: (c)

3. Which of the following statements is true in respect of auditor's responsibilities in respect of subsequent events? 7.1

- (a) There is no obligation for an auditor to perform audit procedures for events occurring between date of financial statements and date of auditor's report.
- (b) There is no obligation for an auditor to perform audit procedures after signing of auditor's report, even if he comes to know of an event, which if known to him earlier would have caused him to amend the audit report.
- (c) The auditor has only to rely upon written representation of management regarding subsequent events. He has no other means to know about such events.
- (d) The auditor should perform necessary audit procedures to know about events occurring between the date of financial statements and date of auditor's report.

Ans: (d)

4. As regards use of qualifying language in written representations, which of the following statement is most appropriate? 7.4

- (a) It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.
- (b) Written representations should be unconditional. Such a wording is not acceptable.
- (c) Such a wording dilutes intent of written representations. However, it can be accepted by auditor only in exceptional circumstances.
- (d) Qualifying language in written representations is compulsory.

Ans: (a)

5. As regards auditor's responsibility regarding matters communicated orally with those charged with governance, which of following is most appropriate? 7.5

- (a) Matters communicated orally have to be documented by the auditor stating when and to whom these were communicated.
- (b) Matters communicated orally need not be put into writing. It is sufficient for auditor to have communicated orally.
- (c) Matters communicated orally need not be put into writing. It is not practically feasible.
- (d) Matters communicated orally have to be documented by the auditor stating to whom these were communicated.

Ans: (a)

Test Your Knowledge

Multiple Choice Questions (MCQs)

1. An auditor of a company communicates significant findings from audit with those charged with governance in the company. Which of the statements is false in regard to communication made? 7.5

- (a) Evaluation of adequacy of communication process is required on part of the auditor.
- (b) Planned scope and timing of audit has also to be communicated.
- (c) Communication of rationale behind audit procedures is necessary.
- (d) Significant difficulties encountered during audit, if any, have to be communicated.

Ans: (c)

2. Written representations are: - 7.4

- (a) Necessary audit evidence
- (b) Sufficient appropriate audit evidence
- (c) Not audit evidence
- (d) Audit evidence depending upon auditor's professional judgment

Ans: (a)

3. Which of the following is false regarding communication of misstatements identified during course of an audit? 7.5

- (a) The auditor should request those charged with governance for correction of identified misstatements.
- (b) The auditor should obtain written representation acknowledging management belief that effect of uncorrected misstatements is material.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (c) The auditor should obtain written representation acknowledging management belief that effect of uncorrected misstatements is immaterial.
- (d) The auditor should communicate effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

Ans: (b)

4. Which of the following is not an example of subsequent event? 7.1

- (a) Event occurring between date of financial statements and date of auditor's report.
- (b) Event occurring on date of financial statements.
- (c) Event occurring after filing audit report with tax authorities. Had such an event been known earlier, auditor would have amended report.
- (d) Event occurring during course of performing audit procedures after date of financial statements

Ans: (b)

5. Which of the following is not an example of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern? 7.2

- (a) Adverse key financial ratios
- (b) Inability to invest in modernisation of plant
- (c) Inability to pay creditors on time
- (d) Inability to pay salary of staff

Ans: (b)

Descriptive Questions Answer

Question 1

List out some matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency". 7.6

Answer 1

Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process, for example:
 - General monitoring controls (such as oversight of management).

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- Controls over the prevention and detection of fraud.
- Controls over the selection and application of significant accounting policies.
- Controls over significant transactions with related parties.
- Controls over significant transactions outside the entity's normal course of business.
- Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).
- The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.
- The interaction of the deficiency with other deficiencies in internal control.”.

Question 2

In what ways an effective two-way communication between auditor and those charged with governance is important? 7.5

Answer 2

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.

Question 3

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 ascenario? 7.2

Answer 3

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (I) If use of Going concern basis of accounting is inappropriate
 If the financial statements have been prepared using the going concern basis of accounting but, in the auditor's judgment, management's use of the going concern basis of accounting in the preparation of the financial statements is inappropriate, the auditor shall express an adverse opinion.
- (II) If use of going concern basis of accounting is appropriate but a material uncertainty exists
- (A) **Adequate Disclosure of a Material Uncertainty is made in the Financial Statements**
 If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to: -
- Draw attention to the note in the financial statements that discloses such matters.
 - State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.
- (B) **Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements**
 If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:
- Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705.
 - In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.
- (III) **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.

Question 4

Discuss documentation requirements for an auditor regarding misstatements identified during audit under SA 450. 7.3

Answer 4

The audit documentation shall include: -

- The amount below which misstatements would be regarded as clearly trivial;
- All misstatements accumulated during the audit and whether they have been

| Get Vivitsu Reviewers | Want Lectures? | Test yourself with Test Series |
|---|--|--|
| Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs | Get Vivitsu Recommended lectures at the lowest price | Test yourself Chapter-wise for a better pass percentage |
| www.thevivitsu.com/ca_inter | www.thevivitsu.com/marketplace | www.thevivitsu.com/test_series?id=18 |

- corrected; and
- (c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

Question 5

Discuss meaning of "Date the financial statements are issued" under SA 560. 7.1

Answer 5

It reflects the date that the auditor's report and audited financial statements are made available to third parties. The date the financial statements are issued generally depends on the regulatory environment of the entity. In some circumstances, the date the financial statements are issued may be the date that they are filed with a regulatory authority. Since audited financial statements cannot be issued without an auditor's report, the date that the audited financial statements are issued must not only be at or later than the date of the auditor's report, but must also be at or later than the date the auditor's report is provided to the entity.



VIVITSU
 STRIVING TOWARDS KNOWLEDGE

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

ILLUSTRATION**Question 1 (Illustration)**

M/s Smart & Associates are the statutory auditors of Hotmeals Ltd. for the FY 2021-22. How will the auditor address the audit report issued on the financial statements for the FY 2021-22? Also give a title to the report.

Answer 1

INDEPENDENT AUDITOR'S REPORT
To the Members of Hotmeals Ltd.

Question 2 (Illustration)

Richa International is a partnership firm dealing in export of blankets. The partners of the firm are Richa and Ashish. Explain how the statutory auditor of the firm will address the auditor's report.

Answer 2

INDEPENDENT AUDITOR'S REPORT
To the Partners of Richa International

Question 3 (Illustration)

M/s Amitabh & Associates are the statutory auditors of Ringston Ltd. which is a company engaged in the business of manufacture of pen drives. The auditor has started drafting the audit report for the FY 2021-22. CA Amitabh, the engagement partner is of the view that the financial statements of Ringston Ltd. represent a true and fair view. Give the draft of the opinion paragraph of the audit report.

Answer 3**Opinion**

We have audited the financial statements of Ringston Limited which comprise the Balance Sheet as at 31.03.2022 and the statement of Profit and Loss Account and the notes to the financial statements, including a summary of significant accounting policies and other explanatory information.

In our opinion and to the best of our information and according to the explanations given to us, the aforesaid financial statements give the information required by the Act in the manner so required and give a true and fair view in conformity with the accounting principles

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

generally accepted in India, of the state of affairs of the company as at 31.03.2022 and the Profit & Loss for the year ending on that date.

Question 4 (Illustration)

M/s Kite Rite & Associates are the statutory auditors of Prime Deluxe Limited, for the FY 2021-22. At the time of finalising the audit report, one of the engagement team members, Mr. Robin, asked the engagement partner, CA Kite as to what all should be included in the Basis of Opinion Paragraph. The engagement partner CA Kite, explained the team in detail and asked Mr. Robin to draft such section for the auditor's report of Prime Deluxe Limited. Help Mr. Robin to draft the Basis for opinion section.

Answer 4

Basis for Opinion

We conducted our audit in accordance with the Standards on Auditing (SAs) specified under section 143(10) of the Companies Act, 2013. Our responsibilities under those Standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the Code of Ethics issued by the Institute of Chartered Accountants of India together with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013 and the Rules thereunder, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Question 5 (Illustration)

Diamond Shine Ltd. is a company engaged in the manufacture of detergent. M/s Bright & Associates are the statutory auditors of the company. Explain how the paragraph related to the management's responsibility will come in the auditor's report.

Answer 5

Management's Responsibility for the Standalone Financial Statements

The Company's Board of Directors is responsible for the matters stated in section 134(5) of the Companies Act, 2013 ("the Act") with respect to the preparation of these standalone financial statements that give a true and fair view of the financial position, financial performance, (changes in equity) and cash flows of the Company in accordance with the accounting principles generally accepted in India, including the accounting Standards specified under section 133 of the Act. This responsibility also includes maintenance of adequate accounting records in accordance with the provisions of the Act for safeguarding of the assets of the Company and for preventing and detecting frauds and other irregularities; selection and application of appropriate accounting policies; making judgements and estimates that are reasonable and prudent; and design, implementation and maintenance of adequate internal financial controls, that were operating effectively for ensuring the accuracy

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

and completeness of the accounting records, relevant to the preparation and presentation of the financial statement that give a true and fair view and are free from material misstatement, whether due to fraud or error. In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so. Those Board of Directors are also responsible for overseeing the Company's financial reporting process.

Question 6 (Illustration)

M/s Ajay Vijay & Associates are the statutory auditors of Sarovar Ltd. for the FY 2021- 22. The company is engaged in the business of manufacture of water bottles. At the time of finalising the auditor's report, one of the audit team members asked CA Ajay, the engagement partner to advise as to how the auditor's responsibilities can be shown in an appendix to the auditor's report. Draft the auditor's responsibility paragraph so as to advise the audit team member.

Answer 6

Auditor's Responsibilities for the Audit of the Financial Statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is included in appendix X of this auditor's report. This description, which is located at [indicate page number or other specific reference to the location of the description], forms part of our auditor's report.

Question 7 (Illustration)

M/s TUV & Associates are the statutory auditors of Venus Ltd. for the FY 2021-22. At the time of finalising the auditor's report, one of the audit team members asked the engagement partner, CA Tarun, to explain as to how the auditor's report will be signed. Help CA Tarun in explaining the same.

Answer 7

The following is the correct way of signing an audit report.

M/s TUV & Associates
 Chartered Accountants
 (Firm's Registration No.)
 Signature

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

(Name of the Member Signing the Audit Report)
 (Designation)
 (Membership No. XXXXX)
 UDIN:

Place of Signature:
 20037320AAAAAH1111
 Date:

Question 8 (Illustration)

Auditor's Report on Financial Statements of a Listed Entity Prepared in Accordance with a Fair Presentation Framework

For purposes of this illustrative auditor's report, the following circumstances are assumed:

- Audit of a complete set of financial statements of a listed company (registered under the Companies Act, 2013) using a fair presentation framework. The audit is not a group audit (i.e., SA 600 does not apply).
- The financial statements are prepared by management of the entity in accordance with the accounting Standards prescribed under section 133 of the Companies Act, 2013.
- The terms of the audit engagement reflect the description of management's responsibility for the financial statements in SA 210.
- The auditor has concluded an unmodified (i.e., "clean") opinion is appropriate based on the audit evidence obtained.
- The relevant ethical requirements that apply to the audit comprise the Code of Ethics issued by ICAI together with the other relevant ethical requirements relating to the audit and the auditor refers to both.
- Based on the audit evidence obtained, the auditor has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570 (Revised).
- Key audit matters have been communicated in accordance with SA 701.
- Those responsible for oversight of the financial statements differ from those responsible for the preparation of the financial statements.
- In addition to the audit of the financial statements, the auditor has other reporting responsibilities required under the Companies Act, 2013

Question 9 (Illustration)

Super Duper Ltd. is a company engaged in the manufacture of office furniture. M/s Young Old & Associates are the statutory auditors of the company for the FY 2021- 22. During the year under audit, the engagement partner CA Young noticed that the company has not bifurcated its loans into long term and short term. CA Young understands that such misstatement is not pervasive though the same is material. Explain the type of opinion that should be given by M/s Young Old & Associates in this case.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 9

M/s Young Old & Associates should give a qualified opinion as the effect of the misstatement on account of the non-bifurcation of loans into long term and short term loans, is material but not pervasive.

Question 10 (Illustration)

M/s Taj Raj & Associates are the statutory auditors of Porex Ltd. engaged in the manufacture of premium watches, for the FY 2021-22. During the course of audit, CA Taj, the engagement partner found that the stocks and debtors of the company constituting about 80% of the total assets of the company are not realisable. Further, the cashier of the company has committed a fraud during the year under audit. Both the facts are not reflected in the financial statements for the year ending 31.03.2022. Accordingly, CA Taj is of the view that the impact of both the situations on the financial statements is material and pervasive and thus, the financial statements represent a distorted view of the state of affairs of the company. Explain the reporting requirements of CA Taj.

Answer 10

The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

In the case Porex Ltd., CA Taj found that the stocks and debtors of the company constituting about 80% of the total assets of the company are not realisable. Further, the cashier of the company has committed a fraud during the year under audit. Such situations are not reflected in the financial statements of the company despite having a material and pervasive impact on the financial statements. As such, CA Taj should give an adverse opinion.

Further, CA Taj should also consider the reporting responsibilities under CARO 2020 and section 143(12) of the Companies Act, 2013.

Disclaimer of Opinion The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

Question 11 (Illustration)

Delightful Ltd. is a company engaged in the production of smiley balls. During the FY 2021-22 the company transferred its accounts to computerised system (SAP) from manual system of accounts. Since the employees of the company were not well versed with the SAP system, there were many errors in the accounting during the transition period. As such the statutory

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

auditors of the company were not able to extract correct data and reports from the system. Such data was not available manually also. Further, the employees and the management of the company were not supportive in providing the requisite information to the audit team. Explain the kind of audit report that the statutory auditor of the company should issue in this case.

Answer 11

When the statutory auditor of the company is unable to obtain sufficient and appropriate audit evidence, the auditor should give disclaimer of opinion as per SA 705.

In the present case, the statutory auditor of the company is unable to extract correct data and reports from the SAP system for conduct of audit. Also, such data and reports are not available manually. As such, the statutory auditor of Delightful Ltd. should give a disclaimer of opinion.

Question 12 (Illustration)

M/s Daisy & Associates are the statutory auditors of Zebra Ltd. for the FY 2021-22. CA Daisy, the engagement partner wants to verify the cash in hand as on 31.03.2022. The cash balance of the company as on 31.03.2022 is ₹ 1,00,000/- and the turnover of the company for the year is ₹ 6 crores. The management of the company informs CA Daisy that such cash verification is not possible as the cashier is on leave for his marriage and no other employee of the company is available as all are busy in year ending activities. Explain the relevant provisions to deal with such a situation.

Answer 12

If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers is likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

In the present case CA Daisy, the statutory auditor is unable to verify the cash in hand of Zebra Ltd. as on 31.03.2022. The same is due to a limitation imposed by the management of Zebra Ltd. which is due to the non availability of the cashier. In such situation, CA Daisy should perform alternate procedures to verify the cash on hand of the company. Further, CA Daisy should consider the impact on the auditor's report and may consider issuing a qualified opinion in this case.

Question 13 (Illustration)

M/s Sun Moon & Associates are the statutory auditors of Venus Ltd. for the FY 2021-22. Owing to the pervasive nature of material misstatements in the financial statements of the company, CA Moon, the engagement partner decided to give an adverse opinion. Explain the responsibility of CA Moon with respect to communication with those charged with governance.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 13

CA Moon, being the statutory auditor of Venus Ltd. should communicate with those charged with governance about the circumstances that led to the expected modification i.e. an adverse opinion. Further the wording of such modification also needs to be discussed.

Question 14 (Illustration)

Lomaxe Ltd. is a company engaged in the business of manufacture of candles. CA Kamalnath is the statutory auditor of the company for the FY 2021-22. During the year under audit, there was a fire in the company's factory as a result of which, some of the company's plant and machinery was destroyed. The same was disclosed by the company in the notes to accounts annexed to the financial statements for the year ending 31.03.2022. CA Kamalnath decided to communicate this matter in the auditor's report as he is of the view that the matter is of such importance that it is fundamental to the user's understanding of the financial statements. Help CA Kamalnath to deal with this situation in the auditor's report.

Answer 14

In the present case there is a need to add Emphasis on Matter Paragraph in the

Auditor's Report. The draft of the same is as under:

Emphasis of Matter – Effects of Fire in Company's Factory

We draw attention to Note Y of the financial statements, which describes the effects of a fire in the Company's factory. Our opinion is not modified in respect of this matter.

Test Your Understanding
Question 1

Maithili Thakur, a CA student, was perusing audit report of a company. Her eyes fell on an 18-digit alpha numeric number stated at end of audit report below the signatures of auditor and membership number. Make her understand objective and significance of such a randomly generated number. Is it required to be stated in case of audit reports only?

Answer 1

The 18-digit alpha numeric number noticed by her at end of audit report is Unique Document Identification number (UDIN). It is a system generated unique number. Its basic objective is to curb the malpractices of non-CAs impersonating themselves as CAs. It helps in securing reports and documents issued by practicing CAs.

It is required to be stated in case of audit reports and certificates.

Question 2

CA. Maya Memani has conducted audit of a company. She has asked Sana, a CA student undergoing training in her office, to prepare draft audit report. Sana was part of engagement team conducting the audit. She has been further told to prepare draft report expressing unmodified opinion. After drafting para comprising unmodified opinion, Sana feels no need to provide basis for opinion. Discuss why her thinking is not proper.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 2

“Basis for Opinion” is one of basic elements of an audit report in accordance with SA-700. Even in cases where unmodified opinion is expressed by auditor, “Basis for opinion” has to be provided by auditor. Basis for opinion section provides context about auditor’s opinion. Therefore, Sana’s thinking is not proper.

Question 3

CA. Sarasbhai Patel, while conducting audit of an entity, feels that there is an atmosphere of non-cooperation all around. He has not been provided with necessary support for attending inventory count process of entity as at year end. Besides, CFO is not providing him present addresses of customers as well as suppliers for sending external confirmations. Even mail ids have not been provided on the pretext of business confidentiality.

He was not able to verify revenues of entity due to lack of complete details. For verifying expenses, he has been asking for bills on a sample basis, but staff has been making lame excuses. The matter was brought to knowledge of higher echelons of management, but of no avail. The auditor feels that there could be misstatements and their possible effects would be material and affecting many aspects of financial statements.

Assuming it is not possible to withdraw from engagement, what type of opinion should be expressed by auditor?

Answer 3

In the given case, auditor has not been able to obtain sufficient appropriate audit evidence relating to inventories, debtors, creditors, revenues and expenses. The matter has brought to knowledge of management but no result has been achieved. Besides, auditor opines that there could be misstatements and their possible effects could be both material and pervasive. In such circumstances, he should make disclaimer of opinion in accordance with SA 705.

Question 4

CA. Dicky Yadav is auditor of a company having four branches. The four branches are audited by another auditor CA. Yamini Jain. The reports in respect of accounts of branches examined by her have already been sent to company auditor. During the course of audit, CA Dicky Yadav asks the branch auditor to share with her summary of audit procedures and findings in respect of accounts of branches examined. CA. Yamini Jain feels it as encroachment of her domain. Discuss the issue.

Answer 4

As per SA 600 - “Using the Work of Another Auditor”, the principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor’s procedures and findings which may be in the form of a completed questionnaire or check-list. Such review of audit procedures and findings can be undertaken if principal auditor

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

feels that it is necessary to apply such procedures to obtain sufficient appropriate audit evidence. It is not an encroachment of another auditor's domain.

Question 5

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?

Answer 5

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.

CASE STUDY Case Scenario

M/s AB & Company is a firm of Chartered Accountants based in Mumbai. Mr. A and Mr. B are the Partners of the Firm. The Firm is engaged in various assignments including Audits. The partners are taking a summary of their work in order to prepare themselves to finalize the Audit and issue the audit report to various clients. You are requested to go through the following and answer the questions that follow:

- During the audit of M/s Persistent & Co, Mr. A found that the firm has changed the method of Depreciation from WDV to SLM but has not given the retrospective effect. Mr. A has calculated the difference of depreciation but M/s Persistent & Co. has stated that they don't want to change the financial statements and if auditor persists they may give the effect in the next financial year.
- During the audit of M/s Dubious Brothers, Mr B observed that the firm had a very large amount of cash sales and there were no details of the customers to whom the sales were made. Further, cash generated was not even deposited into bank regularly. When Mr. B asked the firm to give him an opportunity to count cash, the manager of the firm said that the cash is with the owner and it cannot be made available to the auditor for the checking purpose. The manager also declined to give an opportunity for stock verification to Mr B.
- During the audit of M/s Honest & Associates, Mr. A came to know that the firm has changed its method of valuation of stock. This change has a material impact on the financial statement of the firm. The firm has made relevant disclosures in the financial

ICAI Study Material Questions As Free

Audit & Ethics

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

statements and has given proper accounting treatment to this exercise.

Based on above, answer the following questions: -

1. In case of M/s Persistent & Company, what would be an ideal Audit Opinion?

- (a) Unmodified
- (b) Qualified
- (c) Mention the fact in Emphasis of Matter Paragraph
- (d) Disclaimer

Ans: (b)

2. In case of M/s Dubious Brothers, what Audit Opinion should the Auditor give?

- (a) Qualified
- (b) Adverse
- (c) Disclaimer
- (d) Unmodified

Ans: (c)

3. According to you, what would be appropriate course to take in case of M/s Honest & Associates?

- (a) Issue Qualified Opinion
- (b) Issue Adverse Opinion
- (c) Mention the fact of change in method in Emphasis of Matter Paragraph
- (d) Issue Disclaimer of Opinion

Ans: (c)

4. When the Auditor, after conclusion of an Audit exercise, is of the opinion that there are material misstatements in the Financial Statements, but they are not pervasive, then what should an Auditor do?

- (a) Issue Unmodified Opinion
- (b) Issue Qualified Opinion
- (c) Issue Disclaimer of Opinion
- (d) Mention it in Emphasis of Matter Paragraph

Ans: (b)

5. When the Auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, Auditor shall give:

- (a) Modified Opinion
- (b) Qualified Opinion
- (c) Disclaimer of Opinion
- (d) Unmodified Opinion

Ans: (d)

Test Your Knowledge

Multiple Choice Questions (Mcqs)

1. While expressing an unmodified opinion on financial statements, the auditor shall not use which of the following phrases?

- (a) present fairly in all material respects
- (b) give a true and fair view
- (c) with the foregoing explanation
- (d) All of the above

Ans: (c)

2. is a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to the user's understanding of the financial statements.

- (a) Emphasis of Matter Paragraph
- (b) Other Matter Paragraph
- (c) Key Audit Matter
- (d) Management Responsibility Paragraph.

Ans: (a)

3. Statement 1: Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements.

Statement 2: Instead of modifying an opinion in accordance with SA 705, the statutory auditor can use Key Audit Matter paragraph in the audit report with an unmodified opinion.

- (a) Only Statement 1 is correct
- (b) Only Statement 2 is correct
- (c) Both the statements are correct
- (d) None of the statement is correct

Ans: (d)

4. Which of the following is not correct?

- (a) SA 700 - Forming an Opinion and Reporting on the Financial Statements
- (b) SA 701- Key Audit Matters in the Independent Auditor's Report
- (c) SA 705- Comparative Information- Corresponding figures and Comparative Financial Statements
- (d) SA 706- Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

Ans: (c)

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

5. Responsibilities of Joint Auditors are governed by:

- (a) SA 200
- (b) SA 229
- (c) SA 299
- (d) SA 230

Ans: (c)

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

Question 1

The auditor shall express a qualified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Answer 1

Incorrect: The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

Question 2

There is no need of addressee in the Auditor's report.

Answer 2

Incorrect: The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement. Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed. The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.

Question 3

The auditor shall modify the opinion in the auditor's report only when the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement.

Answer 3

Incorrect: The auditor shall modify the opinion in the auditor's report when:

- (a) The auditor concludes that, based on the audit evidence obtained, 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.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 4

The auditor shall express a disclaimer of opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Answer 4

Incorrect: The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Question 5

Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements.

Answer 5

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

Question 6

When the auditor has to express an adverse opinion, he need not communicate with those charged with governance as this may have an impact on payment of his audit fees.

Answer 6

Incorrect: When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification.

Question 7

Instead of modifying an opinion in accordance with SA 705, the statutory auditor can use Key Audit Matter paragraph in the audit report with an unmodified opinion.

Answer 7

Incorrect: Communicating key audit matters in the auditor's report is not 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).

Question 8

The concept of "joint audit" has legal foothold under the Companies Act, 2013.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 8

Correct: Under provisions of section 139(3), the members of a company may resolve to provide that audit shall be conducted by more than one auditor. Hence, the concept of “joint audit” has legal foothold also under Companies Act, 2013.

THEORETICAL QUESTIONS ANSWER
Question 1

“The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.” Explain

Answer 1

The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

That conclusion shall take into account:

- Whether sufficient appropriate audit evidence has been obtained;
- Whether uncorrected misstatements are material, individually or in aggregate;
- The evaluations.

Question 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.

Answer 2

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 judgements.

Question 3

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

Answer 3

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

- 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

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (b) The auditor's judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements.

The table below illustrates how the auditor's judgement about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed.

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

Question 4

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

Answer 4

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:

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

Question 5

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. Explain and analyse the indicators of lack of neutrality with examples, wherever required.

Answer 5

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:

- The selective correction of misstatements brought to management's attention during the audit.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Example

- Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.
 - The combination of several deficiencies affecting the same significant account or disclosure (or the same internal control component) could amount to a significant deficiency (or material weakness if required to be communicated in the jurisdiction). This evaluation requires judgement and involvement of audit executives.
- (ii) Possible management bias in the making of accounting estimates.

Question 6

The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion." The Opinion section of the auditor's report shall also identify the entity whose financial statements have been audited. Apart from the above, explain the other relevant points to be included in opinion section.

Answer 6

The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion."

The Opinion section of the auditor's report shall also:

- (a) Identify the entity whose financial statements have been audited;
- (b) State that the financial statements have been audited;
- (c) Identify the title of each statement comprising the financial statements;
- (d) Refer to the notes, including the summary of significant accounting policies; and
- (e) Specify the date of, or period covered by, each financial statement comprising the financial statements.

Question 7

Define Emphasis of Matter Paragraph and how it should be disclosed in the Independent Auditor's Report?

Answer 7

Emphasis of Matter paragraph: A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements.

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (i) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
- (ii) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- the financial statements; and
- (iii) Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

Question 8

"An auditor is required to make specific evaluations while forming an opinion in an audit report." State those evaluations.

Answer 8

Specific Evaluations by the auditor: In particular, the auditor shall evaluate whether :

- (i) The financial statements adequately disclose the significant accounting policies selected and applied;
- (ii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- (iii) The accounting estimates made by management are reasonable;
- (iv) The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- (v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
- (vi) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

Question 9

The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain

Answer 9

Responsibilities for the Financial Statements: The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

This section of the auditor's report shall describe management's responsibility for:

- a) Preparing the financial statements in accordance with the applicable financial reporting

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; [because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and

- b) Assessing the entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

Question 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.

Answer 10

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

Question 11

The auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion". Explain what is included in this "Basis for Opinion" section.

Answer 11

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

- (a) States that the audit was conducted in accordance with Standards on Auditing;
- (b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- (c) 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.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (d) 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.

Question 12

Distinguish between an adverse opinion and a qualified opinion. Also draft an opinion paragraph for both types of opinion.

Answer 12

An auditor shall express an adverse opinion, when the auditor having obtained sufficient and appropriate audit evidence, concludes that misstatements, individually or in aggregate are both material and pervasive.

Whereas, when the auditor, having obtained sufficient and appropriate audit evidence, concludes that misstatements are material but not pervasive, shall express a qualified opinion.

SA705 – “Modifications To The Opinion In The Independent Auditor's Report” deals with the form and content of both types of report. The following are the draft of the opinion paragraphs of the reports.

(a) Adverse Opinion

We have audited the accompanying consolidated financial statements of ABC Company Limited (hereinafter referred to as the “Holding Company”) and its subsidiaries (the Holding Company and its subsidiaries together referred to as “the Group”), its associates and jointly controlled entities, which comprise the consolidated balance sheet as at March 31, 2021, the consolidated statement of profit and Loss, (consolidated statement of changes in equity) and the consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (hereinafter referred to as the “consolidated financial statements”). In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 2021, of its consolidated profit/loss, (consolidated position of changes in equity) and the consolidated cash flows for the year then ended.

(b) Qualified Opinion

We have audited the standalone financial statements of ABC Company Limited (“the Company”), which comprise the balance sheet as at March 31, 2021, and the statement of Profit and Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at (location of branches)) . In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

the Basis for Qualified Opinion section of our report, the aforesaid financial statements give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31st, 2021 and profit/loss, (changes in equity) and its cash flows for the year ended on that date.

Question 13

ABC Ltd is a company incorporated in India. It has branches within and outside India. Explain who can be appointed as an auditor of these branches within and outside India. Also explain to whom branch auditor is required to report.

Answer 13

Sub-section (8) of section 143 of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:

It may be noted that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

Further as per rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

Question 14

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.

Answer 14

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;
- ascertain the reporting objectives of the engagement;
- consider and communicate among all joint auditors the factors that are significant in directing the engagement team's efforts;
- consider the results of preliminary engagement activities, or similar engagements

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

performed earlier.

- (e) ascertain the nature, timing and extent of resources necessary to accomplish the engagement.

Question 15

The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Explain stating the advantages of the joint audit.

Answer 15

Joint Audit: The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This is by itself a great advantage.

In specific terms the advantages that flow may be the following:

- (i) Sharing of expertise.
- (ii) Advantage of mutual consultation.
- (iii) Lower workload.
- (iv) Better quality of performance.
- (v) Improved service to the client.
- (vi) In respect of multi-national companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.
- (vii) Lower staff development costs.
- (viii) Lower costs to carry out the work.
- (ix) A sense of healthy competition towards a better performance

Question 16

Discuss the reporting requirements under CARO 2020, with respect to the moneys raised by the company by way of initial public offer or further public offer and where the company has made any preferential allotment or private placement of shares.

Answer 16

The following are the disclosure requirements as per CARO 2020, with respect to the moneys raised by the company by way of initial public offer or further public offer and where the company has made any preferential allotment or private placement of shares.

- (a) whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;
- (b) whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of noncompliance;

Question 17

Discuss which class of companies are specifically exempt from the applicability of CARO 2020?

Answer 17

CARO 2020 shall apply to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013, except–

- (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
- (ii) an insurance company as defined under the Insurance Act, 1938 (4 of 1938);
- (iii) a company licensed to operate under section 8 of the Companies Act;
- (iv) a One Person Company as defined in clause (62) of section 2 of the Companies Act and a small company as defined in clause (85) of section 2 of the Companies Act; and
- (v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than one crore rupees as on the balance sheet date and 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 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.

STRIVING TOWARDS KNOWLEDGE

ICAI Study Material Questions As Free
Audit & Ethics
Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Special Features of Audit of Different Type of Entities

Test Your Understanding

Question 1

It is the duty of Comptroller and Auditor General of India to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it. Discuss, in above context, what is understood by “Consolidated Fund of India”? What is its importance?

Answer 1

Consolidated Fund of India consists of all the revenue received from direct and indirect taxes, all the loans taken by the Govt. of India and all the amount of repayment of loans received by the Govt. of India. Its importance lies in the fact that all government expenditure is incurred from this fund. No moneys out of the Consolidated Fund of India shall be appropriated except in accordance with law and for the purposes and in the manner provided in the Constitution.

Question 2

CA Akash Virmani is auditor of a partnership firm consisting of 4 partners. During the year, one of the partners has retired and another partner has joined the next day. Discuss, any one point, which shall be considered by you to ensure that financial statements of firm are not misstated due to change of constitution of firm.

Answer 2

The auditor shall consider provisions of retirement deed/partnership deed for date of retiring and joining of partners. It should be ensured that profits are appropriately distributed up to date of retirement. Further, profits after retirement should have been distributed among partners as per terms of new partnership deed.

Question 3

You are auditor of a school operating in your city. During audit of a year, it is noticed that fees concessions to students have been provided in substantial number of cases. Discuss, how, you as an auditor, would proceed to verify the same?

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 3

The fees concessions have to be under proper authority of school management. The auditor would verify internal controls in this regard.

Besides, detailed checking of few cases needs to be undertaken to ensure genuineness of fees concessions and proper management approvals.

Question 4

A society has been formed by pan India employees of a public sector bank. The purpose of society is to promote savings habits of members and to grant loan to them up to a small specified amount. Small savings are promoted amongst members by way of compulsory contribution from monthly salary. Identify type of society and also discuss nature of books of accounts to be maintained by such a society.

Answer 4

The society is in nature of Multi-state cooperative society as it serves interests of members in more than one state. It accepts small savings from its members and grants loan to members. As per Multi-State Co-operative Society Rules 2002, every Multi- State Co-operative society shall keep books of account with respect to: -

- all sum of money received and expended and matters in respect of which the receipt and expenditure take place
- the assets and liabilities
-

CASE STUDY

Consider the following five descriptions: -

- (A) **Audit of “Implementation of Nagpur Metro Rail Project” was conducted by the Comptroller and Auditor General of India.**

Following is extract of few audit findings placed on website cag.gov.in.

“The location of New Airport station was not ideal from the viewpoint of ridership due to sparse population in and around the station and also from the accessibility point of view.

Cotton Market station, the second additional station was projected to have high peak hour peak direction trips but the work was kept on hold midway citing fund crunch due to non-release of pending contribution from stakeholders. However, the situation could have been managed through prioritization of works.”

- (B) **Another set of audit findings in respect of audit of Haryana Power Generation Corporation Limited, a wholly owned government company responsible for operation of power generation plants in state of Haryana is as under: -**

“The main reason for low generation was higher variable cost of thermal power stations which resulted in backing down of plants.”

- (C) **A report was tabled in Parliament highlighting main features of direct taxes administration of country as mandated in Constitution of India. This report primarily discussed compliance to the provisions of the Income Tax Act, 1961 and the associated**

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

rules and procedures etc. as applied to administration of direct taxes including irregularities noticed in finalizing assessments etc.

- (D) Radial finance corporation Limited is a government company. The audit of the company is conducted by statutory auditors appointed by Comptroller and Auditor General of India.
- (E) Bharat Insurance Company Limited is a general insurance government owned company. The statutory auditor is appointed by Comptroller and Auditor General of India.

The annual report for a particular year also contains comments of statutory auditors on matters such as whether company has carried out reconciliations in respect of its inter-company balances with other government owned insurance companies.

Based on above, answer the following questions: -

1. Based upon plain reading of audit findings stated at Para (A), identify type of audit carried out by office of the Comptroller and Auditor General of India.

- (a) Audit against provision of funds
- (b) Propriety audit
- (c) Performance audit
- (d) Compliance audit

Ans: (c)

2. Keeping in view audit findings in respect of Haryana Power Generation Corporation Limited, identify type of audit carried out.

- (a) Audit of Government Company
- (b) Audit against rules and orders
- (c) Compliance audit
- (d) Performance audit

Ans: (d)

3. Which of the following is the most appropriate statement in context of report tabled in Parliament regarding administration of direct taxes?

- (a) It is likely to be a report prepared for submission to the President under Article 151 of the Constitution of India by Comptroller and Auditor General of India.
- (b) It is likely to be a report prepared for submission to the Prime Minister under Article 151 of the Constitution of India by an independent task force of experts.
- (c) It is likely to be a report prepared for submission to the President under Article 151 of the Constitution of India by Central Board of Direct Taxes.
- (d) It is likely to be a report prepared for submission to the Prime Minister under Article 151 of the Constitution of India by Central Board of Direct Taxes.

Ans: (a)

4. Who is empowered to conduct “supplementary audit” in case of Radial finance Corporation Limited, a government company?

- (a) Central Government
- (b) Another independent auditor appointed by CAG
- (c) CAG
- (d) Another independent auditor appointed by Ministry of Corporate Affairs

Ans: (c)

5. As regards comments of auditors specified in respect of audit report of above insurance company, which of the following is likely to be most appropriate statement?

- (a) Such are likely to be comments of test audit carried out by CAG.
- (b) Such are likely to be comments in respect of directions to statutory auditor by CAG for reporting on specific aspect of their audit work.
- (c) Such are likely to be comments of supplementary audit carried out by CAG
- (d) Such are likely to be comments of statutory auditors in accordance with requirements of Standards on Auditing

Ans: (b)

Test Your Knowledge

Multiple Choice Questions (Mcqs)

1. The audit of municipal corporation of a large metro city is in progress. Which of the following is not likely an objective of such as audit?

- (a) To report on the adherence to legal and administrative requirements
- (b) To report on whether value is being fully received for money spent
- (c) To report on the weakness of systems of financial control
- (d) To provide better civic amenities to residents of metro city

Ans: (d)

2. “Save Democracy” is an NGO working in cause of promoting democracy and democratic institutions in many countries including India. Its Indian counterpart has received funds from a renowned “Flower Trust” of US. As auditor of NGO, which of the following laws/orders would be relevant to you in context of above information?

- (a) Income Tax Act, 1961
- (b) Foreign Contribution Regulation Act, 2010
- (c) Companies Act, 2013
- (d) Orders issued by Ministry of Social Justice and Empowerment

Ans: (b)

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

3. The appointment of first auditor of a multi-state cooperative society is made by: -

- (a) Central Registrar
- (b) Board of society
- (c) Members of society
- (d) Central Government

Ans: (b)

4. Consider following revenue sources of Union Government.

(P) Revenues from direct taxes

(Q) Revenues from Goods and Services Tax

(R) Revenues from Custom Duties

(S) Revenues from Excise Duties

Out of P, Q, R and S, which of the following flow to "Consolidated Fund of India"?

- (a) P, Q and R
- (b) P, Q and S
- (c) P and Q
- (d) P, Q, R and S

Ans: (d)

5. An LLP files compliance returns with: -

- (a) Registrar of firms & societies
- (b) Central Registrar
- (c) Registrar of Companies
- (d) Local fund audit wing

Ans: (c)

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

Question 1

Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the Finance Minister may on the advice of the C&AG prescribe.

Answer 1

Incorrect- Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C&AG prescribe.

Question 2

According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 2

Correct- According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations i.e. the expenditure is incurred with due regard to broad and general principles of financial propriety.

Question 3

Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads: (a) general administration and revenue collection, (b) public health, (c) public safety, (d) education, (e) public works, and (f) others such as interest payments.

Answer 3

Correct- Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads: (a) general administration and revenue collection, (b) public health, (c) public safety, (d) education, (e) public works, and (f) others such as interest payments, etc., mostly related to civic amenities and local area development and maintenance.

Question 4

The external control of municipal expenditure is exercised by the Central Government through the appointment of auditors to examine municipal accounts.

Answer 4

Incorrect- The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. However, the municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit.

Question 5

NGOs may be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives.

Answer 5

Correct- NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situations. These would include religious organisations, voluntary health and welfare agencies, charitable organisations, hospitals, old age homes, research foundations etc. The scope of services rendered by NGOs is extremely wide.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 6

The accounts of every LLP shall be audited in accordance with rule 24 of LLP Rules 2009.

Answer 6

Incorrect- Rule 24 of LLP Rules 2009 provides that any LLP, whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty five lakh rupees, is not required to get its accounts audited. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rules.

Question 7

The auditor of an LLP may be appointed by the Designated Partners or other Partners whosoever is available at the time of appointment.

Answer 7

Incorrect- The auditor is to be appointed by the designated partners of the LLP. However, the Partners may appoint the auditors only if the Designated Partners have failed to appoint them.

Question 8

The Comptroller and Auditor General does not have any authority to audit the accounts of stores and inventory kept in any office or department of the Union or of a State.

Answer 8

Incorrect- The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State. Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG.

Question 9

An Operating Lease is a kind of Financing arrangement.

Answer 9

Incorrect- A Finance Lease is a Financing arrangement. An Operating lease, on the other hand, is a simple arrangement where, in return for rent, the lessor allows the lessee to use the asset for a certain period.

Question 10

An auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts in the case of audit of a Hotel.

Answer 10

Correct- The auditor should ensure that proper valuation of occupancy-in- progress at the balance sheet date is made and included in the accounts for proper recording of closing and opening entries and maintenance of accounts on Accrual basis as per the Matching concept.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 11

The first auditor of a Multi-State co-operative Society will be appointed in Annual General Meeting.

Answer 11

Incorrect- Section 70 of the Multi-State Co-operative Societies Act, 2002 provides that the first auditor or auditors of a Multi-State co-operative society shall be appointed by the board within one month of the date of registration of such society and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. If the board fails to exercise its powers under this sub-section, the Multi-State Co-operative Society in the general meeting may appoint the first auditor or auditors.

Question 12

Small LLPs are mandatorily required to get their Books of account audited.

Answer 12

Incorrect- The accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009, which provide that any LLP whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty-five lakh rupees, is not required to get its accounts audited. Further, a Small LLP is any LLP the Contribution of which, does not exceed twenty-five lakh rupees (INR 25,00,000) or such higher amount, not exceeding five crore rupees, as may be prescribed; and the Turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed forty lakh rupees (INR 40,00,000) or such higher amount, not exceeding fifty crore rupees, as may be prescribed; Hence, the provisions of audit are not applicable on Small LLP's. Therefore, the Small LLPs can prepare its financial statement merely with the signatures of the Designated Partners.

Theoretical Questions Answer

Question 1

Discuss, in what circumstances, Central Registrar can hold an inquiry into working and financial condition of a multi-state cooperative society.

Answer 1

When:- The Central Registrar may, on a request from :-

- a federal co-operative to which a Multi- State Co-operative society is affiliated or
- a creditor or not less than one-third of the members of the board or
- not less than one-fifth of the total number of members of a Multi-stateco-operative society,

Question 2

Sporting Club of India is a private club engaged in promotion of sports in the country. As an auditor of this leading club, discuss any two points to ensure that expenditure incurred by club during the year is properly authorised.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 2

- (1) **Pricing** :- 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.
- (2) **Purchases** :- Vouch **purchase** of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.
- (3) **Margins earned** :- Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale price so as to confirm that the normal **rates of gross profit** have been earned on their sales. The inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.
- (4) **Inventories** :- Check the **inventory** of furniture, sports material and other assets physically with the respective inventory registers or inventories prepared at the end of the year.
- (5) **Margins earned** :- Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale price so as to confirm that the normal **rates of gross profit** have been earned on their sales. The inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.
- (6) **Inventories** :- Check the **inventory** of furniture, sports material and other assets physically with the respective inventory registers or inventories prepared at the end of the year.

Question 3

Tomo Construction Engineering LLP approached CA K to understand various returns to be filed by them as part of statutory compliance. Discuss, how, CA K should advise them.

Answer 3

Returns to be maintained and filed by an LLP :-

- ◆ Every LLP would be required to file annual return in Form 11 with ROC within 60 days of closer of financial year. The annual return will be available for public inspection on payment of prescribed fees to Registrar.
- ◆ Every LLP is also required to submit Statement of Account and Solvency in Form 8 which shall be filed within a period of thirty days from the end of six months the financial year to which the Statement of Account and Solvency relates.

Question 4

CA Irfan Zaidi is auditor of a prestigious five-star hotel in Jaipur. He notices that there is a gift shop doing brisk business inside 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.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 4
Travel Agents & Shops -

- (i) For ledgers coming through travel agents or other booking agencies the bills are usually made on the travel agents or booking agencies. The auditor should ensure that money are recovered from the travel agents or booking agencies as per the terms of credit allowed.
- (ii) Commission, if any, paid to travel agents or booking agents should be checked by reference to the agreement on that behalf.

Question 5

A multi-speciality hospital has come up in your city. You are appointed as auditor for first year. Discuss, any four, broad areas to be kept in mind while conducting audit of accounts of such a newly opened multi-speciality hospital.

Answer 5

The special steps involved in such an audit are stated below-

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:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
3. **Income from Investments, Rent etc:** See with reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected.
4. **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
5. **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
6. **Authorization and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
7. **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
8. **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee,

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

significant variations which have taken place.

9. **Internal Check:** Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
10. **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
11. **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
12. **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.
13. **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.

Question 6

You have been appointed as an auditor of an NGO, briefly state the points on which you would concentrate while planning the audit of such an organisation?

Answer 6

While planning the audit, the auditor may concentrate on the following:

- (i) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates.
- (ii) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. Foreign Contribution (Regulation) Act 2010, Societies Registration Act, 1860, Income Tax Act 1961 etc. and the Rules related to the statutes.
- (iii) Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.
- (iv) Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
- (v) Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
- (vi) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
- (vii) Setting of materiality levels for audit purposes.
- (viii) The nature and timing of reports or other communications.
- (ix) The involvement of experts and their reports.
- (x) Review the previous year's Audit Report.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 7

The general transactions of a hospital include patient treatment, collection of receipts, donations, capital expenditures. You are required to mention special points of consideration while auditing such transactions of a hospital?

Answer 7

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:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
3. **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
4. **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.

Question 8

Mention the special points to be examined by the auditor in the audit of a charitable institution running hostel for students pursuing the Chartered Accountancy Course and which charges only INR 500 per month from a student for their lodging/boarding.

Answer 8

The auditor has to ascertain :-

- (a) whether accounts are maintained regularly and in accordance with the provisions of the applicable Act and the rules;
- (b) whether receipts and disbursements are properly and correctly shown in the accounts and money received in the form of donations is being applied as per the objects of the trust and as per the specific direction by the donor, if any.
- (c) whether the cash balance and vouchers in the custody of the manager or trustee on the date of audit were in agreement with the accounts;
- (d) whether all books, deeds, accounts, vouchers or other documents or records required by the auditor were produced before him;
- (e) whether a register of movable and immovable properties is maintained, the changes therein are communicated from time to time to the regional office, and the defects and inaccuracies mentioned in the previous audit report have been duly complied with and rectified.
- (f) whether the manager or trustee or any other person required by the auditor to appear before him did so and furnished the necessary information required by him;
- (g) whether any property or funds of the Trust were applied for any object or purpose other than the object or purpose of the Trust;

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (h) the amounts of outstanding for more than one year and the amounts written off, if any;
- (i) whether any money of the public trust has been invested contrary to the provisions of applicable Act which have come to the notice of the Auditor
- (j) all cases of irregular, illegal or improper expenditure, or failure or omission to recover monies or other property belonging to the public trust or of loss or waste of money or other property thereof, and whether such expenditure, failure, omission, loss or waste was caused in consequence of breach of trust or misapplication or any other misconduct on the part of the trustees or any other person while in the management of the trust
- (k) whether the maximum and minimum number of the trustees is maintained;
- (l) whether the meetings are held regularly as provided in such instrument
- (m) whether the minute books of the proceedings of the meeting is maintained
- (n) whether any of the trustees has any interest in the investment of the trust
- (o) whether any of the trustees is a debtor or creditor of the trust.
- (p) whether anonymous donations received are properly accounted for and donations in cash are not received by the Trust over and above the prescribed limit of accepting cash donations.
- (q) whether the irregularities pointed out by the auditors in the accounts of the previous year have been duly complied with by the trustees during the period of audit.
- (r) any special matter which the auditor may think fit or necessary to bring to the notice of the Deputy or Assistant Charity Commissioner

Question 9

Explain in detail the duties of Comptroller and Auditor General of India

Answer 9

Duties of the C&AG:

- (i) **Compile and submit Accounts of Union and States** - The Comptroller and Auditor General shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account. The Comptroller and Auditor General shall, from the accounts compiled by him or [by the

Government or any other person responsible in that behalf] prepare in each accounts (including, in the case of accounts compiled by him, appropriation accounts) showing under the respective heads the annual receipts and disbursements for the purpose of the Union, of each State and of each Union Territory having a Legislative Assembly, and shall submit those accounts to the President or the Governor of a State or Administrator of the Union Territory having a Legislative Assembly, as the case may be, on or before such dates as he may, with the concurrence of the Government concerned, determine.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

NOTE :- The C&AG Act of 1971 has provisions for relieving him of this responsibility to give information and render assistance to the Union and States: The Comptroller and Auditor General shall, in so far as the accounts, for the compilation or keeping of which he is responsible, enable him so to do, give to the Union Government, to the State Government or to the Governments of Union Territories having Legislative Assemblies, as the case may be, such information as they may, from time to time, require and render such assistance in the preparation of the annual financial statements as they may reasonably ask for.

(ii) **General Provisions Relating to Audit** - It shall be the duty of the Comptroller and Auditor General—

- (a) to audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it;
- (b) to audit and report all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;
- (c) to audit and report on all trading, manufacturing and profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State.

(iii) **Audit of Receipts and Expenditure** - Where anybody or authority is **substantially financed** by grants or loans from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly, the Comptroller and Auditor General shall, subject to the provisions of any law for the time being in force applicable to the body or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him.

Meaning of Substantially financed :- Where the grant or loan to a body or authority from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly in a financial year is not less than ₹ **25 lakhs** and the amount of such grant or loan is not less than 75% of the total expenditure of that body or authority, such body or authority shall be deemed, for this purpose to be substantially financed by such grants or loans as the case may be.

(iv) **Audit of Grants or Loans** - Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly to any authority or body, not being a foreign State or international organisation, the Comptroller and Auditor General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body.

- (v) **Audit of Receipts of Union or States** - It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon.
- (vi) **Audit of Accounts of Stores and Inventory** - The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State.
- (vii) **Audit of Government Companies and Corporations** - The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013. The Comptroller and Auditor-General of India shall appoint the auditor under section 139(5) or 139(7) (i.e. appointment of First Auditor or Subsequent Auditor) and direct such auditor in the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

Question 10

An NGO operating in Delhi had collected large scale donations for Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations.

Answer 10

Receipt of Donations:

- (i) **Internal Control System:** Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.
- (ii) **Custody of Receipt Books:** Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.
- (iii) **Receipt of Cheques:** Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (iv) **Bank Reconciliation:** Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.
- (v) **Cash Receipts:** Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.
- (vi) **Foreign Contributions,** if any, to receive special attention to compliance with applicable laws and regulations.

Remittance of Donations to Different NGOs:

- (i) **Mode of Sending Remittance:** All remittances are through accountpayee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.
- (ii) **Confirming Receipt of Remittance:** All remittances are supported by receipts and acknowledgements.
- (iii) **Identity:** Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.
- (iv) **Direct Confirmation Procedure:** Send confirmation letters to entities to whom donations have been paid.
- (v) **Donation Utilisation:** Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.
- (vi) **System of NGOs' Selection:** System for selecting NGO to whom donations have been sent.

Question 11

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.

Answer 11

Room Sales & Hall Bookings - 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. The source of these entries is invariably the guest register and audit tests should be carried out to ensure that the correct numbers of guests are charged for the correct period.

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.

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. The auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts. The auditor should ensure that proper records are maintained for booking of halls and other premises for special parties and recovered

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

on the basis of the tariff.

Question 12

You are auditing the Books of accounts of Karla Multiplex which runs 15 Film shows everyday. One of the major issues which are of concern to you as an auditor is the Agreement entered into the Multiplex owners with the Film Distributors. State what points would you check as an auditor in this respect.

Answer 12

- (1) Vouch payments on account of film hire with bills of **distributors** and in the process, the agreements concerned should be referred to.
- (2) Examine unadjusted balance out of **advance paid to the distributors** against film hire contracts to see that they are good and recoverable. If any film in respect of which an advance was paid has already run, it should be enquired as to why the advance has not been adjusted. The management should be asked to make a provision in respect of advances that are considered irrecoverable.

Question 13

Define Government Audit & explain its objectives.

Answer 13

Government auditing 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 actions
- 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 :-

- (a) **Accounting for Public Funds:-** Government audit serves as a mechanism or process for public accounting of government funds.
- (b) **Appraisal of Government 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.
- (c) **Base for 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.
- (d) **Administrative accountability:-** Government audit is neither equipped nor intended to function as an investigating agency, to pursue every irregularity or misdemeanour

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

to its logical end. The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration. In India, the function of Government Audit is discharged by the independent statutory authority of the **Comptroller and Auditor General** through the agency of the **Indian Audit and Accounts Department**. Audit is a necessary function to ensure accountability of the executive to Parliament, and within the executives of the spending agencies to the sanctioning or controlling authorities. The purpose or objectives of audit need to be tested at the touchstone of public accountability. The Comptroller and Auditor General (C&AG), in the discharge of his functions, watches that the various authorities act in regard to financial matters in accordance with the Constitution and the laws made by Parliament, and conform to the rules or orders made thereunder.

Question 14

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.

Answer 14

Subscriptions and donations

- (i) Ascertaining, if any, the changes made in amount of **annual or lifemembership** 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.

Question 15

In case of Government entities, audit of accounts of stores and inventories has been developed as a part of expenditure audit. Discuss about the duties and responsibilities entrusted to C&AG.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 15

Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG. Audit is conducted :-

- ◆ to ascertain whether the Regulations governing purchase, receipt and issue, custody, sale and inventory taking of stores are well devised and properly carried out.
- ◆ to bring to the notice of the government any deficiencies in quantities of stores held or any defects in the system of control.
- ◆ to verify that the purchases are properly sanctioned, made economical and in accordance with the Rules for purchase laid down by the competent authority.
- ◆ to ensure that the prices paid are reasonable and are in agreement with those shown in the contract for the supply of stores, and that the certificates of quality and quantity are furnished by the inspecting and receiving units. Cases of uneconomical purchase of stores and losses attributable to defective or inferior quality of stores are specifically brought by the audit.
- ◆ to check the accounts of receipts, issues and balances regarding accuracy, correctness and reasonableness of balances in inventories with particular reference to the specified norms for level of consumption of inventory holding. Any excess or idle inventory is specifically mentioned in the report and periodical verification of inventory is also conducted to ensure their existence. When priced accounts are maintained, the auditor should see that the prices charged are reasonable and have been reviewed from time to time. The valuation of the inventories is seen carefully so that the value accounts tally with the physical accounts and that adjustment of profits or losses due to revaluation, inventory taking or other causes is carried out.

Question 16

Local Fund Audit Wing of a State of a State Government has appointed you to audit the accounts of one of the Local body governed by it. As an auditor, what will be your reporting areas?

Answer 16

The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. However, the municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit.

The important objectives of audit are:

- (a) reporting on the fairness of the content and presentation of financial statements;
- (b) reporting upon the strengths and weaknesses of systems of financial control;
- (c) reporting on the adherence to legal and/or administrative requirements;
- (d) reporting upon whether value is being fully received on money spent; and
- (e) detection and prevention of error, fraud and misuse of resources.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Audit is another method of financial control on local governments. This provision is coupled with the privilege of ultra vires. An action of the local authority if it is beyond legal authority can result in 'surcharge' by audit. This procedure is a legacy of colonial days and even in England it is being resorted to less and less. This may well be because of the increasing competence of the local government authorities.

In addition to the external audit, it is also opined by the learned author that there should be a system of internal audit in all municipal institutions. Internal audit should be provided by the institutions' own staff. It should be performed on a continuous basis according to a well-defined programme. The external auditor should be able to rely upon the work of the internal audit as forming part of a complete system of internal financial control. Where there is no internal audit, as may happen in the case of small or poorly staffed municipalities, the external auditor himself has to do detailed checking. As described under government audit above, increasing attention is being given, to what is described as 'value for money' audit. This kind of audit focuses upon assessment of whether urban institutions are fulfilling their responsibilities with efficiency, economy and effectiveness (sometimes known as 'the three Es').

Question 17

You have been appointed as an auditor of VJM Schools. Discuss the points which merit your consideration as an auditor while verifying Assets and Liabilities of VJM Schools.

Answer 17

Assets & Liabilities :-

1. Report any old heavy arrears on account of fees, dormitory rents, etc. to the Managing Committee.
2. Confirm that caution money and other deposits paid by students on admission, have been shown as liability in the balance sheet not transferred to revenue, unless they are not refundable.
3. See that the investments representing endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.
4. Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorised and passed before payment.
5. Verify the inventories of furniture, stationery, clothing, provision and all equipment etc. These should be checked by reference to Inventory Register or corresponding inventories of the previous year and values applied to various items should be test checked.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 18

State the points which merit consideration in the audit of a CLUB w.r.t its members.

Answer 18

The special steps involved in such an audit are stated below-

- (1) **Entrance Fee** :- 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) **Subscriptions** :- 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) **Arrears of Subscriptions** :- 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) **Arithmetical accuracy** :- Check totals of various columns of the Register of members and tally them across.
- (5) **Irrecoverable Member Dues** :- 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) **Member Accounts** :- Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Test Your Understanding**Question 1**

The financial statements of a bank are prepared in a specified format. Discuss legal provisions in this regard as applicable to financial statements of a nationalized bank.

Answer 1

Sub-sections (1) and (2) of Section 29 of the Banking Regulations Act, 1949 deal with the form and content of financial statements of a banking company and their authentication. These provisions are also applicable to nationalized banks. Every banking company is required to prepare a Balance Sheet and a Profit and Loss Account in the forms set out in the Third Schedule to the Act or as near thereto as the circumstances admit. Form A of the Third Schedule to the Banking Regulation Act, 1949, contains the form of Balance Sheet and Form B contains the form of Profit and Loss Account.

Question 2

Ranjana Ceramic Private Limited is sanctioned a cash credit facility of ₹100 lacs from a branch of LMO Bank. Besides, branch has also sanctioned a one-time bank guarantee of ₹ 10 lacs on behalf of the company in favour of a statutory authority. Discuss, what type of credit facilities have been sanctioned by branch of LMO bank to the company along with probable purpose for each of credit facility.

Answer 2

Cash credit facility sanctioned by bank to company is in nature of funded credit facility. Its purpose is to meet working capital requirements of business. Bank guarantee sanctioned to the company is in nature of non-funded credit facility. Its probable purpose could be requirement of a guarantee by a statutory authority in exchange of company fulfilling some statutory obligations.

Question 3

During course of audit of branch of a nationalized bank, you find that system has generated a report marking ten term loan accounts as SMA. Discuss, meaning of SMA accounts and significance of such a classification.

Answer 3

Special Mention Account (SMA) is an account which is exhibiting signs of incipient stress resulting in the borrower defaulting in timely servicing of debt obligations, though the

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

account has not yet been classified as NPA as per the RBI guidelines. In the given case, ten term loan accounts have been classified as SMA. It means that there are overdues in the accounts for a period of 0 to 90 days. Since period of 90 days has not been exceeded as on the date, such accounts have not been classified as NPA as per RBI norms.

Such a classification is significant as early recognition of such accounts enables banks to initiate timely remedial actions to prevent potential slippages of such accounts into NPAs.

Question 4

CA P is conducting stock audit of a borrower availing cash credit facility of ₹100 lacs from branch of a bank. The cash credit facility is against security of paid stocks and debtors up to 90 days. Margin stipulated is 25% for stocks and 40% for debtors. Following further information is available as on 31.12.22: -

| | |
|--|------------|
| Value of stocks | ₹ 125 lacs |
| Value of stocks (fully damaged) included in above | 5 lacs |
| Value of debtors | 50 lacs |
| Value of debtors exceeding 90 days included in above | 10 lacs |
| Value of creditors for goods | 50 lacs |

Is Drawing Power computed by CA P for ₹ 82.50 lacs proper?

Answer 4

| | |
|--|--------------|
| Value of stocks as on 31.12.22 | ₹ 125 lacs |
| Less: value of damaged stocks | ₹ 5 lacs |
| | ₹ 120 lacs |
| Less: creditors for goods as on 31.12.22 | ₹ 50 lacs |
| Value of Paid stocks | ₹ 70.00 lacs |
| Less: Margin @ 25% | ₹17.50 lacs |
| Drawing power (A) | ₹ 52.50 lacs |
| Value of debtors as on 31.12.22 | ₹ 50 lacs |
| Less: debtors exceeding 90 days | ₹ 10 lacs |
| | ₹40 lacs |
| Less: Margin @ 40% | ₹ 16 lacs |
| Drawing Power (B) | ₹ 24 lacs |
| Drawing Power (A+B) | ₹ 76.50 lacs |
| The drawing power calculated by CA P is not proper. Drawing Power comes to ₹ 76.50 lacs. | |

Question 5

You are verifying interest on deposits paid by branch of a nationalized bank. Discuss, any two “analytical procedures”, to verify interest on deposits paid by branch.

Answer 5

The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter. From such information, the auditor may work out a weighted average interest rate. The auditor may then compare this rate with the actual average rate of

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

interest paid on the relevant deposits as per the annual accounts and enquire into the difference, if material.

The auditor should also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyze any material differences.

CASE STUDY

CA M is conducting statutory audit of branch of MMC Bank. During the course of audit, it is noticed as under:-

- (i) Loans under “Kisan credit card” are given by Bank to farmers to meet their short-term credit needs for cultivation of crops.

In respect of one agricultural advance classified under “Kisan Credit Card” having an outstanding balance of ₹ 20 lacs as at year end, there is no transaction in account since last 90 days. The said loan has been granted for cultivation of paddy which is harvested in a period of 3-4 months from sowing. The branch has classified the said advance as “Standard asset”.

- (ii) It is also observed that account of one borrower availing cash credit limit of ₹50 lacs was taken over from another bank. The proposal was sanctioned by branch manager instead of immediate next higher authority as required in “Manual of Delegation of Powers” of Bank.
- (iii) It is noticed that head office of bank has flagged a savings account maintained in branch in which interest was wrongly paid at higher rate due to wrong data feeding entry. Now, situation has been rectified by debiting excess interest paid in the account. Since there was little balance in savings account, a debit balance of ₹1.50 lac was created in the said savings account due to above reversal. The matter was immediately informed to account holder. However, he has not turned up for payment since matter was informed to him about six months ago.
- (iv) There are many cash credit accounts in the branch. Such borrowers are required to submit monthly stock statements to branch showing calculation of drawing power.
- (v) One borrower has availed a housing loan and a car loan from the branch. Housing loan EMIs are overdue for 120 days as on date of Balance sheet. Car loan EMIs are overdue for 60 days as on date of Balance sheet.

Based on above, answer the following questions: -

1. As regards description of agricultural advance, which of the following statements is most appropriate in this regard?

- (a) The branch has erred in making classification as per RBI norms. It is a “Sub-standard” asset.
- (b) The classification made by branch is proper. However, there are no transactions in

account since last 90 days, it is SMA.

- (c) The classification made by branch is proper.
- (d) The branch has erred in making classification as per RBI norms. It is a “doubtful” asset.

Ans: (c)

2. Regarding taken over account from another bank, which of following statements is most appropriate?

- (a) It is an internal issue of Bank and auditor is not concerned with it.
- (b) It is an internal issue of Bank. However, the auditor may, at his discretion, report it.
- (c) It is a serious violation of laid down procedures of bank for sanction of advances and should be reported by auditor without fail.
- (d) There is no issue involved as credit facility was properly sanctioned.

Ans: (c)

3. As regards debit balance of ₹ 1.50 lacs in Savings account, which of the following is correct from point of view of an auditor?

- (a) The situation does not attract RBI norms on asset classification.
- (b) The debit balance of ₹1.50 lacs should be classified as NPA.
- (c) The situation does not attract RBI norms on asset classification as nocredit facility was granted.
- (d) The bank cannot demand excess interest paid to account holder.

Ans: (b)

4. Which of the following statements is not true about “drawing power” (DP)?

- (a) Drawing Power refers to the amount calculated based on primary securityless margin as on particular date.
- (b) It is always less than sanctioned limit.
- (c) It can be different from sanctioned limit.
- (d) Creditors for goods are reduced for purpose of calculating DrawingPower.

Ans: (b)

5. Considering housing loan and car loan availed by a borrower, which of the following statements is appropriate?

- (a) Both Housing loan as well as car loan should be classified as “Non- Performing Assets” in accordance with RBI norms on asset classification.
- (b) Housing Loan should be classified as “Non-Performing Asset” in accordance with RBI norms on asset classification. However, Car loanshould be classified as Standard asset.
- (c) Car Loan should be classified as “Non-Performing Asset” in accordance with RBI norms on asset classification. However, Housing Loan should be classified as

Standard asset.

- (d) Both Housing as well as car loans should be classified as Standard assets.

Ans: (a)

Test Your Knowledge

Multiple Choice Questions

1. Which of the following is included in "Interest Earned" in Profit & loss A/c of a bank?

- (a) Discount on Bills
- (b) Loan Processing fees
- (c) Commission on bills for collection
- (d) Credit Card Fees

Ans: (a)

2. While auditing advances of a bank as statutory auditor, which of the following is not a likely concern of auditor?

- (a) Appropriate documentation of advances
- (b) Ensuring budgeted targets of advances given by bank management
- (c) Compliance of sanctioned terms and conditions
- (d) Operations in advance accounts

Ans: (b)

3. Any amount due to the bank under any credit facility is 'overdue' if: -

- (a) it is not paid on the due date fixed by the bank
- (b) it is not paid within 30 days of due date fixed by the bank
- (c) it is not paid within 60 days of due date fixed by the bank
- (d) it is not paid within 90 days of due date fixed by the bank

Ans: (a)

4. Which of the following statement is true regarding appointment of statutory branch auditor of a nationalized bank?

- (a) The appointment is made by bank acting through its board of directors with prior approval of Central govt.
- (b) The appointment is made by bank acting through its board of directors with prior approval of RBI
- (c) The appointment is made by bank acting through its board of directors with prior approval of ICAI
- (d) The appointment is made by shareholders in AGM.

Ans: (b)

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

5. Identify the correct statement: -

- (a) Income from non-performing assets is recognized on accrual basis
- (b) Income from non-performing assets is never recognized.
- (c) Income from non-performing assets is recognized on basis of actual recovery
- (d) Income from non-performing assets is recognized only when such assets are upgraded to standard assets

Ans: (c)

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

Question 1

RBI has been entrusted with the responsibility of regulating the activities of commercial banks only.

Answer 1

Incorrect. RBI has been entrusted with the responsibility of regulating the activities of commercial and other banks. All the Banks and even NBFC's fall under the regulatory function of RBI.

Question 2

In the computerised environment, the auditor need not be familiar with latest applicable RBI guidelines.

Answer 2

Incorrect. In the Computerised environment, it is imperative that the auditor is familiar with, and is satisfied that, all the norms/parameters as per the latest applicable RBI guidelines are incorporated and built into the system that generates information/data having a bearing on the classification/ provisions and income recognition.

Question 3

The auditor can assume that the system generated information is correct and relied upon.

Answer 3

Incorrect. The auditor should not go by the assumption that the system generated information is correct and can be relied upon without evidence that demonstrates that the system driven information is based on validation of the required parameters for the time being in force and applicable.

Question 4

Collateral security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 4

Incorrect. 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. Collateral security is in addition to the Primary security.

Question 5

Registered mortgage is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof

Answer 5

Incorrect. Registered Mortgage can be affected by a registered instrument called the 'Mortgage Deed' signed by the mortgagor. It registers the property to the mortgagee as a security. Equitable mortgage, on the other hand, is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof.

Question 6

Any amount due to the bank under any credit facility is 'overdue' if it is not paid within 90 days of becoming due.

Answer 6

Incorrect. Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank and 90 days of becoming overdue.

Question 7

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.

Answer 7

Correct. An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet; or credits are there but are not enough to cover the interest debited during the same period.

Question 8

Banks recognize income on Non-Performing Assets on accrual basis.

Answer 8

Incorrect: Income from non-performing assets (NPA) is not recognised on accrual basis due to its uncertainty but is booked as income only when it is actually received i.e. on actual receipt basis.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 9

Auditor of a Nationalised bank is to be appointed at the annual general meeting of the shareholders.

Answer 9

Incorrect- Auditor of a nationalized bank is to be appointed by the bank concerned acting through its Boards of Directors and approval of the Reserve bank is required before the appointment is made.

Question 10

Reporting of fraud of INR 150 Lakhs by auditor will be done within three days of the fraud coming to the knowledge of the auditor to the Board or the Audit Committee along with remedial action taken in case of audit of ABA Bank Ltd.

Answer 10

Incorrect- The auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days.

The Banking Company is bound to disclose remedial action taken in Board's report.

Question 11

Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets.

Answer 11

Correct: Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets, but regarded as NPA for Income Recognition purpose.

Theoretical Questions Answer

Question 1

Discuss outline of audit approach including audit procedures while auditing "provisions and contingencies" in financial statements of a bank.

Answer 1

For audit of Provisions and contingencies the auditor should :-

- ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled.
- obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets. The auditor may verify the loan classification on a sample basis.
- obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation.
- examine the other provisions for expenses vis-a-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

Question 2

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

Answer 2

Assess the Risk of Fraud including Money Laundering: 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.

Question 3

List out any four points which highlight peculiarities involved in banking operations.

Answer 3

Peculiarities involved:

- Huge volumes and complexity of transactions;
- Wide geographical spread of banks' network;
- Large range of products and services offered;
- Extensive use of technology;
- Strict vigilance by the banking regulator etc.

Question 4

Is statutory auditor of a bank required to report on the requirements relating to Companies (Auditor's Report) Order, 2020?

Answer 4

It is pertinent to mention that the reporting requirements relating to the Companies (Auditor's Report) Order, 2020 is not applicable to a banking company, as defined in clause (c) of Section 5 of the Banking Regulation Act, 1949.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 5

Account of a borrower availing cash credit facility from branch of a bank has become “Out of order.” Discuss the term “Out of order”.

Answer 5

Out of Order: An account should be treated as ‘out of order’ if:-

- the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
- In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet ; or
- credits are there but are not enough to cover the interest debited during the same period, these accounts should be treated as ‘out of order’.

Question 6

The functioning of banking industry in India is regulated by the Reserve Bank of India (RBI) which acts as the Central Bank of our country. Explain

Answer 6

Reserve Bank of India: Regulating Body

The functioning of banking industry in India is regulated by the Reserve Bank of India (RBI) which acts as the Central Bank of our country.

RBI is responsible for :-

- development and supervision of the constituents of the Indian financial system (which comprises banks and non-banking financial institutions)
- determining, in conjunction with the Central Government, the monetary and credit policies keeping in with the need of the hour.
- regulating the activities of commercial and other banks

Important functions of RBI are :-

- issuance of currency;
- regulation of currency issue;
- acting as banker to the central and state governments; and
- acting as banker to commercial and other types of banks including term- lending institutions. Besides, RBI has also been entrusted with the responsibility of regulating the activities of commercial and other banks.

No bank can commence the business of banking or open new branches without obtaining license from RBI. The RBI also has the power to inspect any bank.

Question 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

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

misstatements of the financial statements. All these discussions should be appropriately documented for future reference". Explain.

Answer 7

Engagement Team Discussions: All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement are known to be the "Engagement Team". 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. The discussion between the members of the engagement team and the audit engagement partner should be done on the susceptibility of the bank's branch financial statements to material misstatements. These discussions are ordinarily done at the planning stage of an audit.

The engagement team discussion ordinarily includes a discussion of the following matters:

- (a) Errors that may be more likely to occur;
- (b) Errors which have been identified in prior years;
- (c) Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
- (d) Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
- (e) Need to maintain professional skepticism throughout the audit engagement;
- (f) Need to alert for information or other conditions that indicates that a material misstatement may have occurred (e.g., the bank's application of accounting policies in the given facts and circumstances).

Advantages of such a discussion :-

- 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 procedure 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.

Question 8

Write a short note on reversal of income under bank audit.

Answer 8

Reversal of Income:

- (a) If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (b) In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.
- (c) Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s).
- (d) Furthermore, the auditor should enquire if there are any large debits in the Interest Income account that have not been explained. It should be enquired whether there are any communications from borrowers pointing out differences in interest charge and whether appropriate action has been taken in this regard.



VIVITSU
 STRIVING TOWARDS KNOWLEDGE

ICAI Study Material Questions As Free

Audit & Ethics

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Ethics And Terms of Audit Engagements

Test Your Understanding

Question 1

CA P. Suryakantam has conducted audit of accounts of an entity for a particular year. ICAI has issued a letter to him relating to certain matters concerning audit. He didn't even bother to reply to the letter despite reminders. Discuss which fundamental principle governing professional ethics is disregarded by him.

Answer 1

Failure to reply to professional body smacks of lack of courtesy and professional responsibility. The principle of "Professional behaviour" is disregarded.

Question 2

A Chartered accountant in practice issued a certificate showing original cost of plant and machinery installed in premises of a client for Rs. 9 crores to save some regulatory fees for his client. However, original cost of plant and machinery was Rs.15 crore as per records of client. Which fundamental principle governing professional ethics is violated in this case?

Answer 2

"Integrity" requires that a professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information contains a materially false or misleading statement; contains statements or information provided negligently or omits or obscures required information where such omission or obscurity would be misleading.

In the given case, a false certificate is knowingly issued showing misstated original cost of machinery. Therefore, fundamental principle of "integrity" is violated.

Question 3

CA Raman Gupta is offered appointment as auditor of a company. One of his distant uncles held some shares in the same company. Holding of such shares, by a distant relative, is not prohibited under provisions of law nor does it affect his independence. Before he could accept appointment, he received unfortunate news of death of his uncle who had died without any children. He came to know that he was nominee of these shares having substantial value. It landed him in a tricky situation. What should be proper course of action for him?

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 3

When threats to independence 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.

Holding of shares involves financial interest in the company and is in nature of self-interest threat. He has come to hold shares due to nomination made by his distant relative before accepting the appointment. Considering above, he should take steps to eliminate the threat by selling shares immediately before accepting appointment. Holding of shares of the same company for which he is offered appointment as auditor constitutes threat to his independence.

Question 4

A Chartered accountant receives about 40% of his total audit fees from a single client. Discuss how it could affect independence of Chartered accountant as auditor of this client. What are such types of threats referred to as?

Answer 4

Undue dependence on fees of a client constitutes a threat as there is fear of losing the client. Such threats are referred to as self-interest threats.

Question 5

CA Murli Madhavan provides accounting and book keeping services to a leading NGO engaged in environmental protection work. He is also offered audit of the accounts of NGO. Identify and discuss what kind of threat to independence may be involved in accepting such an engagement.

Answer 5

In this case, Chartered Accountant is already rendering accounting and book keeping services to an NGO. If he accepts audit, he would be involved in reviewing own work. Therefore, the same constitutes "self-review" threat.

Question 6

The auditors of a company have only relied upon management representation letter regarding treatment of certain tax matters under appeal by the company. The auditors have not carried out any other audit procedures to justify management's treatment of the said tax matters under appeal in the financial statements. What is lacking on part of auditors in such a situation?

Answer 6

In the given case, auditors have relied only upon management representation letter regarding treatment of certain tax matters under appeal by the company. No other audit procedures to verify management's treatment of such matters under appeal have been performed by auditors. It shows lack of "professional skepticism" on part of auditors.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 7

Chirag, as part of articled training, is part of an engagement team conducting audit of a company. He has read somewhere that engagement letter issued by auditor to client also includes expected form and content of the auditor's report. He was at a loss to understand how could an auditor include form and content of the report beforehand. Try to help Chirag by making things clear to him.

Answer 7

Engagement letter includes reference to expected form and content of audit report. It merely states that auditor would provide opinion in this form. However, engagement letter also includes statement that the form and content of report may need to be amended in the light of audit findings. Therefore, if in light of audit findings, auditor needs to give a modified opinion, he shall do so.

Question 8

The management of an entity feels that it is not necessary for it to give in writing explicitly to the auditor that it understands its responsibilities for preparation of financial statements in accordance with applicable financial reporting framework. Discuss, whether, it is necessary for the management to do so. In case management refuses, why should an auditor not accept the proposed engagement?

Answer 8

It is necessary for management to give in writing explicitly to the auditor that it understands its responsibilities for preparation of financial statements in accordance with applicable financial reporting framework. It is a necessary precondition for an audit in accordance with SA 210.

If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement: -

- (a) If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable or
- (b) If the agreement of management is not obtained on matters relating to understanding of responsibility of management on preparation of financial statements, internal controls for preparation of financial statements, providing access to all information to auditor and unrestricted access to persons within the entity.

Unless required by law or regulation to do so, such a refusal on the part of auditor is necessary as management is not willing to accept its responsibility for preparation of financial statements in accordance with applicable financial reporting framework. An audit is conducted on this basic premise according to SA 210. When basic premise on which audit is conducted is not fulfilled, refusal by auditor is necessary.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Question 9

CA PK Nair is offered appointment as auditor of a company engaged in providing tourism services. While making due diligence of the proposed client, he comes to know that there have been raids on premises of the company and residences of its directors by National Investigation Agency (NIA) on suspicion of links with terror outfits. It has been followed up with searches by Enforcement Directorate hunting for illicit money trail. There is a strong suspicion of tourism services provided by company being façade of terror funds. Should proposed offer be accepted by him?

Answer 9

Integrity of principal owners has to be considered before accepting an audit engagement in accordance with SA 220. In this regard, SA 220 states requirements on lines of SQC 1. SQC 1 clearly states that in cases where there are indications that the client might be involved in money laundering or other criminal activities, appointment should not be accepted.

In the instant case, there have been raids of NIA on suspected links with terror outfits which is a criminal activity. Further, raids by Enforcement Directorate also point towards money laundering. Therefore, proposed offer should not be accepted.

Question 10

CA Arpita has joined a mid-sized CA firm recently. She finds that partners remain too busy and the firm

is proposing to accept audit work in areas in which it has no experience or capabilities. The firm is proposing to accept audit of some entities engaged in emerging “fin-tech” sector. Such audits may be requiring extensive use of technology and data analytics. However, the said firm has no such capabilities and trained personnel. Discuss, whether, firm should accept such audits with reason.

Answer 10

SQC 1 requires that before accepting an engagement, competence (including capabilities, time and resources) to perform engagement have to be considered.

In the given case, the proposed engagements involve use of technology and data analytics. The firm has no prior experience of audits in emerging “fin- tech” sector. The firm does not have trained personnel to carry out these audits. Hence, offer for these audits should not be accepted.

CASE STUDY

Das & Co, a firm of auditors, is offered appointment as auditor of a company, a prospective new client. CA Sukanya, one of partners, is dealing with new client. While meeting with officers of the company, she comes to know that Sushant, CFO of the company, was her class mate. In fact, both of them had started CA together. However, Sushant had left CA

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

mid-way due to repeated failures and tried his luck to pursue MBA (finance) from one of leading institutions.

During initial discussions, it transpires that company is going to launch new services in the field of “weather-forecasting”. Such services would be available on web site of company and micro weather information would be available on payment of charges. The company requests audit firm to be visibly associated with their marketing blitz.

Assume that firm choses to accept the offer and writes to previous auditor, Walker & Co., to advise whether there exist any professional reasons for them not to accept the proposed offer. However, Walker & Co. do not reply to the request of Das & Co.

During preliminary discussions, it also became known that the said company has acquired all shares of another company. Under relevant provisions of law, financial statements of both companies needed to be consolidated and audited. Despite this knowledge, Das & Co. failed to advise their client regarding audit of consolidated financial statements.

The company also offers auditors contract for providing IT services pertaining to information system of company.

1. Considering discussion about Sukanya and Sushant, which of the following statements seems most appropriate?

- (a) The above discussion is irrelevant in context of proposed offer.
- (b) The proposed offer should be accepted by firm. The engagement team may be headed by CA Sukanya for better coordination and results.
- (c) The proposed offer should be accepted by firm. The engagement team may be headed by a different partner of the firm.
- (d) The matter is too trivial to be reported by CA Sukanya to other partners of firm.

Ans: (c)

2. Keeping in view request of the company to be visibly associated with company’s new services, identify which type of threat is being faced by audit firm.

- (a) Self-interest threat
- (b) Familiarity threat
- (c) Self-review threat
- (d) Advocacy threat

Ans: (d)

3. The previous auditors, Walker & Co., have not replied to communication of Das & Co. Which fundamental principle of professional ethics is not followed by them?

- (a) Objectivity
- (b) Professional behaviour
- (c) Professional competence and due care
- (d) Integrity

Ans: (b)

4. Das & Co. have failed to advise the company regarding audit of consolidated financial statements. Which fundamental principle of professional ethics is violated by Das & Co.?

- (a) Professional behaviour
- (b) Integrity
- (c) Objectivity
- (d) Professional competence and due care

Ans: (d)

5. Which of the following statements is most appropriate regarding providing offer of work of IT services by auditors to the company?

- (a) Such offer may create a self-review threat.
- (b) Such offer may create an advocacy threat.
- (c) Such offer does not constitute any threat.
- (d) Such offer may create self-review and advocacy threats

Ans: (a)

Test Your Knowledge

Multiple Choice Questions (Mcqs)

1. Identify the most appropriate statement:

- (a) SA 220 applies at the level of firm.
- (b) SQC 1 is premised on the basis that firm is subject to SA 220.
- (c) SA 220 is premised on the basis that firm is subject to SQC 1.
- (d) SA 220 applies to all engagements.

Ans: (c)

2. Professional skepticism includes-

- (a) Overlooking unusual circumstances.
- (b) Using inappropriate assumptions in determining extent of audit procedures.
- (c) Over generalising when drawing conclusions from audit observations.
- (d) Being vigilant to conditions that might indicate possibilities of fraud.

Ans: (d)

3. Which of the following is not a fundamental principle governing professional ethics?

- (a) Professional competence and due care
- (b) Integrity
- (c) Objectivity
- (d) Safeguards to independence

Ans: (d)

4. Which of the following is not necessary to establish preconditions for an audit?

- (a) Acceptability of financial reporting framework.

ICAI Study Material Questions As Free

Audit & Ethics

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (b) Acknowledgment of cooperation from management in designing audit procedures.
- (c) Acknowledgment from management of providing access to persons within company.
- (d) Acknowledgment of management in understanding its responsibility for preparation of financial statements.

Ans: (b)

5. Identify the most appropriate statement in context of SQC 1.

- (a) Assembly of engagement files should be completed in not more than 60 days after date of auditor's report in case of audit engagements.
- (b) Engagement files should be completed before date of auditor's report in case of audit engagements.
- (c) Engagement files should be completed in not more than 60 days after completion of an engagement.
- (d) Engagement files should be completed on date on which audit report is signed in case of audit engagements.

Ans: (a)

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

Question 1

The audit engagement letter is sent by the client to auditor.

Answer 1

Incorrect: As per SA 210 "Agreeing the Terms of Audit Engagements", the Audit engagement letter is sent by the auditor to his client.

Question 2

The Audit Engagement documentations should ordinarily be retained by the auditor for minimum of six years from the date of the auditor's report or the date of the group auditor's report, whichever is later.

Answer 2

Incorrect: SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

Theoretical Questions Answer

Question 1

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

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 1

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.

Question 2

How application of professional skepticism throughout audit is helpful in reducing audit risk?

Answer 2

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.

Professional skepticism is necessary to the critical assessment of audit evidence. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount. The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary.

Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud, the SAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism.

Question 3

A Chartered accountant is conducting audit of a client for last two years. Before proceeding to start audit for next year, he notices that there is substantial change in management. Besides, client has ventured into areas of business activity which were not present at time

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

of accepting initial audit engagement. Discuss responsibility of auditor in this regard in context of SA 210.

Answer 3

Recurring audit is an audit which is performed by an auditor over years. On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

- (i) Any indication that the entity misunderstands the objective and scope of the audit.
- (ii) Any revised or special terms of the audit engagement.
- (iii) A recent change of senior management.
- (iv) A significant change in ownership.
- (v) A significant change in nature or size of the entity's business.
- (vi) A change in legal or regulatory requirements.
- (vii) A change in the financial reporting framework adopted in the preparation of the financial statements.
- (viii) A change in other reporting requirements.

Question 4

How does SQC 1 ensure that independence in engagements is not breached by an audit firm?

Answer 4

The firm's system of quality control should include policies and procedures addressing each of the following elements: -

- (A) Leadership responsibilities for quality within the firm
- (B) Ethical requirements
- (C) Acceptance and continuance of client relationships and specific engagements
- (D) Human resources
- (E) Engagement performance
- (F) Monitoring

Quality control policies and procedures should be documented and communicated to the firm's personnel. By communicating, the firm recognizes the importance of obtaining feedback on its quality control system from its personnel. Therefore, the firm encourages its personnel to communicate their views or concerns on quality control matters.

Question 5

An engagement partner takes overall responsibility for maintaining audit quality in an audit engagement in accordance with SA 220. What are his objectives in taking and emphasizing such responsibility?

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Answer 5

Leadership responsibility of an engagement partner is to take responsibility for the overall quality on each audit engagement. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise

- (a) The importance to audit quality of: -
 - (i) Performing work that complies with professional standards and regulatory and legal requirements;
 - (ii) Complying with the firm's quality control policies and procedures as applicable;
 - (iii) Issuing auditor's reports that are appropriate in the circumstances; and
 - (iv) The engagement team's ability to raise concerns without fear of reprisals.
- (b) The fact that quality is essential in performing audit engagements.



VIVITSU
 STRIVING TOWARDS KNOWLEDGE

ICAI Study Material Questions As Free
Audit & Ethics
Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Case Scenario 1

M/s Vishwacharya and Associates, a CA firm based in Orissa, is appointed as an auditor of CBF Bank for the financial year 2023-24. During the course of audit, it came to notice that CBF Bank has sanctioned an overdraft facility of ₹ 75 lakh to Times Ltd. However, as per the stock statement furnished for the last quarter, the drawing power was calculated to be ₹ 50 lakh. It was observed that few advances were guaranteed by the

- (i) Central Government as part of 'Make in India' initiative. However, the guarantee was not invoked, and the advances were overdue by 95 days. These advances were classified as standard assets and were regarded as NPA for income recognition purpose.
- (ii) State Government as part of 'Power Generation' initiative. However, the guarantee was not invoked, and the advances were overdue by 80 days. These advances were also classified as standard assets and were regarded as NPA for income recognition purpose.

Additionally, XYZ Ltd., is a borrower availing cash credit facility of ₹ 110 Lakh against security of paid stocks and debtors up to 90 days. Margin stipulated was 25% of stock and 40% for debtors. Bank has calculated drawing power based on following information provided by XYZ Ltd.

| Particulars | Amount (₹) |
|---|------------|
| Value of Stocks (as on 31.12.2023) | 130 lakh |
| Value of Debtors (as on 31.12.2023) | 75 lakh |
| Value of stocks (Fully damaged and included in (i) above) | 7 lakh |
| Value of Debtors (exceeding 90 days included in (ii) above) | 10 lakh |
| Value of Debtors (exceeding 90 days included in (ii) above) | 60 lakh |

Also, the outstanding balance in one of the Loan accounts was ₹ 25 Lakh and the realisable value of the security as assessed by the bank / approved valuers was ₹ 2.25 Lakh. Bank identified the same as erosion in the value of security. It was classified as doubtful category and provision was made for the doubtful assets. A discussion also took place among the team members regarding issuance of the audit reports after completion of the bank audit and annexure to the same such as Long Form Audit Report, Report on compliance with SLR Requirements, Report on Treasury Operations – as per RBI guidelines, Report on compliance as per Ghosh committee recommendations and Report on adverse credit - lending ratio in the rural areas, etc.

Based on the above, answer the following: -

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

1. With respect to the overdraft facility sanctioned to Times Ltd., the account would be termed as out of order if:
- (i) The outstanding balance remains continuously in excess of ₹ 75 Lakh.
 - (ii) The outstanding balance remains continuously in excess of ₹ 50 Lakh.
 - (iii) The outstanding balance in the account is less than ₹ 75 Lakh but there are no credits or payments deposited into the account continuously for 90 days as on balance sheet date
 - (iv) The outstanding balance is less than ₹ 50 Lakh.

Choose the correct option from below:

- (a) (i), (ii) and (iii)
- (b) (i), (iii) and (iv)
- (c) (ii), (iii) and (iv)
- (d) (iii) and (iv)

Ans: (a)

2. Which of the treatment by the bank on the provisioning and income recognition is correct in case of bank guarantee given by the Central Government and State Government?
- (a) Both (i) and (ii) are correct
 - (b) Only (ii) is correct
 - (c) Only (i) is correct
 - (d) Both (i) and (ii) are incorrect.

Ans: (c)

3. In the given case drawing power of the borrower XYZ Limited should be:

- (a) ₹ 86.25 Lakh
- (b) ₹ 76.35 Lakh
- (c) ₹ 96.25 Lakh
- (d) ₹ 85.45 Lakh

Ans: (a)

4. The Bank has identified an erosion in the value of security and made provision for doubtful assets. Whether the treatment by bank for the doubtful asset is correct?
- (a) Yes. The security should be classified under doubtful category. It may be either written off or fully provided by the bank.
 - (b) No. The existence of such security should be ignored, and the asset should straight away be classified as loss asset. It may be either written off or fully provided by the bank.
 - (c) Yes. The security should be classified under doubtful category and provisioning should be made as applicable for doubtful assets.

- (d) No. The existence of the security should be ignored, and the asset should straight away be classified as loss asset. Provisioning should be made for doubtful assets.

Ans: (b)

5. The Statutory Central Auditors of a bank must furnish, in addition to the main audit report, various other audit reports. From the options, choose the audit reports that M/s Vishwacharya and Associates shall furnish.

- (i) Long Form Audit Report
- (ii) Report on compliance with SLR Requirements
- (iii) Report on Treasury Operations – as per RBI guidelines
- (iv) Report on compliance as per Ghosh committee recommendations
- (v) Report on adverse credit - lending ratio in the rural areas.

Choose the correct answer:

- (a) (i), (ii), (iii), (iv) and (v)
- (b) Only (i), (ii), (iii) and (iv)
- (c) Only (i), (ii) and (iii)
- (d) Only (i), (ii) and (v)

Ans: (b)

Case Scenario 2

Pluto Limited is engaged in the manufacturing and distribution of furniture. After Covid, as the number of people working from home has gone up, this customisable range home office furniture has gained lot of importance. They were able to perform very well over the years and the same has been reflected in their financial statements.

During the year 2023-24, M/s Saha and Associates was reappointed as the auditor. The new engagement team has CA Saha (partner) and five article assistants. Given the large volume of transactions, the partner instructed the article assistants to review the financial statements and auditor's report from the previous year, 2022- 23, to gain a thorough understanding. While reviewing the summary page, one of the article Kabir noticed that few points were under discussion with the partner before finalising the audit:

The team verified the following points with respect to employee benefit expenses:

- The employee benefit expenses recorded in the books were actually incurred during the relevant period.
- The expenses in respect of all personnel have been accounted for.
- The expenses recognised during the period are pertaining to the current accounting period.

It was also noted that dividend to equity shareholders for the year 2022-23, was declared on 15.04.2023 and was recognised as liability in the year 2022-23.

Another article Krish noticed that debtors constitute a major component of the company's financial statements. As part of audit procedure, the auditor requested the client to obtain external confirmations from the parties. For this, a list of all the debtors were obtained and

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

a random sampling was performed by the auditor. The client directly obtained the selected debtor confirmations from the customers on time.

Krish also observed addition in the assets amounting ₹ 50 lakhs during the year supported by sufficient audit evidence. However, upon scrutiny, it was found that some of the invoices were not in the name of the company. Further, Cash and cash equivalents were classified as balances with banks, cheques and drafts on hand, cash on hand and earmarked balances with banks (e.g. unpaid dividend).

Based on above, answer the following questions: -

1. Which among the following assertions are discussed with respect to the employee benefit expenses?

- (i) Measurement
- (ii) Occurrence
- (iii) Cutoff
- (iv) Completeness

Choose the correct combination from below:

- (a) (i), (ii) and (iv)
- (b) (ii), (iii) and (iv)
- (c) (i), (iii) and (iv)
- (d) (i), (ii) and (iii)

Ans: (b)

2. Whether disclosure of dividend under the liability head during the year 2022- 23 is appropriate?

- (a) Yes. It should be recognised in the same year irrespective of the year of declaration as the amount of dividend belongs to year 2022-23.
- (b) No. The amount should be recognised equally between two financial years.
- (c) No. The amount should not be recognised as a liability. It should be disclosed in the notes to accounts.
- (d) No. The amount should neither be recognised as liability nor disclosure is required in the financial statements.

Ans: (c)

3. Which assertion has been affected in the case of fixed assets?

- (a) Existence
- (b) Rights and obligation
- (c) Completeness
- (d) Measurement.

Ans: (b)

4. Cash and cash equivalents were not properly classified by the client. Which of the following is incorrect disclosure of the same?

- (a) Balances with banks

- (b) Cheques and drafts on hand
- (c) Cash on hand
- (d) Earmarked balances with banks (e.g.: unpaid dividend)

Ans: (d)

Case Scenario 3

Priority Limited is a large company engaged in manufacturing of terry towels making steady profits on a year-to-year basis. PMR & Associates, statutory auditors of the company since last two years, are in process of establishing audit strategy for conducting statutory audit under the Companies Act, 2013 for year 2023-24.

The company has 5 branches which are audited by independent auditors appointed under the Companies Act, 2013. It also has a wholly owned subsidiary company which is audited by another audit firm under name of JKL & Associates. The engagement team has noticed that company has maintained several bank accounts and there is substantial movement in fixed deposits during the year leading to risk of misstatement in cash and cash equivalents. The engagement team has planned procedures regarding the same.

- (i) At the planning stage, engagement partner is also trying to set materiality for financial statements as a whole. The following information extracted from financial statements is given as under: -

| Particulars | (Amount in ₹ crores) |
|--------------------------------------|----------------------|
| Revenue | 100 |
| Total Assets | 40 |
| Profit before Tax | 8 |
| Total Liabilities (excluding Equity) | 30 |

- (ii) While designing a sample for verifying revenues of company as part of tests of details, engagement partner has determined “tolerable misstatement” for ₹ 5.00 Lakh in order to address the risk that aggregate of individual immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements. One of the newly joined engagement team members has little conceptual understanding of “tolerable misstatement” determined by engagement partner. He also has no idea of the effect of change in tolerable misstatement on sample size.
- (iii) During course of audit, while performing tests of details, engagement team has come across certain misstatements in selected sample pertaining to verification of revenues. The team has projected misstatements to population of revenues. The team wants to comply with the Standards on Auditing strictly.

Based on the above, answer the following: -

1. The auditors of the company are in the process of establishing an audit strategy. Which of the following is not a relevant factor in establishing overall audit strategy in the given case scenario?

- (a) Consideration of 5 branches which are audited by independent auditors
- (b) Consideration of wholly owned subsidiary company audited by another audit firm
- (c) Expected time of holding AGM in accordance with provisions of the Companies Act, 2013
- (d) Nature, timing and extent of planned procedures for cash and cash equivalents

Ans: (d)

2. For Priority limited, which benchmark would the engagement partner most likely to use for setting materiality for the financial statements as a whole?

- (a) A percentage of Revenue
- (b) A percentage of Total assets
- (c) A percentage of Profit before tax
- (d) A percentage of Total liabilities (excluding equity)

Ans: (c)

3. In the given case scenario, assume that the engagement partner has decided to increase tolerable misstatement to ₹ 10.00 Lakh while designing sample described. Select the correct statement.

- (a) It would lead to decrease in sample size.
- (b) It would lead to an increase in sample size.
- (c) It would have no effect on sample size.
- (d) It is not possible to draw inference on sample size due to increase in tolerable misstatement.

Ans: (a)

4. While performing procedures on designed sample, the engagement team identified certain misstatements in selected sample and projected these to the entire population of revenues. According to the requirements of the Standards on Auditing, which statement is correct in this regard?

- (a) Anomalous misstatement is auditor's best estimate of misstatement in population.
- (b) The projected misstatement plus anomalous misstatement, if any, is best estimate of misstatement in population.
- (c) When projected misstatement exceeds tolerable misstatement, sample provides a reasonable basis for conclusion about tested population.
- (d) When projected misstatement plus anomalous statement, if any, exceeds tolerable misstatement, sample provides a reasonable basis for conclusion about tested population.

Ans: (b)

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

Case Scenario 4

Bandhu Charitable Trust is considering the appointment of MNO & Associates, Chartered Accountants, as independent auditors of its financial statements. The Trust is engaged in providing affordable healthcare services. It is in interest of both auditor and client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent. It is, therefore, important that each party should be clear about the nature of engagement. It should exactly specify the scope of the work. Such an “engagement letter” is exchanged between Trust management and auditors.

While performing audit procedures, it is noticed by auditors that bills of two vehicles are not in name of Trust but in name of trustees. However, payment of these vehicles was made from bank account of Trust. The said vehicles are used for activities of Trust.

It is also noticed that the sum of ₹ 50.00 Lakh is reflected in Trust’s financial statements in name of Gamma Instrument and Equipment in schedule of creditors. The said amount is outstanding since two years. The auditors sent confirmation request to the said supplier and seek management’s co-operation in this regard. However, management of the Trust informs the auditor regarding certain dispute going on with the supplier of equipment due to some quality issues. It is further informed that dispute is near settlement and it would not be proper to send confirmation request as it can affect negotiation process.

Based on the above, answer the following :-

1. As regards exchange of engagement letter between Trust management and auditors is concerned, which of the following statements is likely to be true?

- Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It includes reference to the expected form and content of report to be issued by them and a statement that there may be circumstances in which such report may differ from its expected form and content.
- Engagement letter is sent by Bandhu Charitable Trust to MNO & Associates. It includes reference to the expected form and content of report to be issued by auditors. However, it does not include a statement that such report may differ from its expected form and content.
- Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It includes reference to expected form and content of report to be issued by them. However, it does not include a statement that such a report may differ from its expected form and content.
- Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It does not include reference to the expected form and content of report to be issued by them.

Ans: (a)

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

2. Considering the issues related to vehicles as described in the case study, identify the most appropriate statement.

- (a) Auditors have identified misstatement concerning “Existence” assertion made by Trust management.
- (b) Auditors have identified misstatement concerning “Rights and Obligations” assertion made by Trust management.
- (c) Auditors have identified misstatement concerning “Accuracy” assertion made by Trust management.
- (d) Auditors have identified misstatement concerning “Completeness” assertion made by Trust management.

Ans: (b)

3. What course of action should the auditor take regarding the amount payable to the equipment supplier when management has communicated that sending a confirmation request could negatively impact the negotiation process?

- (a) The auditor should issue adverse opinion in auditor’s report.
- (b) The auditor should seek audit evidence as to the validity and reasonableness of the reasons for refusal and perform alternative audit procedures.
- (c) The auditor should withdraw from engagement as Trust management’s refusal is a limitation on scope of independent audit.
- (d) The auditor should disclaim opinion in auditor’s report.

Ans: (b)

Case Scenario 5

Dhanush, a CA student undergoing articles, is part of an engagement team conducting audit of Test Enterprises Private Limited. The company is engaged in business of conducting aptitude and language tests every fortnight at centres spread all over major cities of country for Indian students desirous of applying to foreign universities. It also sells books containing model test papers for the benefit of students.

The company has substantial number of computers at each center to enable seamless experience for students appearing for standardized aptitude and language tests. The company has acquired new identifiable software involving substantial expenditure for conducting tests during the year which is expected to drive company’s revenues in coming years. At the time of taking a test, a CD containing software is run in each system for enabling students to take tests. Cost of CD without software is nominal.

The revenue of the company during the year 2023-24 was ₹ 50 crores (₹ 45 crores from fees charged from students and ₹ 5 crores from sale of books). Besides, company has also received ₹ 10 lacs as interest on certain investments during the year. The company has a history of profitable operations.

During the course of audit, it is noticed by Dhanush that computers form significant chunk of PPE items in financial statements of company. The company has taken useful life of

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

computers consisting of desktops for 3 years. However, depreciation charged on computers in financial statements of the company is higher than depreciation allowable under Income tax law. It results in lower accounting income as per books of accounts of company as compared with taxable income under Income tax law.

During the course of audit, he notices that the cost of CDs along with software cost is treated as an intangible asset by company. It is also part of his responsibility to verify PPE register in accordance with audit programme. On perusing details in PPE register, he finds that some computers have moved from one center to another center to meet business requirements. Further, many computers were disposed of or scrapped in earlier years. However, proper details in relation to movement and disposal/scrapping have not been entered in PPE register. When these items were physically verified by the management during the year, it has resulted in material discrepancies. The management has properly dealt with such discrepancies in the books of accounts.

Based on above, answer the following questions : -

1. Considering description provided in case scenario regarding accounting income as per books of accounts and taxable income under Income tax law, choose appropriate responsibility of Dhanush:
 - (a) To verify deferred tax liability likely created in financial statements in accordance with AS 22.
 - (b) To verify deferred tax asset likely created in financial statements in accordance with AS 22.
 - (c) To verify deferred tax asset likely created in financial statements in accordance with AS 29.
 - (d) To verify deferred tax liability likely created in financial statements in accordance with AS 29.
- Ans: (b)
2. Keeping in view description provided in case scenario, which of the following statements is likely to be correct regarding accounting treatment of cost of CDs and software acquired by company to run tests?
 - (a) The company's accounting treatment of treating the cost of CDs with software costs as intangible assets is not proper. It should have treated such costs as revenue expenditure.
 - (b) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is proper.
 - (c) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as intangible asset.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (d) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as revenue expenditure.

Ans: (b)

3. As regards discrepancies noticed in computer systems on physical verification by management as described in case scenario, which of the following statements is most appropriate?

- (a) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it may result in modification of auditor's opinion.
- (b) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it entails specific reporting requirement for auditor under the Companies Act, 2013.
- (c) The management has properly dealt with such discrepancies. Therefore, Dhanush should not do anything further.

- (d) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it is in nature of misstatement which needs to be communicated and documented by auditor.

Ans: (b)

4. Which of the following statements meets requirements of law in respect of revenue from operations of the company?

- (a) Revenue from operations of ₹ 50 crores should be shown in Statement of Profit and loss.
- (b) Revenue from operations of ₹ 50.10 crores should be shown in Statement of Profit and loss. However, revenue from sale of books, fees charged from students and interest on investments should be disclosed separately in notes.
- (c) Revenue from operations of ₹ 50.10 crores should be shown in Statement of Profit and loss.
- (d) Revenue from operations of ₹ 50 crores should be shown in Statement of Profit and loss. However, revenue from sale of books and fees charged from students should be disclosed separately in notes.

Ans: (d)

5. The company has taken useful life of desktops to be 3 years. Such a requirement is

- prescribed under Schedule III to the Companies Act, 2013. However, a company can choose a useful life different from what is prescribed under Schedule III.
- is not prescribed under the Companies Act, 2013. It depends upon manufacturing specifications of desktops.
- prescribed under Schedule II to the Companies Act, 2013. However, a company can choose a useful life different from what is prescribed under Schedule II.
- is not prescribed under the Companies Act, 2013. It needs to be arrived at mandatorily by a management expert.

Ans: (c)

Case Scenario 6

CDL Limited, a company dealing in FMCG goods, is having 50 branches in India. SKC & Associates (referred to as company's auditor) are appointed as statutory auditors of the company for year 2023-24. Further, company has also appointed Mr. D as branch auditor for 5 of its branches.

Since Mr. D is conducting audit of only 5 branches of company, he has not arrived at materiality level in respect of auditee branches. On the same lines, identification and assessment of risk of material misstatement has not been performed. He is of the view that determination of materiality and identifying & assessing risks of material misstatement is done for financial statements of company as a whole. He has mainly performed substantive audit procedures in respect of financial statements of auditee branches like verification of PPE items, inventories, trade receivables, cash, bank balances and trade payables at auditee branches and maintained documentation of the same.

During the course of audit at two branches dealing in same kind of goods, Mr. D has performed analytical procedures pertaining to inventories. He has arrived at and compared inventory turnover ratio (Cost of goods sold/Average inventory) over a period of years of two branches. The results of analytical procedures are summarized in Table I below:

Table 1

| Particulars | Branch | Year 2021-22 | Year 2022-23 | Year 2023-24 |
|--------------------------|--------|--------------|--------------|--------------|
| Inventory turnover ratio | I | 15 | 4 | 12 |
| Inventory turnover ratio | II | 4 | 6 | 10 |

The company's auditor has also decided to use work of Mr. D with respect to financial information of 5 branches included in financial information of the company. During the course of audit, company's auditor has advised Mr. D by way of email certain significant accounting, auditing and reporting requirements and has asked him to provide representation as to compliance with them. Irritated and surprised, Mr. D is of the view that such an email is beyond the rights of the company's auditor.

Based on above, answer the following questions :-

1. As regards audit of a branch of CDL Limited as referred to in case scenario is concerned, which of the following statements is most appropriate?

- The accounts of a branch shall be audited either by the company's auditor or by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of the Companies Act, 2013. In case branch accounts are audited by a person other than company's auditor, branch audit report is sent by branch auditor to company's auditor.
- The accounts of a branch shall only be audited by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of the Companies Act, 2013 except company's auditor. In such a case, branch audit report is sent by branch auditor to members of company.
- The accounts of a branch shall only be audited by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of the Companies Act, 2013 except company's auditor. In such a case, branch audit report is sent by branch auditor to company's auditor.
- The accounts of a branch shall be audited either by the company's auditor or by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of the Companies Act, 2013. In case branch accounts are audited by a person other than company's auditor, branch audit report is sent by branch auditor to members of company.

Ans: (a)

2. After reading methodology for carrying out branch audits by Mr. D, which of the following statements is likely to be most appropriate?

- Separate determination of materiality and identifying & assessing risk of material misstatement is not required in respect of each of the branches. He is required to perform only substantive procedures as described in the case scenario in respect of auditee branches and maintain documentation of the same.
- Separate determination of materiality and identifying & assessing risk of material misstatement is required in respect of each of branches. However, documentation for these matters regarding branches is not required. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.
- Separate determination of materiality and identifying & assessing risk of material misstatement is required along with documentation thereof in respect of each of branches. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.
- Identifying & assessing risk of material misstatement is required along with documentation in respect of each of branches. However, materiality is required to be arrived at for financial statements of company as a whole. He is required to perform

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.

Ans: (c)

3. Choose the correct statement regarding results of analytical procedures performed by Mr. D summarized in Table 1 in case scenario.

- (a) Choose the correct statement regarding results of analytical procedures performed by Mr. D summarized in Table 1 in case scenario.
- (b) During the year 2023-24, inventories of Branch II have moved faster in comparison to Branch I.
- (c) Comparison of inventory turnover ratio of Branch II over a period of years may indicate that branch's sales have likely been weak with higher inventory holdings in year 2023-24 as compared to previous years.
- (d) Comparison of inventory turnover ratio of Branch I over a period of years may indicate that branch's sales have likely been strong with lower inventory holdings in year 2023-24 as compared to previous years.

Ans: (a)

4. Considering the contents of email sent by company's auditor to Mr. D, which of the following statements is likely to be in accordance with Standards on Auditing?

- (a) Company's auditor can advise Mr. D regarding certain significant accounting, auditing and reporting requirements and ask him to provide representation as to compliance with them.
- (b) Company's auditor can advise Mr. D certain significant accounting, auditing and reporting requirements. However, asking him to provide representation as to compliance with them is breach of Mr. D's independence.
- (c) Company's auditor cannot advise Mr. D certain significant accounting, auditing and reporting requirements. It is breach of Mr. D's independence.
- (d) Company's auditor can advise Mr. D regarding certain significant accounting, auditing and reporting requirements only when Mr. D makes such a request.

Ans: (a)

Case Scenario 7

CA B is conducting statutory audit of branch of a nationalized bank. Saurabh, a CA student, is also part of the engagement team conducting statutory branch audit. The field of bank branch audit is new to him, and he is following instructions as required by engagement partner.

The engagement partner has asked him to prepare a summary of non-funded credit facilities outstanding as on balance sheet date. The following information is appearing in branch's CBS data/records as on 31st March, 2024:

| S.No, | Particulars in CBS (Core Banking solution)/records | Amount in ₹ crores |
|-------|--|-----------------------|
| 1. | Agricultural term loans | 15.00 |
| 2. | Staff housing loans | 3.50 |
| 3. | Staff vehicle loans | 0.20 |
| 4. | Housing loans-General public | 10.00 |
| 5. | Letters of credit issued | 2.50 |
| 6. | Education loans | 1.50 |
| 7. | Guarantees issued (Fully secured by 100% margin) | 1.00 |
| 8. | Bills purchased and discounted | 2.00 |
| 9. | Bills for collection | 0.10 |

On going through listing of housing loans to public, CA B notices that branch has sanctioned many housing loans of small ticket size ranging between ₹ 10.00 to ₹ 20 lakhs. Therefore, he has assessed the risk of material misstatements to be high. As a consequence, he has designed procedures to perform tests of controls as well as substantive tests.

Saurabh has been further asked to go through SMA (Special Mention Accounts) jotting as on 30th November, 2023. Such reports are available from the system monthly frequency. Being new to such type of assignment, he is unable to understand relevance of above audit procedure mandated by engagement partner.

Based on above, answer the following questions:

1. Considering table given in the case scenario, which of the following combinations is appropriate example of non- funded credit facilities provided by branch to its customers?
 - (a) Bills purchased and discounted; bills for collection
 - (b) Bills for collection; staff housing loans; letters of credit issued
 - (c) Bills purchased and discounted; letters of credit issued; guarantees issued (fully secured by 100% margin)
 - (d) Letters of credit issued, guarantees issued (fully secured by 100% margin)

Ans: (d)

2. CA B's decision to perform both tests of controls as well as substantive tests was taken after he had assessed the risk of material misstatement in financial statements to be high due to large number of small ticket size loans. Which Standard on Auditing deals with auditor's responsibility to design such tests?
 - (a) SA 500
 - (b) SA 330
 - (c) SA 330
 - (d) SA 315

Ans: (b)

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

3. Saurabh is unable to understand relevance of going through SMA jotting as on 30th November, 2023. Which of the following statements is most appropriate in this context?

- (a) It would necessarily help the auditor in identifying accounts with significant lending exposure.
- (b) It would help the auditor in identifying accounts which may involve downgrading from Sub-standard asset category to doubtful category.
- (c) It would help the auditor in identifying accounts where substantial recoveries have been received during the year.
- (d) It would help the auditor in identifying accounts which may involve downgrading from standard category to non-performing asset.

Ans: (d)

Case Scenario 8

Watch IT India Private Limited is a company engaged in business of manufacturing smart watches. The company had a slow start in the beginning as the company's products were gaining traction with customers. However, momentum has picked up during the year. The company wants to appoint M/s Tripathi & Associates, a CA firm, as their auditor for year 2023-24 by replacing their existing auditors M/s Sreepath and Co. M/s Tripathi & Associates are willing to accept the engagement. They communicated with previous auditors before accepting the engagement. However, M/s Sreepath and Co. have failed to respond. CA Kishan, partner of M/s Tripathi & Associates explained to his team members about the importance of Engagement letter. He also arranged a team discussion on matters relating to acceptance of terms of engagement.

The first point of consideration was concerning preconditions for an audit. Mr. Arun, a team member, could recollect a few of them. Those included determining whether financial reporting framework used in the preparation of financial statement is acceptable, management providing auditor with access to all relevant information and additional information upon auditor's request. It was further elaborated by Arun that management must provide unrestricted access to employees within entity as may be required by auditor for obtaining audit evidence. Team members were asked to list factors that may necessitate revision of Engagement letter in case of recurring audits. Mr. Kumar, another team member replied that revision may be required in cases involving significant change in ownership, recent changes in senior management, change in financial reporting framework adopted in preparation of financial Statements, modest change in nature or size of the entity's business, change in legal and regulatory requirements etc.

Mr. Ram, one of the team members, raised a doubt. He enquired regarding recourse available to incoming auditor in case management makes it clear before acceptance of engagement by auditor regarding its inability in providing support to him in respect of certain procedures expected to be performed during course of audit. In this respect, specific question was raised relating to sending of confirmation requests to material trade payables reflecting in financial statements of a company. Trade payables pertain to material input

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

and input services acquired and utilised by company during the year. Lack of support by management in such a case would, in effect, signify management's refusal to allow auditor to send confirmation requests at the outset before engagement is accepted by auditor.

Based on above, answer the following questions:

1. As regards the doubt of Mr. Ram described in the last para of case scenario, which of the following statements is likely to be in accordance with Standards on Auditing?

- The auditor needs to inquire into management's reasons for the refusal and perform alternative audit procedures to obtain relevant and reliable audit evidence.
- The auditor needs to evaluate implications of management's refusal on auditor's assessment of risk of material misstatement and perform alternative audit procedures to obtain relevant and reliable audit evidence.
- The auditor should not accept such an engagement
- The auditor needs to evaluate implications of management's refusal on risk of fraud and perform alternative audit procedures to obtain relevant and reliable audit evidence.

Ans: (c)

2. When CA Kishan, the partner, asked about preconditions for an audit, Mr. Arun could recollect only few of them. Read the passage and find out which among the following points were missed.

- Obtaining management responsibility on specific legal aspects governing the organisation.
- Obtaining management responsibility on Standards on Auditing applicable to the organisation.
- Obtaining management responsibility for the preparation of financial statements as per applicable financial reporting framework.
- Obtaining management responsibility on necessary Internal controls to enable preparation of financial statements which are free from material misstatement whether due to error or fraud.

Choose the correct answer from below options.

- (i), (ii) and (iii)
- (ii), (iii) and (iv)
- (iii) and (iv)
- (i) and (iv)

Ans: (c)

3. From what Mr. Kumar replied about the factors requiring a revision of Engagement letter one point was incorrect. Read the passage and find that incorrect factor.

- It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of objectivity governing professional ethics.

- (b) It was ethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It does not involve violation of any of fundamental principles governing professional ethics.
- (c) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of Professional competence and due care governing professional ethics.
- (d) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of professional behaviour governing professional ethics.

Ans: (d)

4. M/s Sreepath & Co. have failed to respond to incoming auditors. In this regard, choose the most appropriate option: -

- (a) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of objectivity governing professional ethics.
- (b) It was ethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It does not involve violation of any of fundamental principles governing professional ethics.
- (c) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of Professional competence and due care governing professional ethics.
- (d) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of professional behaviour governing professional ethics.

Ans: (d)

Case Scenario 9

In accordance with the requirements of Standards on Auditing, CA Tina (a freshly qualified professional) wants to obtain sufficient appropriate audit evidence in an audit engagement pertaining to financial statements of a partnership firm for the year 2023-24. The firm trades in FMCG goods. Appointed in May, 2024, she needs evidence to obtain information for arriving at her judgment. Clearly remembering fundamentals that an auditor must obtain sufficient appropriate audit evidence to draw reasonable conclusions on financial statements, she proceeded in accordance with audit plan prepared by her.

During the year 2023-24, the firm was maintaining a current account with a branch of a public sector bank. Her audit plan had included procedure of confirming balance of current account directly from bank. As at 28th March, 2024, the firm had an urgent need to pay its utility bill amounting to ₹ 1.00 lacs. However, due to insufficiency of funds, it had requested branch manager to get cheque drawn on

ICAI Study Material Questions As Free

Audit & Ethics

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

utility company cleared. Therefore, balance in current account of firm in books of bank branch stood at ₹ 0.92 lacs (Debit). The firm had also issued cheques in evening of 31st March, 2024 in anticipation of funds on next working day i.e. 3rd April, 2024. It had also certain cheques dated 27th March, 2024 from its debtors lying with it which were deposited in afternoon of 31st March, 2024 in bank branch at request of debtors.

Her plan also included performance of certain procedures pertaining to verification of inventories. Inventories of FMCG goods were material to financial statements. Her assistant, Tisha, had her own notion about understanding sufficient appropriate audit evidence. She further feels that when audit evidence is obtained from available records of an entity, it is known as internal evidence like purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law. She is also of the view that audit evidence obtained by auditor is final and conclusive.

Based upon above, answer the following questions: -

1. As regards matter of balance in current account and related issues is concerned, which of the following statements is likely to be most appropriate?

- Amount of ₹ 0.92 lac is required to be classified under cash & bank balances in financial statements of firm. Procedure of confirming balance directly from the bank alone is likely to constitute sufficient appropriate audit evidence.
- Amount of ₹ 0.92 lac is required to be classified under cash & bank balances in financial statements of firm. The procedure of confirming balance directly from the bank alone is not likely to constitute sufficient appropriate audit evidence.
- Amount of ₹ 0.92 lac is required to be classified under current liabilities in financial statements of firm. The procedure of confirming balance directly from the bank alone is likely to constitute sufficient appropriate audit evidence.
- Amount of ₹ 0.92 lac is required to be classified under current liabilities in financial statements of firm. Procedure of confirming balance directly from the bank alone is not likely to constitute sufficient appropriate audit evidence.

Ans: (d)

2. Considering matter of verification of inventories, which of the following statements is based on facts described in the situation and also in essence of Standards on Auditing?

- She should verify subsequent sale invoices of inventory items lying in stocks as at year end. Besides, she should also review stock records of the year 2023-24 and subsequent period. Such evidence may constitute sufficient appropriate audit evidence.
- She should verify subsequent sale invoices of inventory items lying in stocks as at year end. Besides, she should also review stock records of year 2023-24 and subsequent period. She should attend physical inventory count at year end in above situation. Such evidence may constitute sufficient appropriate audit evidence.

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18

- (c) She should verify purchase invoices of inventory items lying in stocks as at year end. Stock records are not required to be verified. Such evidence is likely to constitute sufficient appropriate audit evidence.
- (d) She should verify purchase invoices of inventory items lying in stocks as at year end. She should attend physical inventory count at year end in above situation Such evidence may constitute sufficient appropriate audit evidence.

Ans: (a)

3. Identify correct statement on the basis of description provided in case scenario: -

- (a) Purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are all examples of internal evidence. Audit evidence obtained by auditor is final and conclusive.
- (b) Purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are all examples of internal evidence. Audit evidence obtained by auditor is persuasive.
- (c) Only debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are examples of internal evidence. Audit evidence obtained by auditor is persuasive.
- (d) Only debit notes issued by firm on debtors for GST short charged earlier during the year is an example of internal evidence. Audit evidence obtained by auditor is persuasive.

Ans: (c)

Get Vivitsu Reviewers

Get your Vivitsu Reviewer for all subjects to practice all questions of RTPs, MTPs and PYPs

www.thevivitsu.com/ca_inter

Want Lectures?

Get Vivitsu Recommended lectures at the lowest price

www.thevivitsu.com/marketplace

Test yourself with Test Series

Test yourself Chapter-wise for a better pass percentage

www.thevivitsu.com/test_series?id=18