Case Scenario 1

Oval Services Ltd. appointed Rupa & Associates as the auditors for the financial year 2023-2024. The auditors believe that an audit program is crucial in providing clear and comprehensive instructions for the tasks to be carried out, offering a total perspective of the work involved. This is particularly important for large audits, and as such, they prepared an initial audit program based on the company's organisational structure and effective internal controls. During the audit, CA Nitin, Engagement Partner identified issues with the company's debt management practices, prompting the inclusion of a more detailed review of the loan agreements.

However, in his opinion the planned review of petty cash was unnecessary due to the company's policy of limiting cash transactions. Thus, review procedure was removed from the audit programme.

To verify the balances of trade payables, the auditor decided to send external confirmation requests to the creditors of the company. These requests were made to verify the balances as on 20th March 2024, a date chosen deliberately to ensure the accuracy and completeness of the liabilities, free from any influence or prior knowledge of management. This approach was taken to maintain the integrity of the confirmation process. However, it was noted that M/s. Keshav Traders and M/s. Amrit Distributors did not respond to the confirmation requests.

Furthermore, the auditor noted that in the financial year 2023-2024, the company's Property, Plant, and Equipment (PPE) was revalued, resulting in an increase of 5% in the net carrying value of its machinery from ₹10 lakh to ₹10.5 lakh.

Also, due to the significant compliance burden, company is considering to convert into a Limited Liability Partnership (LLP). Management views the LLP structure as a hybrid business model that combines the advantages of both companies and partnerships. Additionally, they believe this conversion would relieve them of mandatory audit requirements.

Based on the above facts, answer the following: -

1. Whether audit team is correct in excluding the planned review of petty cash from the audit programme?

(a) No. Because an audit programme should always include a petty cash review, regardless of company policy.

(b) Yes. Because the company's internal controls and policy of limiting cash transactions reduce the need for a petty cash review in the audit programme.

(c) No. Because the audit programme must cover all the areas of financial transactions, including petty cash, to ensure comprehensive auditing.

(d) Yes. Because the audit programme should only focus on areas with high financial risk, and petty cash is not a high-risk area.

2. Whether the decision of auditor to send the confirmation request to the creditors of the company as on 20th March 2024 justified?

(a) Yes, decision of the auditor is correct as the auditor is allowed to choose any date reasonably close to the balance sheet date for confirmation, and the selected date helps to ensure the accuracy of the liabilities without consultation from the management.

(b) No, decision of the auditor is not correct as the auditor should have sent the confirmation requests for the balance sheet date as this would accurately reflect the liabilities as on that date.

(c) Yes, decision of the auditor is correct as the auditor is allowed to choose any date which is reasonably close to the balance sheet date for confirmation, and the selected date should be decided in consultation with the management.

(d) No, decision of the auditor is not correct as confirmation should be asked within a week of the date of audit report.

3. Which of the following is not an appropriate procedure to verify the balances for M/s. Keshav Traders and M/s. Amrit Distributers?

(a) Breaking down the balance into individual transactions and making sure they actually happened.

(b) Checking payments made after the year-end to vendors who didn't respond to confirmation requests.

(c) Comparing the balance to the original invoices from the vendors.

(d) Request a written representation from management confirming that all payables are accurately recorded and complete.

4. In the given case, is there any requirement for separate disclosure of the PPE revaluation?

(a) Yes, separate disclosure is required due to the 5% increase in carrying value.

(b) No, separate disclosure is not required as the change in carrying value is less than 10%.

(c) Yes, separate disclosure is required regardless of the percentage change.

(d) No, separate disclosure is not required unless the revaluation results in a material change in the carrying value.

5. What is your perspective on the management's view regarding the audit requirements for an LLP?

(a) An LLP is always required to conduct an audit, regardless of its turnover or capital contribution.

(b) An LLP is always required to conduct an audit if either the turnover exceeds ₹40 lakhs or the capital contribution exceeds ₹25 lakhs.

(c) An LLP is always required to conduct an audit if either the turnover exceeds ₹25 lakhs or the capital contribution exceeds ₹40 lakhs.

(d) An LLP is always required to conduct an audit if the capital contribution exceeds ₹25 lakhs and the turnover exceeds ₹40 lakhs.

S No.	Ans	Description
1	B	Yes. Because the company's internal controls and policy of limiting cash transactions reduce the need for a petty cash review in the audit programme.
2	C	Yes, decision of the auditor is correct as the auditor is allowed to choose any date which is reasonably close to the balance sheet date for confirmation, and the selected date should be decided in consultation with the management.
3	D	Request a written representation from management confirming that all payables are accurately recorded and complete.
4	B	No, separate disclosure is not required as the change in carrying value is less than 10%.
5	B	Ans should be (d)

Case Scenario 2

Shreyansh, a Chartered Accountancy student, is part of an engagement team conducting audit of the Coimbatore branch of XYZ Bank under the guidance of CA Dilip, the Engagement Partner. Shreyansh has been assigned the task of verifying provisions made for the branch's non-performing assets (NPAs) and classification of certain loans as on March 31, 2024, of which details are as under:

Non-Performing Assets (NPAs):

Name of Account	NPA classification	Outstanding amount as on March 31st, 2024 (In ₹ lakhs)	Amount of provision made (In ₹ lakhs)	Security Available
AB Industries	Doubtful (D1)	10.00	5.00	Fully secured
Mars Traders	Substandard asset	50.00	7.50	Fully secured
RS Enterprises	Doubtful (D2)	30.00	30.00	Fully secured
NPS & Sons	Loss	1.00	1.00	Only personal guarantee of proprietor (Net worth ₹50 lakhs)

<u>Housing Loan and Car Loan</u>

A borrower Mr. Shyam has availed following two loans from the branch:

- Housing Loan: EMIs are overdue for 120 days as on March 31, 2024.
- Car Loan: EMIs are overdue for 60 days as on March 31, 2024.

<u>Agricultural Advances</u>

The branch has provided a loan of ₹20 lakhs under the Kisan Credit Card (KCC) scheme to a farmer for the cultivation of paddy, which has a harvest period of 3–4 months. There has been no transaction in the account for the last 90 days. The branch has classified the loan as a Standard Asset.

CA Dilip has clarified that the NPA classification has been verified and is in accordance with RBI guidelines. He instructed Shreyansh to focus on evaluating the adequacy of the provisions, considering

RBI Guidelines mandate specific percentages for provisioning based on the NPA classification and the nature of the security.

Based on the above facts, answer the following: -

6. Is the provision made for AB Industries (Doubtful—D1) appropriate?

(a) Yes, as it exceeds the required 25% provisioning for secured assets.

(b) No, as it should be 40% of the outstanding amount.

(c) No, as the required provision is ₹ 2.50 lakhs (25% of ₹ 10.00 lakhs).

(d) Yes, as provisions for Doubtful assets can exceed the minimum requirement.

7. Considering the Housing Loan and Car Loan availed by the borrower Shyam, which of the following statements is appropriate?

(a) Both Housing Loan and Car Loan should be classified as "NonPerforming Assets" in accordance with RBI norms on asset classification.

(b) Housing Loan should be classified as "Non-Performing Asset" in accordance with RBI norms. However, Car Loan should be classified as Standard Asset.

(c) Car Loan should be classified as "Non-Performing Asset." However, Housing Loan should be classified as Standard Asset.

(d) Both Housing Loan and Car Loan should be classified as Standard Assets.

8. What is the minimum provision required for RS Enterprises (Doubtful—D2), considering the account is fully secured?

(a) ₹30.00 lakhs

(b) ₹12.00 lakhs

(c) ₹15.00 lakhs

(d) ₹25.00 lakhs

9. As regards the description of the agricultural advance under Kisan Credit Card, which of the following statements is most appropriate?

(a) The branch has erred in making classification as per RBI norms. It is a "Sub-standard" asset.

(b) The classification made by the branch is proper. However, since there are no transactions in the account for 90 days, it is an SMA (Special Mention Account).

(c) The classification made by the branch is proper.

(d) The branch has erred in making classification as per RBI norms. It is a "Doubtful" asset.

S No.	Ans	Description
6	C	No, as the required provision is ₹ 2.50 lakhs (25% of ₹ 10.00 lakhs).
7	A	Asset classification is borrower wise not facility wise.
8	B	40% of 30 L = 12 L
9	C	The classification made by the branch is proper as it's a short duration crop & amount is not overdue for 2 crop seasons.

Case Scenario 3

M/s MCP Associates are having 3 partners namely CA Mahavir, CA Chandana and CA Prabha. CA Mahavir is about to conclude audit of a company. During the audit, he noticed that there is a shortage of important raw material supplies being imported from China due to prevailing geopolitical 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. He also verifies that all subsequent events have been accounted for and requests written representations from management, although the representations include qualifying language. Significant findings were communicated both orally and in writing to those charged with governance, with relevant communications documented.

CA Chandana is conducting an audit of a manufacturing company dealing in towels and bedspreads. The company's inventory is spread across its own locations and third-party premises. As part of audit procedures, she is performing many audit procedures required by different Standards on Auditing. She attends the physical inventory count, sends confirmation requests for trade receivables, and assesses controls. She relies on sampling extensively while auditing transactions, balances, and controls.

CA Prabha is auditing a firm's financial statements and performs detailed procedures to verify assertions. 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. She checks classification of expenses, ensures trade payables are genuine, compares current and past wages, examines title deeds for land, and check the accuracy of calculation of the conversion of foreign currency into Indian rupees for export invoices.

Based on the above facts, answer the following: -

10. Which of the following best describes CA Mahavir's responsibility for subsequent events as per SA 560?

(a) He has no obligation to perform audit procedures for events occurring between date of financial statements and date of auditor's report.

(b) He should perform necessary audit procedures to know about events occurring between the date of financial statements and date of auditor's report.

(c) He has no obligation 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.

(d) He has to only rely upon written representation of management regarding subsequent events. He has no other means to know about such events.

11. Which is the most appropriate action CA Chandana should take for verifying inventories held at third-party premises?

(a) Request confirmation of the inventory's quantity and condition from third parties or inspect the inventory at their premises.
(b) Inspect all inventories at third-party premises without requesting confirmation.
(c) Rely on management's written representation regarding inventories at third-party locations.
(d) Confirm the inventory's value along with its quantity and condition from third parties.

12. Which audit procedure CA Prabha performed to verify whether conversion of foreign currency into Indian rupees is proper or not?

(a) Inspection
(b) Recalculation
(c) Observation
(d) Reperformance

S No.	Ans	Description
10	B	He should perform necessary audit procedures to know about events occurring between the date of financial statements and date of auditor's report.
11	A	Request confirmation of the inventory's quantity and condition from third parties or inspect the inventory at their premises.
12	B	Recalculation

13. CA Kamal, a partner at KPS & Co., is conducting an audit of Ridhi Ltd., a manufacturing company. During the audit it was found that KPS & Co. generates 72% of its total revenue from Ridhi Ltd., raising concerns about the firm's financial dependence on this single client. Identify the kind of threat to independence that may be involved in this case.

(a) Familiarity threat
(b) Self-interest threat
(c) Self-review threat
(d) Advocacy threat

14. The auditor is evaluating the most appropriate method to assess the internal control system of the company. The selected method should be widely recognised for gathering information about the existence, operation, and efficiency of internal controls, while also minimizing the risk of oversight of important review procedures. Furthermore, the method should facilitate easier interim reviews of controls. Which method would be most appropriate for evaluating internal control based on the description provided above?

(a) Internal Control Questionnaire
(b) Flow Chart
(c) Check List
(d) Narrative Record

15. Gori 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 the following statements seems to be appropriate in this regard?

(a) 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.

(b) 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.

(c) 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.

(d) 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.

S No.	Ans	Description
13	B	Huge dependence on fees & concern of losing client.
14	B	Internal Control Questionnaire
15	A	Checking authenticity of documents is outside audit scope.

Descriptive Questions

Question 1 (Audit Documentation → Assembly of file)

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

On the basis of Standards on Auditing regarding audit documentation, comment on the action taken by CA Tanuj. (MTP Jan'25)

Solution

As per **SA 230, "Audit Documentation"**, the auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

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

- After the assembly of the final audit file has been completed, the auditor shall **not delete or discard** audit **documentation** of any nature **before the end of its retention period**.

Facts of Case

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

Conclusion

Thus, CA Tanuj **can make said changes** to the audit documentation during the final assembly process.

Question 2 (SA 210 → Change in terms)

Deepa Ltd., initially requested an audit engagement for the financial year 2023-2024. However, midway through the audit process, the management claims that they are unable to provide complete supporting documentation for a significant portion of their receivables. As a result, the management asks the auditor to change the audit engagement to a review engagement, arguing that it would prevent the issuance of a qualified opinion. The auditor is now facing challenge in determining whether this change is justified or not. Comment in accordance with relevant SA.

Solution

As per SA 210, "Agreeing the Terms of Audit Engagements", a request from the entity for the auditor to change the terms of the audit engagement may result from

- a **change in circumstances** affecting the need for the service,
- a **misunderstanding** as to the **nature of an audit** as originally requested or
- a **restriction on the scope** of the audit engagement, whether imposed by management or caused by other circumstances.

The auditor **considers the justification given** for the request, particularly the implications of a restriction on the scope of the audit engagement.

A **change in circumstances** that affects the entity's requirements **or a misunderstanding** concerning the nature of the service originally requested **may be considered a reasonable** basis for requesting a change in the audit engagement.

In contrast, a **change may not be considered reasonable if** it appears that the change **relates to information** that is **incorrect, incomplete or otherwise unsatisfactory**.

An **example** might be where the auditor is **unable to obtain sufficient appropriate audit evidence** regarding receivables and the **entity asks** for the audit engagement to be **changed to a review** engagement to **avoid a qualified opinion or a disclaimer of opinion**.

<u>Conclusion</u>

Hence **Deepa Ltd.'s request** for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion is **not reasonable**.

<u>MTP 1 Sep'24 Question</u>

CA H has been offered audit of financial statements of a society engaged in promoting social causes, such as setting up of drug de-addiction centres for misguided youth and rehabilitating such young people by helping them find avenues of gainful employment. However, CA H failed to send audit engagement letter to the society's governing body and proceeded to conduct the audit. In the absence of this letter, the governing body is of the view that purpose of such an audit is to provide absolute assurance against probable errors and frauds in the financial statements. Does it constitute violation of fundamental principles governing professional ethics? State reasons for the same.

As per **SA 210**, "Agreeing the Terms of Audit Engagements", the auditor shall **agree the terms of the audit engagement** with management or those charged with governance, as appropriate.

- The agreed terms of the audit engagement shall be **recorded in an audit engagement letter** or other suitable form of written agreement.
- Such a **letter includes**, inter alia, **objective and scope** of audit of financial statements.

The **absence of such a letter leads to misunderstanding** between auditor and management.

As auditor has failed to send engagement letter, the governing body has formed an improper view of objective and scope of audit of financial statements.

By not following requirements of SA 210, CA H is not acting ethically. He has **violated principle of professional competence and due care governing professional ethics**. This principle requires an accountant to **attain and maintain professional knowledge and skill** at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation and **act diligently** and in accordance with applicable **technical and professional standards**. Maintaining professional competence requires awareness of current technical and professional standards. Non sending of engagement letter shows lack of such awareness on part of CA H. Therefore, he has violated said fundamental principle governing professional ethics.

Question 3 (Coop Society)

Aman Cooperative Society appointed FAB & Associates as an auditor for the financial year 2023-2024. During the audit, the auditors noted the following details:

Number of shares	1000 shares @ ₹ 10/- each
Net Profit before compulsory transfer to reserve fund	₹ 10,000/-
Net Profit after compulsory transfer to reserve fund	₹ 8000/-

i. Mr. Dhairya, a member of society, holds 200 shares amounting to ₹ 2000 from the previous year.
ii. Upon verifying the society's borrowings, the auditors found that Cooperative Society had accepted a loan from Mr. Shivam, a nonmember. The auditors did not find any restrictions regarding this in the society's bye laws.

Comment on the above transactions of the society with reference to the Co-operative Societies Act, 1912. (MTP Jan'25)

Solution

Restrictions on share holdings: - According to section 5 of the Central Act, in the case of a society where the **liability of a member** of the society is **limited**, **no member** of a society **other than a registered society can hold** such portion of the **share capital** of the society as would **exceed a maximum of twenty percent of the total number of shares or** of the value of shareholding to **₹ 1,000/-**.

Restrictions on borrowings - Section 30 of the Central Act further puts restriction on borrowings. According to this section, a registered society shall accept loans and deposits from persons who are not members subject to the restrictions and limits of the bye-laws of the society. The auditor will have to examine the bye-laws in this respect."

Facts of case

In the given situation, Mr. Dhairya, a member of the society, is holding 200 shares amounting to ₹ 2000 from the previous year.

Conclusion

- In view of the aforementioned restriction on shareholding by a member, Mr. Dhairya is allowed to **hold a maximum of 100 shares** according to the Act.
- Further, Aman Co-operative Society had accepted a loan from Mr. Shivam, a non-member. Since, there are **no restrictions** regarding the **acceptance of loan** received from non-member in the society's bye-laws, the **loan received from Mr. Shivam is permissible**.

Question 4 (Items of FS → Obsolete inventory : Valuation)

During the audit of HST Ltd., CA Mukund, the auditor, observed a significant volume of unsold electronic parts as inventory that had remained stagnant for more than two years. He noted that the company was facing difficulty selling these items due to the changes in the market. Additionally, some parts were damaged, and others were discontinued models. CA Mukund also ensured that the inventory was accurately valued to ensure proper financial reporting.

You are required to outline the detailed audit procedures that are generally undertaken when auditing such inventories which at the time of observance of physical counting were noted as being damaged or obsolete.

Solution

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

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

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

Question 5 (SA 501: Letter of inquiry)

CA Kavita, auditor of Healthify Ltd., while assessing potential risks of material misstatement related to litigations at Healthify Ltd., identified a possible legal claim that could affect the financial statements. She sent a general inquiry letter to the company's external legal counsel, Mohit & Co., seeking clarification. However, Mohit & Co. informed her that their professional rules prohibited them from responding to these general inquiries.

Guide CA Kavita that what other option is available to obtain the necessary information for the audit?

Solution

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.

The auditor shall do so **through a letter of inquiry** requesting the entity's external legal counsel to communicate directly with the auditor. If **law, regulation** or the respective legal professional body **prohibits** the entity's external legal counsel from **communicating directly with the auditor**, the auditor shall perform **alternative audit procedures**.

If it is considered **unlikely** that the entity's external legal counsel will **respond** appropriately **to a letter of general inquiry**, for example if the professional body to which the external legal counsel belongs prohibits response to such a letter, the auditor may seek direct communication **through a letter of specific inquiry**.

For this purpose, a letter of specific inquiry includes:

i) A **list** of litigation and claims;

ii) Where available, **management's assessment of the outcome** of each of the identified litigation and claims and its **estimate of the financial implications**, including costs involved; and

iii) A request that the entity's external legal counsel **confirm the reasonableness of management's assessments** and provide the auditor with **further information if the list is** considered by the entity's external legal counsel to be **incomplete or incorrect**.

Question 6 (Familiarity Threat)

Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. Explain.

Solution

Familiarity threats: Familiarity threats are self-evident and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways including:

i) **close relative** of the audit team working in a senior position in the client company;
ii) **former partner** of the audit firm being a director or senior employee of the client;
iii) **long association** between specific auditors and their specific client counterparts; and
iv) acceptance of **significant gifts or hospitality** from the client company, its directors or employees.

Provisions in Companies Act, 2013 regarding rotation of auditors mainly address these very familiarity threats. Such provisions prescribe that **auditor is rotated after a certain number of years** so that auditors do not become too familiar with their clients.

Question 7 (RAIC → Understanding entity)

Knowledge of the Client's business play an important role in developing an overall audit. In fact, without adequate knowledge of the client's business, a proper audit is not possible.

As per SA 315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework.

Substantiate with the help of examples. (MTP II Jan'25)

Solution

As per **SA 315**, “Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment”, the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework.

Relevant industry factors include industry conditions such as the **competitive environment**, **supplier** and **customer** relationships, **and technological** developments.

- Examples of matters the auditor may consider include **market and competition**, whether entity is engaged in **seasonal activities**, **product technology** relating to the entity’s products. The industry in which the entity operates may give rise to specific risks of material misstatement arising from the nature of the business or the degree of regulation.

Relevant regulatory factors include the **regulatory environment**.

The regulatory environment includes, among other matters, the applicable **financial reporting framework** and the **legal and political environment**.

- Examples of matters the auditor may consider include **accounting principles** and **industry specific practices**, regulatory framework for a regulated industry, **legislation and regulation** that significantly affect the entity’s operations, including direct **supervisory activities, taxation, government policies** currently affecting the conduct of the entity’s business, environmental requirements affecting the industry and the entity’s business.

Examples of other external factors affecting the entity that the auditor may consider include the general **economic conditions**, **interest rates** and availability of **financing**, **and inflation** etc.