

01 Nature, Objective and Scope of Audit

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.

Selection Of Accounting Policies:

- Choosing of appropriate accounting policies is responsibility of management. Role of auditor lies in evaluating selection and consistent application of accounting policies by management.
- **Auditor's duties in relation to accounting policies includes: -**
 - a) To evaluate whether accounting policies selected by management are proper and
 - b) Whether chosen policy has been applied consistently on a period-to-period basis.

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

Answer.

1. Audit engagement is an assurance engagement. However, assurance engagements are not restricted to auditing alone.
2. There are other assurance engagements too like review engagements, engagements providing assurance involving prospective financial information, engagements providing assurance on internal controls in an entity'.
3. Assurance engagements provide assurance to users.
4. The difference is of degree.
5. Whereas an audit provides reasonable assurance which is a high level of assurance, review provides lower level of assurance as compared to audit.
6. There are also assurance engagements which relate to matters other than historical financial information like providing assurance on matters involving prospective financial information and providing assurance on internal controls in an entity.
7. In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that management's assumptions on which the prospective financial information is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions, and it is properly presented, and all material assumptions are adequately disclosed.

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

Answer.

Three Party Relationship of Assurance Engagements:



An assurance engagement involves three parties - a practitioner, a responsible party, and intended users.

- a) **Practitioner:** Person who provides the assurance. Practitioner is broader than auditor. Audit is related to historical information whereas practitioner may provide assurance not necessarily related to historical financial information.
- b) **Responsible party:** Party responsible for preparation of subject matter.
- c) **Intended users:** Persons for whom an assurance report is prepared. These persons may use the report in making decisions.

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.

Examination of Accounts for Determining Existence of Fraud

- Assurance engagement is 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.
- Reasonable Assurance requires a high, but absolute assurance.
- In this case, a Chartered Accountant is specifically asked to check accounts whether fraud exists.
- **Conclusion:** - 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.

Inherent Limitations of an Audit – Nature of Audit Procedures

There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

- a) 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.
- b) 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 requested. 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.
- c) 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.
- d) 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.
- e) 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.



02 Audit Strategy, Audit Planning & Audit Programme

Question 1. Discuss how performing preliminary engagement activities as part of planning an audit assists auditor.

OR

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

Answer.

Preliminary Engagement Activities

• As per SA 300 "Planning an Audit of F.S.", preliminary engagement activities include the following:

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

• 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

Question 2. Discuss how an engagement partner ensures that firm complies with relevant ethical requirements including independence in relation to client.

OR

CA N, engagement partner of LPS & Associates, is planning for audit of a large company. As part of preliminary engagement activities being performed in this regard, he wants to ensure that compliance with independence requirements is adhered. How shall he form a conclusion that audit firm complies with independence requirements?

Answer.

Evaluating Compliance With Ethical Requirements, Including Independence

• As a part of Preliminary Engagement Activities, auditor is required to evaluate compliance with ethical requirements including independence.

• EP shall form a conclusion on compliance with independence requirements. In doing so, he shall:

1. Obtain relevant information from the firm to identify and evaluate circumstances & relationships that create threats to independence.



2. Evaluate information on identified breaches, if any, to determine whether they create a threat to independence for audit engagement.
3. 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.
4. EP shall promptly report to the firm any inability to resolve the matter for appropriate action.

Question 3. "Purported disadvantages of an audit programme can be overcome". Do you agree?

OR

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

OR

CA Vikas Jain discussed with his audit team about advantages and disadvantages of audit programme. He explained to his team that - "work may become mechanical" as disadvantage of the audit programme. Discuss explaining the disadvantages of an audit programme.

Answer.

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

The disadvantages are: -

1. 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.
2. 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.
3. 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.
4. A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.

Elimination of disadvantages of audit programme:

Disadvantages of an Audit programme may be eliminated by:

- (1) imaginative supervision of the work carried on by the assistants;
- (2) receptive attitude of auditor as regards the assistants
- (3) encouraging assistants 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.

Consequences of Failure to Document Audit Strategy & Audit Plan

- Documentation of overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to ET.
- Documentation of the audit plan is a record of the planned NTE of RAPS and FAPs 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.
- Record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned NTE of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit.
- If auditor fails to document audit strategy and audit plan, he will not be able to carry out audit in an efficient and effective manner and will not be able to prove that audit was planned and performed in accordance with Standards on Auditing.

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.

OR

“The Nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors.” Explain.

OR

The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. Explain the factors due to which above varies.

Answer.

Planning the Direction & Supervision of Engagement Team

- As per SA 300 "Planning an Audit of Financial Statements" 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:
 - a) The size and complexity of the entity.
 - b) The area of the audit.
 - c) The assessed risks of material misstatement.



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



03 Risk Assessment And Internal Control

Question 1. Discuss how "analytical procedures" performed as "risk assessment procedures" can be useful to an auditor.

Answer.

Use of Analytical Procedures as Risk Assessment Procedures:

- Analytical procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing ROMM in order to provide a basis for designing and implementing responses to the assessed risks.
- Analytical procedures may include both financial and non-financial information.
- Analytical procedures may help identify 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 ROMM, especially ROMM due to fraud.

Question 2. Is materiality required to be documented by the auditor? What factors have to be considered this regard?

Answer.

Documentation of Materiality:

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

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

Question 3. Discuss relationship between "General IT controls" and "application controls" in an automated environment.

Answer.

General IT controls and Application controls:

- These two categories of control over IT systems are interrelated.



- Relationship between application controls and 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. 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 check completeness of data and population that is used in either test of controls or substantive audit tests. Explain in detail stating all the relevant points.

OR

While it is true that companies can benefit immensely from the use of data analysis in terms of increased profitability, better customer service, etc., Analyze various functions that can be performed even by the auditor also using Data Analytics tools and techniques in the audit process to obtain good results.

OR

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

OR

While auditing in an automated environment how data analytics can be used in testing electronic records and data residing in IT systems using spread sheets and specialised audit tools?

Answer.

Concept of Data Analytics:

- Data analytics is an analytical process by which meaning information is generated and prepared from raw system data using processes, tools, and techniques.
- In an automated environment, various insights can be extracted from operational, financial, and other forms of electronic data internal or external to the organization.
- The data so extracted is useful for preparation of Management Information System (MIS) reports and electronic dashboards that give a high-level snapshot of business performance.
- The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATS.
- Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL.

Application of Data Analytics:

In an automated environment, auditors can apply the concept of data analytics for several aspects of an audit including the following:



- a) Check completeness of data and population that is used in either test of controls or substantive audit tests.
- b) Selection of audit samples - random sampling, systematic sampling.
- c) Re-computation of balances - reconstruction of trial balance from transaction data.
- d) Reperformance of mathematical calculations - depreciation, bank interest calculation.
- e) Analysis of journal entries.
- f) Fraud investigation.
- g) 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.

Non – routine transactions:

- Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently.
- **ROMM may be greater for significant non-routine transactions arising from matters such as the following:**
 - a) Greater management intervention to specify the accounting treatment.
 - b) Greater manual intervention for data collection and processing.
 - c) Complex calculations or accounting principles.
 - d) The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

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.

Activities used to monitor internal control over financial reporting:

- Auditor shall obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting.
- **Following point merit consideration in this regard:**
 - a) Monitoring of controls is a process to assess effectiveness of internal control performance over time.
 - b) It involves assessing the effectiveness of controls on a timely basis and taking necessary corrective actions.
 - c) 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.
 - d) Management's monitoring activities may also 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.

Components of risk of material misstatement:

- ROMM 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:**
- a) **Inherent Risk:** Susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, assuming that there were no related internal controls.
- b) **Control Risk:** 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 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.

Combined Assessment of ROMM:

- SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "ROMM". However, auditor may make separate or combined assessments of inherent and control risk depending on audit techniques or methodologies and practical considerations.
- **Assessment of ROMM may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms:**

Audit risk = Risks of material misstatement - Detection risk

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.

OR

The auditor of XYZ Ltd., engaged in FMCG (Fast Moving Consumable Goods) obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether:

- (i) Management has created and maintained a culture of honesty and ethical behavior; and



- (ii) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

Advise what is included in control environment. Also explain the elements of control environment.

Answer.

Elements of Control Environment:

A. Control environment includes:

- a) The governance and management functions and
- b) The attitudes, awareness, and actions of those charged with governance and management concerning the entity's internal control and its importance in the entity.
- c) The control environment sets the tone of an organization, influencing the control consciousness of its people.

B. Control environment includes the following elements:

- (1) **Communication and enforcement of integrity and ethical values:** These are essential elements that influence effectiveness of design, administration & monitoring of controls.
- (2) **Commitment to competence:** Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.
- (3) **Participation by TCWG:** It includes attributes of TCWG such as their independence from management, their experience, extent of their involvement and the information they receive, and the scrutiny of activities.
- (4) **Management's philosophy and operating style:** It comprises of management characteristics such as:
 1. Approach to taking and managing business risks.
 2. Attitudes and actions toward financial reporting.
 3. Attitudes toward information processing and accounting functions and personnel.
- (5) **Organizational structure:** Framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed.
- (6) **Assignment of authority and responsibility:** Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorization hierarchies are established.
- (7) **Human resource policies and practices:** Policies & practices that relate to, e.g., recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.

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.



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 unauthorised 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.



04

Audit Evidence

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.

OR

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.

Nature of Related Party Relationships & Transactions:

- Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties.
- However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.
- **For example:**
 - 1) 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.
 - 2) Information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
 - 3) 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.

Reporting w.r.t Opening Balances

- If the auditor is unable to obtain SAAE regarding the opening balances, he shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.
- If auditor concludes that the opening balances contain a misstatement that materially affects current period's F.S., and effect of the misstatement is not properly



accounted for or not adequately presented or disclosed, he shall express a qualified opinion or an adverse 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.

Circumstances When Work Of The Internal Audit Function Cannot Be Used

External auditor shall not use work of internal audit function if he 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.

Question 4. Discuss what is understood by “appropriateness” of audit evidence.

Answer.

Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

The reliability of evidence is influenced by its source and nature, and is dependent on the individual circumstances under which it is obtained.

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.

Advantages Of Using Audit Trail Feature In Accounting Software

- 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.
- 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.



- 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.

Question 6. Explain how a statutory auditor of a company can apply analytical procedures at the planning phase of audit.

OR

In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk. Explain.

Answer.

Use of Analytical Procedures in Planning Stage:

- 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 the auditor with respect to the opening balances when conducting an initial audit engagement.

Answer.

Objective of Auditor with respect to Opening Balances - in an Initial Audit Engagement:

- In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient **appropriate audit evidence about whether:**
 - a) Opening balances contain misstatements that materially affect the current period's financial statements; and
 - b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable FRF.

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.

Auditor's Procedures W.R.T. Opening Balances In Case Of Initial Audit Engagement:

- Initial audit engagement is an engagement in which either:
 - a) The financial statements for the prior period were not audited; or
 - b) The financial statements for the prior period were audited by a predecessor auditor.
- As per SA 510 "Initial Audit Engagements- Opening Balances", in case of initial audit engagement auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's F.S. 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:
 - 1) Where the prior year F.S. were audited, perusing the copies of the audited F.S. including the other relevant documents relating to the prior period F.S.;
 - 2) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
 - 3) Performing specific audit procedures to obtain evidence regarding the opening of the balances.
- In the present case, 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.
- Conclusion: - Approach of Mr. Pankaj is not correct. He needs to apply procedures as stated in SA 510.

Question 9. Discuss the techniques available as substantive analytical procedures.

OR

Explain the techniques available as Substantive Analytical procedures.

OR

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.

Techniques available while applying SAP:



- a) **Trend analysis:** Trend analysis is most commonly used technique which involves comparison of current data with the prior period balance or with a trend in two or more prior period balances.
 - **Example:** Auditor may compare the salary paid during the year under audit with the salary paid for several earlier years. There may be some percentage increase in the salary expense over the years. However, an unusual increase may indicate that fraudulent payments are being made to fake employees.
- b) **Ratio analysis:** Ratio analysis involves analyzing revenue and capital items forming part of balance sheet and profit and loss account. Ratios can also be compared over a period of time or to the ratios of other entities within the industry.
- c) **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. These tests are generally more applicable to income statement accounts and certain accrual or pre-payment accounts.
- d) **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. 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.

OR

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.

Nature of Related Party Relationships & Transactions:

- Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties.
- However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.
- **For example:**
 - 4) 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.
 - 5) Information systems may be ineffective at identifying or summarizing transactions and outstanding balances between an entity and its related parties.
 - 6) 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.

OR

CA J is conducting statutory audit of Gemini Ltd engaged in manufacturing of pharma products. 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, CA J 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 the approach of CA J proper?

Answer.

Control over External Confirmation requests:

As per SA 505 "External Confirmations" 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.

CONCLUSION-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 12. Explain clearly the examples of matters relevant in planning attendance at physical inventory counting.

Answer.

Matters relevant in planning attendance at physical inventory counting:

- 1) Nature of inventory.
- 2) Stages of completion of work-in-progress.



- 3) The risks of material misstatement related to inventory.
- 4) The nature of the internal control related to inventory.
- 5) Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- 6) The timing of physical inventory counting.
- 7) Whether the entity maintains a perpetual inventory system.
- 8) 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.
- 9) 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.

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:**
 - a) **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.
 - b) **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 required in the circumstances of the case to obtain further sufficient and appropriate audit evidence.

Question 14. Most of the auditor's work informing the auditor's opinion consists of obtaining and evaluating audit evidence. Explain.

OR

Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature off and is primarily obtained from audit procedures



performed during the course of the audit. Most of none the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain.

Answer.

Obtaining and Evaluating Audit Evidence:

- SA 500 "Audit Evidence" defines audit evidence as information used by the auditor in arriving at the conclusions on which the auditor's opinion is based.
- 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 also include inspection, observation, confirmation, recalculation, reperformance 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.

Factors Determining Extent Of Reliance On Analytical Procedures (SA-520)

The application of analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. The presence of these relationships provides audit evidence as to the completeness, accuracy and validity of the data produced by the accounting system.

Factors Affecting The Reliability Of Data On Which Analytical Procedures Are To Be Performed:



As per SA 520 "Analytical Procedures" facts that may affect the reliability of data are:

a) **Source of the information available.**

For example, information may be more reliable when it is obtained from independent sources outside the entity;

b) **Comparability of the information available.**

For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products;

c) **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

d) **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.

Question 16. Define Analytical Procedures.

Answer.

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 2023-24. 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.

Objective of Auditor with respect to Opening Balances - in an Initial Audit Engagement:

- In conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient **appropriate audit evidence about whether:**
 - a) Opening balances contain misstatements that materially affect the current period's financial statements; and
 - b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes



thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable FRF.

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.

- 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".

Answer.

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.
- **Samples Selection methods:**
 - a) **Random selection:** This method of sampling ensures that all items within a population stand an equal chance of selection by the use of random number tables or random number generators. The sampling units could be physical items, such as sales invoices or monetary units.
 - b) **Systematic selection:** 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.
 - c) **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.
 - d) **Haphazard selection:** Samples are selected without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability. Haphazard selection is not appropriate when using statistical sampling.
 - e) **Block selection:** It 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.

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.

Meaning of Audit Sampling:

- As per SA 530 on "Audit Sampling", the term Audit Sampling is defined as "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 is known as audit sampling".
- **Requirement of SA 530 as to Sample Design, Size and Selection of Items for Testing**
 - a) **Sample Design:** When designing an audit sample, the auditor shall consider the purpose of 1,2331 and the characteristics of the population from which the sample will be drawn.
 - b) **Sample Size:** The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.
 - c) **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?

Answer.



Sampling Risk:

- SA 530 "Audit Sampling" deals with auditor use of sampling in performing audit procedures. However, due to application of sampling in audit procedures, there arise risk of sampling.
- Sampling Risk may be defined as 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:**
 - a) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test 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.
 - b) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test 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 old 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.

Advantages of Statistical Sampling:

- Audit testing done through Statistical sampling is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.
- Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.
- **The advantages of statistical sampling may be summarized as follows -**
 - a) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
 - b) The sample selection is more objective and thereby more defensible.
 - c) The method provides means of estimating the minimum sample size associated with a specified risk & precision.
 - d) 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.
 - e) 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.
 - f) 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.

Stratified Sampling:



- This method involves dividing whole population in few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population. Number of groups into which the whole population has to be divided is determined on the basis of auditor judgment.
- **Example:** Trade receivables balances may be divided as:
 - a) Balances in excess of 10,00,000;
 - b) Balances in the range of 5,00,001 to 10,00,000;
 - c) Balances in the range of 1,00,001 to 5,00,000;
 - d) Balances 1,00,000 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% of the items; from the third group 10% of the items; and from the lowest group 2% of the items may be selected.

Question 23. What precautions should be taken by the auditor while applying test check techniques?

Answer.

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 for deciding upon the extent of checking on a sampling plan.

Answer.

Factors to be considered to decide extent of checking:

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

- Size of the organization under audit.
- State of the internal control.
- Adequacy and reliability of books and records.
- Tolerable error range.
- Degree of the desired confidence.



05

Audit of Items of Financial Statements

Question 1. How will you vouch/verify the following:

- a) Goods sent out on sale or return basis?
- b) Borrowings from banks?

Answer.

Vouching Of Goods Sent on Sale or Return Basis

- a) Check maintenance of separate memoranda records of goods sent out on sale or return. Only after approval from customer, personal account of customer is debited and the sales account is credited.
- b) Ensure that the price of such goods is unloaded from the sales account and the debtor's record before the approval from customer.
- c) In respect of the goods for which approval period has expired, ensure that either goods have been received back or customer's account have been debited.
- d) In respect of the goods for which approval period has not expired till the close of the year and lying with the party, ensure that cost of such goods has been included in the closing stock.

Verification Of Borrowings 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:

- 1. Reconcile the balances in the overdrafts or loan accounts with that shown in the pass book(s) to 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.
- 2. 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 RoC and recorded in the Register of charges.
- 3. Verify the authority under which the loan or draft has been raised. In the case of a company, only the BoD is authorised to raise a loan or borrow from a bank.
- 4. Confirm, in the case of a company, that the restraint contained in Sec. 180 of the Companies Act, 2013 as regards the maximum amount of loan that the company can raise has not been contravened.
- 5. 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.



Verification Of Goods Sent on Consignment:

- a) Verify the accounts sales submitted by the consignee showing goods sold and inventory of goods in hand.
- b) 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.
- c) 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.
- d) Ensure that quantity of goods in hand with the consignee has been valued at cost plus proportionate non-recurring expenses, e.g., freight, dock dues, customs due, etc., unless the value is lower. In case NRV is lower, the inventory in hand of the consignee should be valued at NRV. Also see that the allowance has been made for damaged and obsolete goods in making the valuation.
- e) See that goods in hand with the consignee have been shown separately under the head inventories.

Vouching of 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 authorized 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 authorization 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 AS 11 "The Effects of Changes in Foreign Exchange Rates".

Receipt of Capital Subsidy:

- (1) Check the application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.
- (2) Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.
- (3) 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.
- (4) Check relevant entries for receipt of subsidy.
- (5) 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.

Provision of Taxes:



1. 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.
2. Review adjustments, expenses, disallowed special rebates, etc. with particular reference to the last available completed assessment.
3. Examine relevant records and documents pertaining to advance tax, self-assessment tax and other demands.
4. Compute tax payable as per the latest applicable rates in the Finance Act.
5. Ensure that overall provisions on the date of the balance sheet is adequate having regard to levis current year provision, advance tax paid, assessment orders, etc.
6. 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/verify payment of taxes?

Answer.

- 1) 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.
- 2) Payments or advance payments of income-tax should also be verified with the notice of demand and the receipted challan acknowledging the amount paid.
- 3) 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.
- 4) 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.
- 5) 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.
- 6) 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 will you vouch/verify the following:

- a) Advertisement Expenses
- b) Sale of Scrap

Answer.

Vouching Of 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 that it has been rent 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.

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.

Issue Of Shares at Premium

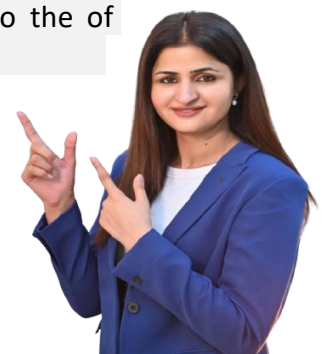
- Where a company has issued shares at a premium, whether for cash or otherwise, aggregate amount of the premium received on those shares shall be transferred to securities premium account.
- **As per Sec. 52 of Companies Act, 2013 the securities premium account may be applied by the company for the following purposes:**
 - a) issue of unissued shares of the company to the members of the company as fully paid bonus shares;
 - b) writing off the preliminary expenses of the company;
 - c) writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
 - d) 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 u/s 68.
- 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.

Verification of Addition to Property, Plant & Equipment:

- (1) 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 of respective entity.



- (2) 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.
- (3) The auditor should insist and verify the original title deeds for all immovable properties held as at the balance sheet date.
- (4) In case the entity has given such immovable 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 immovable property as security.
- (5) In addition, the auditor should also verify the register of charges, available with the entity to assess bonbons the PPE that has been given as security to any third parties.

Question 7. Write the audit Procedure for verification of existence of Trade Receivables.

Answer.

Verification of Existence of Trade Receivable:

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.
- Ask for a period-end accounts receivable ageing report and trace the balance as per the report to the general ledger.
- 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.
- If any large balance is due for a long time, auditor should ask for reasons and justification for the same.
- 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.
- 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.
- 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. The Company should be asked to investigate and reconcile the discrepancies, if any.
- Where no reply is received, the auditor should perform alternate procedures regarding the balances.

This could include:

- a) Agreeing the balance to cash received subsequently;
 - b) 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)
- 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.
 - 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 2023-24. 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 basic disclosure requirements with respect to such loans required by Schedule III to the Companies Act, 2013. What should Mr. Manik advise Mr. Viaan?

Answer.

Disclosure Requirements with Respect to Loans

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

- repayable on demand or
- 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. How is "Cash and cash equivalents" disclosed in the Financial Statements as required under Schedule III (Part I) to Companies Act, 2013?

OR

What are the required disclosures for Cash & Cash equivalents to be made by the company as per Schedule III (Part I) to Companies Act, 2013?

Answer.

Disclosure Of Cash and Cash Equivalent

Auditor is required to ensure whether the following disclosures as required under Schedule III (Division I) to Companies Act, 2013 have been made:

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



- Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
- Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.
- 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.

Disclosure Requirement with Respect to The Ageing Schedule of the Trade Receivables

- 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:**

Particulars	(Amount in Rs)					
	Outstanding for following periods from due date of payment [#]					Total
(j) Undisputed Trade receivables - considered good	Less than 6 months	6 months-1 year	1-2 years	2-3 years	More than 3 years	
(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 2023-24. 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.

Disclosures W.R.T. Capital-Work-In Progress

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

CWIP ageing schedule

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

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

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

(Amount in Rs)					
	To be completed in				
CWIP	Less than 1 year	Less than 1-2 years	Less than 2-3 years	More than years 3 years	
Projects 1					
Projects 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 31.03.2024. What audit procedures should the statutory auditor of the company perform?

Answer.

Audit Procedure to Establish the Ownership Rights



1. Vouch recorded purchases to underlying documentation (purchase requisition, purchase order, receiving report, vendor invoice and cancelled cheque or payment file).
2. Evaluate the consigned goods.
3. Examine client correspondence, sales and receivables records, purchase documents.
4. Determine existence of collateral agreements.
5. Review consignment agreements.
6. Review material purchase commitment agreements.
7. 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.
8. For instances of inventory held by third party, 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.



06

Audit Documentation

Question 1. The form, content and extent of audit documentation depend upon number of factors . List out any four such factors.

Answer.

Factors affecting Form, Content and Extent of Audit Documentation

- SA 230 "Audit Documentation" deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements.
- **Accordingly, the various factors that may affect form, content and extent of audit documentation are following:**
 - 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.

The following are the purpose of Audit documentation:

- a) Assisting the engagement team to plan and perform the audit.
- b) Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.
- c) Enabling the engagement team to be accountable for its work.
- d) Retaining a record of matters of continuing significance to future audits.
- e) Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
- f) Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

Question 3. Define audit documentation. Also give some examples.

Answer.

Audit Documentation

SA 230 "Audit Documentation" defines the term as audit documentation as record of:



- audit procedures performed;
- relevant audit evidence obtained; and
- the conclusions the auditor reached.

Examples Of Audit Documentation Include

- a) Audit programmes.
- b) Analyses.
- c) Issues memoranda.
- d) Summaries of significant matters.
- e) Letters of confirmation and representation.
- f) Checklists.
- g) 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.

Completion Memorandum (Audit Documentation Summary)

- SA 230 "Audit Documentation" defines the term as "Record of audit procedures performed, relevant audit evidence obtained and the conclusions the auditor reached".
- **Accordingly, auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (known as a completion memorandum) that describes:**
 - a) the significant matters identified during the audit and
 - b) how they were addressed.
- Such a summary may facilitate effective and efficient reviews and inspections of the audit documentation, particularly for large and complex audits.
- Preparation of such a summary may assist the auditor's consideration of the significant matters.
- Further, the preparation of such a summary may assist the auditor's consideration of the significant matters.
- It may also help the auditor to consider whether, in light of the audit procedures performed and conclusions reached, there is any individual relevant SA objective that the auditor has not met or is unable to meet that would prevent the auditor from achieving the auditor's overall objective.



07

Completion and Review

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”.

Answer.

Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency

- 1) The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- 2) The susceptibility to loss or fraud of the related asset or liability.
- 3) The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- 4) The financial statement amounts exposed to the deficiencies.
- 5) The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- 6) **The importance of the controls to the financial reporting process, for example:**
 - General monitoring controls (such as oversight of management)
 - 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).
- 7) The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.

Question 2. In what ways an effective two-way communication between auditor and those charged with governance is important?

Answer.**Role of Communication:**

Effective two-way communication is important in assisting:

- a) Auditor and TCWG in understanding matters related to the audit and in developing a constructive working relationship;
- b) Auditor in obtaining from TCWG information relevant to the audit. For example, TCWG may assist auditor in understanding entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and
- c) TCWG in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the RoMM.



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 a scenario?

Answer.

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 SAAE regarding management's use of the going concern basis of accounting in the preparation of the F.S.

Question 4. Discuss documentation requirements for an auditor regarding misstatements identified during audit under SA 450.

Answer.

Documentation Requirements Regarding Misstatements Identified During Audit

Documentation shall include:

- (1) Amount below which misstatements would be regarded as clearly trivial;
- (2) All misstatements accumulated during the audit and whether they have been corrected; &
- (3) 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.

Answer.

Meaning Of "Date the Financial Statements Are Issued

- 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



08

Audit Report

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.

Forming An Opinion

- Auditor shall form an opinion on whether the F.S. are prepared in all material respects in accordance with the applicable FRF.
- To form this opinion, auditor needs to conclude as to whether he has obtained reasonable assurance that F.S. as a whole are free of material misstatements, whether due to fraud or error.
- **The conclusion shall take into account:**
 - a) The auditor's conclusion, in accordance with SA 330, whether sufficient appropriate audit evidence has been obtained;
 - b) The auditor's conclusion, in accordance with SA 450, whether uncorrected misstatements are material, individually or in aggregate; and
 - c) 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.

Qualitative Aspects of The Entity's Accounting Practices

- a) Management makes a number of judgements about the amounts and disclosures in the F.S.
- b) SA 260 contains a discussion of qualitative aspects of accounting practices.
- c) In considering qualitative aspects of the entity's accounting practices, auditor may become aware of possible bias in management's judgements. Auditor may conclude that cumulative effect of lack of neutrality, together with effect of uncorrected misstatements, causes the F.S. as a whole to be materially misstated.
- d) SA 540 addresses possible management bias in making accounting estimates. Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on reasonableness of individual accounting estimates.

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



Answer.

Factors Affecting the Decision Regarding Type Of Modified Opinion:

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

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

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.

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

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

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.

Indicators Of Lack of Neutrality

- 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:

- 1) The selective correction of misstatements brought to management's attention during the audit.

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.



2) 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.

Opinion Section in the Auditor's Report:

As per SA 700 "Forming an Opinion and Reporting on Financial Statements", Opinion Section of the Auditor's Report shall include the auditor's opinion, and shall have the heading "Opinion" and also cover the following:

- Identify the entity whose FS have been audited;
- State that Financial Statements have been audited;
- Identify title of each statement that comprises F.S;
- Refer to the notes, including the summary of significant accounting policies; and
- Specify date of period covered by each Financial Statement.

Question 7. Define emphasis of matter paragraph and how it should be disclosed in the independent auditor's report.

Answer.

Emphasis of Matter Paragraph:

- SA 706 "Emphasis of matter Paragraph and Other Paragraphs in the Independent Auditor's Report" defines Emphasis of Matter paragraph as Para included in Auditor's Report that refers to a matter appropriately presented/disclosed in financial statement that in the auditor's judgment is of such importance that it is fundamental to users' understanding of financial statements.
- EOM paragraph is not a substitute for need for expression of qualified opinion, adverse opinion or Disclaimer of opinion or the disclosures to be made by management in financial statements as required by applicable FRF.

Circumstances when EOM Para can be included in Auditor's Report:

- An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- Early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

Disclosure Of Emphasis of Matter Paragraph In The Auditor's Report:



As per SA 706, when the auditor includes an EOM paragraph in the auditor's report, the auditor shall:

- Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
- 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 the financial statements; and
- 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 them.

Answer.

Specific Evaluations by The Auditor:

The auditor shall evaluate whether:

- 1) The financial statements adequately disclose the significant accounting policies selected and applied;
- 2) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- 3) The accounting estimates made by management are reasonable;
- 4) The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- 5) 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 not financial statements; and
- 6) 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.

Responsibilities Of Management For The Financial Statements

- As per SA 700 "Forming an Opinion & Reporting on 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, TCWG, on which an audit in accordance with SAS is conducted. Management and, where appropriate, TCWG 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.

"Responsibilities of Management for the Financial Statements" section of auditor's report shall describe management's responsibility for:

- 1) Preparing the F.S. in accordance with the applicable FRF, and for such internal control as management determines is necessary to enable the preparation of F.S. that are free from material misstatement, whether due to fraud or error; and
- 2) 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 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 considered as a substitute or alternative for a number of important items. What are those items?

Answer.

Scope Of SA 701

- As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", 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) A substitute for disclosures in the F.S. that the applicable FRF requires management to make, or that are otherwise necessary to achieve fair presentation;
 - b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705;
 - c) 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
 - d) 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.

Basis For Opinion Section in the Auditor's Report:

As per SA 700 "Forming an Opinion and Reporting on Financial Statements", 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 SA;
- (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. The statement shall refer to the Code of Ethics issued by ICAI; and
- (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.

Adverse Opinion And A Qualified Opinion

- 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.
- SA 705 - "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 and its subsidiaries, associates and jointly controlled entities, which comprise the consolidated balance sheet as at March 31, 2024, 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, 2024, 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, which comprise the balance sheet as at March 31, 2024, 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 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 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, 2024 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.

Branch Auditor

- Sec. 143(8) 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.
- **Accordingly, where a company has a branch office, the accounts of that office shall be audited by either of following:**
 - a) the auditor appointed for the company, i.e. company auditor, or
 - b) any other person qualified for appointment as an auditor of the company under this Act, or
 - c) 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.
- 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 audit, the joint auditors should discuss and develop a joint audit plan." Discuss the points to be considered in developing the joint audit plan by the joint auditors.

OR

PQR & Associates and MNO & Co., both firms of Chartered Accountants, have been appointed as joint auditors of Gama and Beta Limited. 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 with reference to the Standards on Auditing.

Answer.

Points To Be Considered in Developing the Joint Audit Plan

As per SA 299 "Joint Audit of Financial Statements" Prior to the commencement of the audit, the joint auditors shall discuss and develop a joint audit plan.

In developing the joint audit plan, the joint auditors should:

- a) Identify division of audit areas and common audit areas;
- b) Ascertain the reporting objectives of the engagement;



- c) Consider and communicate among all joint auditors the factors that are significant in directing the engagement team's efforts;
- d) Consider the results of preliminary engagement activities, or similar engagements 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.

Advantages of 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.
- **Other advantages of joint audit are:**
 - a) Sharing of expertise.
 - b) Advantage of mutual consultation.
 - c) Lower workload.
 - d) Better quality of performance.
 - e) Improved service to the client.
 - f) In respect of MNCs, 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.
 - g) Lower staff development costs.
 - h) Lower costs to carry out the work.
 - i) A sense of healthy competition towards a better performance.

Question 16. Discuss the reporting requirements regarding statutory dues and Internal Audit as per CARO, 2020.

OR

Discuss the reporting requirements as per CARO, 2020, regarding:

- (a) disputed and undisputed statutory dues and
- (b) internal audit system of the company.

Answer.

Reporting Under CARO, 2020 Regarding Statutory Dues [Para 3(VII)]

- Whether the company is regular in depositing undisputed statutory dues including GST, provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding



statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated.

- Where statutory dues referred above have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

Reporting Requirements Regarding Internal Audit [Para 3 (XIV)]

- Whether the company has an internal audit system commensurate with the size and nature of its business.
- Whether the reports of the Internal Auditors for the period under audit were considered by the a statutory auditor.

Question 17. Discuss which class of companies are specifically exempt from the applicability of CARO 2020?

OR

Mr. Chetan is appointed as an auditor of Spot Limited, a small company. Mr. Chetan is aware that CARO 2020 is not applicable to small company. List out the classes of companies that are specifically exempt from the applicability of CARO 2020.

Answer.

Companies Are Specifically Exempt from the Applicability of CARO 2020

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;
- (ii) an insurance company;
- (iii) a company licensed to operate under section 8 of the Companies Act;
- (iv) a One Person Company and a small company; 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 1 crore as on the balance sheet date and
 - which does not have total borrowings exceeding 1 crore 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 10 crore during the financial year as per the financial statements.



09 Special Features of Audit of Different Types of Entities

Question 1. Discuss, in what circumstances, Central Registrar can hold an inquiry into working and financial condition of a multi-state cooperative society.

Answer.

Circumstances When Inquiry May Be Hold or Ordered

- **Central Registrar may, on a request from**
 - a) a federal cooperative to which multi-state cooperative society is affiliated; or
 - b) a creditor; or
 - c) not less than 1/3rd of the members of the board; or
 - d) not less than 1/5th of the total number of members of a multi-state cooperative society
- hold an inquiry or direct some person authorised by him by order in writing in this behalf to hold an inquiry into the constitution, working and financial condition of a multi-state cooperative 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.

Answer.

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) **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.
- 7) **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.
- 8) **Purchases:** - Vouch **purchase** of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.



- 9) **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.
- 10) **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.
- 11) **Investments:** - Inspect the share scrips and bonds in respect of **investments**, check their current values for disclosure in final accounts; also ascertain that the arrangements for their safe custody are satisfactory.
- 12) **Management Powers:** - Examine the **financial powers of the secretary** and, if these have been exceeded, report specific case for confirmation by the Managing Committee.

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.

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.

Answer.

Verification Of Common Amenities Used by Gift Shop Owner to The Hotel

1. Review the lease agreement between the hotel and the gift shop owner to understand the terms and conditions related to common amenities.
2. Assess the internal controls in place at the hotel and the gift shop to track and report payments for common amenities accurately.
3. Physically observe the common amenities and inquire about their usage with both the hotel management and the gift shop owner.
4. Obtain a breakdown of common expenses incurred by the hotel, including maintenance, security, utilities, and shared amenities.
5. Communicate with hotel management to confirm the receipt of payments from the gift shop owner for common amenities.
6. Review invoices and contracts from vendors providing common amenities to ensure that the gift shop owner is meeting their financial obligations.



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.

OR

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?

OR

Mention any 8 special points which you as an auditor would look into while auditing the books of account of Hospital.

OR

You have been appointed auditor of M/s. Divine Children Hospital. Discuss any four important points that would attract your attention while audit.

Answer.

Special Points in Audit of books of account of Hospital

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 e.g., copies of patient's bill, counterfoils of dividend and other interest warrants, copies of rent bills etc.
3. **Income from Investments, rent etc.:** See by 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. **Authorisation and sanctions:** Vouch all purchases and expenses and verify that the capital expenditure incurred only with the prior sanction of the trustees of 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, 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 ensure 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 the 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?

OR

While planning the audit of an NGO, the auditor may focus on Knowledge of the NGO's work, its mission and vision, Updating knowledge of relevant statutes especially with regard to recent amendments, circulars etc. Explain the other relevant points the auditor needs to focus while planning the audit of NGO.

Answer.

Points To Be Concentrated While Planning an Audit of an NGO:

- 1) Knowledge of the NGO's work, its mission and vision, areas of operations & environment in which it operates.
- 2) 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.
- 3) Reviewing its legal form and its MOA, AOA, rules and Regulations.
- 4) Reviewing the Organisation chart, Manuals relating to financial and administrative matters.
- 5) Examination of minutes of meetings of Managing Committee/ Governing Body to ascertain the impact of decisions on the financial records.
- 6) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
- 7) Setting of materiality levels for audit purposes.
- 8) Nature and timing of reports or other communications.
- 9) Involvement of experts and their reports.
- 10) Review the previous year's Audit Report.

Question 7. 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.

OR



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?

OR

Mention any 8 special points which you as an auditor would look into while auditing the books of account of Hospital.

OR

You have been appointed auditor of M/s. Divine Children Hospital. Discuss any four important points that would attract your attention while audit.

Answer.

Special Points in Audit of books of account of Hospital

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 e.g., copies of patient's bill, counterfoils of dividend and other interest warrants, copies of rent bills etc.
3. **Income from Investments, rent etc.:** See by 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. **Authorisation and sanctions:** Vouch all purchases and expenses and verify that the capital expenditure incurred only with the prior sanction of the trustees of 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, 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 ensure 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 the 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 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.

OR

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.

Special Points to Be Examined in Audit of a Charitable Institution:

- Determine the constitution under which the charitable institution has been established.
- Ensure that the institution is being managed in the manner contemplated by the law under which it has been established.
- Examine the system of internal check, especially as to accounting of receipts.
- Verifying in detail the income and ensure that the amounts received have been deposited in the bank regularly and promptly.

Subscriptions And Donations

- Determine whether any changes made in amount of annual or life membership subscription during the year.
- Ensure the following in relation to official receipts;
 - issue of official receipts
 - adequate control is imposed over unused receipt books;
 - obtain all receipt books covering the period under review;
 - test check the counterfoils with the cash book;
 - cancelled receipts to be specially looked into;
 - obtain the printed list of subscriptions and donations and agreeing them with the total collections shown in the accounts;
 - examine the system of internal check regarding moneys received from box collections, flag days, etc.; and
 - verifying the total subscriptions and donations received with any figures published in reports, etc. issued by the charity.

Question 9. Explain in detail the duties of Comptroller and Auditor General of India.

Answer.

Duties of Comptroller and Auditor General:



- 1) **Compilation and submission of Accounts:** C&AG should compile the accounts pertaining to annual receipts and disbursements of the Union or State or Union Territory, and submit these to the President or Governor or Administrator.
- 2) **Rendering Assistance in Accounts Maintenance:** C&AG should provide such information to the Union or State or Union Territory, as they may require from time to time and render such assistance for preparing annual F.S. as they reasonably ask for.
- 3) **Auditing and Reporting:**
The C & AG should audit and report on:
 - a) All the expenditures from Consolidated Fund of India/State/Union Territory having a Legislative Assembly and to determine whether the monies disbursed were legally available for and applicable to the purpose for which they are applied.
 - b) All the transactions of Union or State pertaining to Contingency Funds and Public Accounts.
 - c) All Trading, Manufacturing, Profit & Loss A/cs & Balance Sheets & other subsidiary accounts kept in any department of a Union or State.
- 4) **Audit of Receipts and Expenditure of substantially financed entities:** Where any body or authority is substantially financed by grant or loans from the Consolidated Fund of India/State/Union Territory, C&AG shall audit and report on all receipts and expenditure of that body or authority.
- 5) **Audit of Grants or Loans:** Where any grant or loan is given for any specific purpose from the Consolidated Fund of India/State/Union Territory to any authority or body, not being a Foreign State or International Organisation, C&AG shall scrutinize procedures by which the sanctioning authority satisfies itself as to the fulfilment of the conditions subject to which such grants or loans were given.
- 6) **Audit of Receipts of Union or States:** C&AG shall audit all receipts which are payable into the Consolidated Fund of India/State/Union Territory and satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection & proper allocation of revenue and are being duly observed.
- 7) **Audit of Accounts of Stores and Stock:** C&AG shall have authority to audit and report on the accounts of stores and stock kept in any office or department of the Union/State.
- 8) **Audit of Govt. Companies and Corporations:** Duties and powers of C&AG in relation to audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013.

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.

OR

An NGO based in Kolkata collected significant donations for flood victims in Bihar. The funds were distributed to various NGOs operating in Bihar to support relief efforts. You have been appointed as the auditor for this NGO's accounts for the year in which it



collected and disbursed these donations. Draft an audit program to audit the receipts of donations and the remittance of the collected funds to different NGOs.

Answer.

Audit of Donation Receipts:

- 1) **Internal Control System:** Examine internal control system particularly with reference to division of responsibilities in respect of authorized collection of donations, custody of receipt books and safe custody of money.
- 2) **Custody of Receipt Books:** Examine the 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.
- 3) **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.
- 4) **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.
- 5) **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.
- 6) **VI Foreign Contributions,** if any, to receive special attention to compliance with applicable laws and regulations.

Remittance of Donations to Different NGOs:

- a) **Mode of Sending Remittance:** Ensure that all remittances are made through account payee Cheques. Remittances through Demand Draft need to be scrutinized thoroughly with reference to recipient.
- b) **Confirming Receipt of Remittance:** Ensure that all remittances are supported by receipts and acknowledgements.
- c) **Identity:** Verify address, Registration Number, etc. of recipient NGO.
- d) **Direct Confirmation Procedure:** Send confirmation letters to entities to whom donations have been paid.
- e) **Donation Utilisation:** Ensure that amount of donation is utilised for providing relief to Tsunami victims.
- f) **NGOs' Selection:** Check 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.

Areas Of Consideration While Auditing ROOM SALES During the Audit of a Hotel

- Charge for room sales is normally posted to guest bills by the receptionist/front office. 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, housekeeper prepares a daily report of the rooms which were occupied the previous night. 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.
- Ensure compliance with the provisions of FEMA and RBI if receipts are in foreign currency. Ensure application of proper Conversion rate.
- Special emphasis to be laid on receipts through Credit Cards.
- Auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts.
- Auditor should ensure that proper records are maintained for booking of halls and other premises for special parties and recovered on the basis of the tariff.

Question 12. You are auditing the Books of accounts of Karla Multiplex which runs 15 Film shows every day. 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.

1. Review the agreement between Karla Multiplex and film distributors to understand the terms and conditions governing the relationship.
2. Confirm that the agreement clearly outlines the rights and obligations of both parties regarding film screenings.
3. Ensure that the multiplex has the proper rights to exhibit the films and that it complies with licensing agreements.
4. Examine the revenue sharing structure between the multiplex and film distributors. Verify the agreed-upon percentage or fixed amount for each film screening.
5. Vouch payments on account of film hire with bills of distributors and in the process, the agreements concerned should be referred to.
6. Confirm that any film rental advances or deposits required by the distributors are properly accounted for and recorded in the books.
7. Examine unadjusted balance out of advance paid to the distributors against film hire contracts to see that they are good and recoverable
8. Ensure a provision in respect of advances that are considered irrecoverable are being made by the management.

Question 13. Define Government Audit and explain its objectives.

Answer.

Government Audit and Its Objectives

- Government auditing may be defined as 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 of Government audit includes the following:**

- 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:** The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration.

Question 14. 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.

OR

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.

Special Points To Be Examined In Audit Of A Charitable Institution:

- a) Determine the constitution under which the charitable institution has been established.
- b) Ensure that the institution is being managed in the manner contemplated by the law under which it has been established.
- c) Examine the system of internal check, especially as to accounting of receipts.
- d) Verifying in detail the income and ensure that the amounts received have been deposited in the bank regularly and promptly.

Subscriptions And Donations

- a) Determine whether any changes made in amount of annual or life membership subscription during the year.
- b) Ensure the following in relation to official receipts;
 - issue of official receipts
 - adequate control is imposed over unused receipt books;
 - obtain all receipt books covering the period under review;
 - test check the counterfoils with the cash book;
 - cancelled receipts to be specially looked into;
 - obtain the printed list of subscriptions and donations and agreeing them with the total collections shown in the accounts;



- examine the system of internal check regarding moneys received from box collections, flag days, etc.; and
- verifying the total subscriptions and donations received with any figures published in reports, etc. issued by the charity.

Other Incomes

a) **Legacies and Grants:** Verify amounts of legacies, grants, charities etc. received by reference to correspondence with any figures and other available information.

b) **Investment Income:**

- Vouch amounts received with dividend and interest counterfoils.
- Check calculations of interest received on securities bearing fixed rates of interest.
- Check that appropriate dividend has been received where any investment has been sold ex- dividend or purchased cum-dividend.
- Compare dividend received with schedule of investments making special enquiries into any investments held for which no dividend has been received.

c) **Rental Income:** If any property is given or taken on rent, the tenancy agreement should be checked to determine the accuracy of rent received or paid.

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

- Vouching the refund with correspondence with the Income-tax department; and
- Checking the calculation of the repayment of claims.

e) **Expenditures**

- In any grant is being allowed to any person, verify whether grant have been paid only for a charitable purpose or purposes falling within the purview of the objects.
- Verify the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test basis.
- Verifying the cash and bank balances.

Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.

Question 15. In case of Government entities, audit of accounts of stores and inventories has been developed as a Slide part of expenditure audit. Discuss about the duties and responsibilities entrusted to C&AG.

Answer.

Audit Of Accounts of Stores and Inventories in Government Companies

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:



- (i) to ascertain whether the Regulations governing purchase, receipt and issue, custody, sale and inventory taking of stores are well devised and properly carried out.
- (ii) to bring to the notice of the government any deficiencies in quantities of stores held or any defects in the system of control.
- (iii) to verify that the purchases are properly sanctioned, made economical and in accordance with the Rules for purchase laid down by the competent authority.
- (iv) 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.
- (v) 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.

Question 16. The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. Explain stating important objectives of audit of such bodies.

OR

Local Fund Audit Wing of a State Government has appointed you to audit the accounts of one of the Local bodies governed by it. As an auditor, what will be your reporting areas?

OR

State the important objectives of Local Bodies Audit.

Answer.

Important Objectives of Local Body's Audit:

- 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.

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.

OR

You are auditor of a college running different courses 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 and also explain two other points to verify fees from students.

Answer.



Special Points in audit of Educational Institutions (School):

a) General

- 1) In the case of school or college, examine the Trust Deed or Regulations, and note all the provisions affecting accounts.
- 2) In the case of a university, refer to the Act of Legislature and the Regulation framed thereunder.
- 3) Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.

b) Fee from Students

- Check names entered in the Students Fee Register and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- Check fees received through comparison of counterfoils of receipts issued with entries in the Cash Book.
- Examine that fee paid in advance, if any, have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- Ensure that admission fees received during the period has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
- Check whether scholarships and concessions are granted by authorised person, having regard to the Rules prepared by the Managing Committee.
- Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority.
- Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded.

c) Other Receipts/Grants & Donations

- Verify rental income from landed property with the rent rolls, etc.
- Vouch income from endowments and legacies, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
- Verify any Government or local authority grant with the memo of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons thereof.

d) Expenditure

- Verify that the Provident Fund money of the staff has been invested in appropriate securities.
- Vouch donations, if any with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
- Vouch, all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
- Vouch, in the usual manner, all establishment expenses and enquire into any unduly heavy expenditure under any head. If there was any annual budget prepared, see that any excess under any head over the budgeted amount was duly sanctioned by the Managing Committee. If not, bring it to the Committee's notice in your report.
- See that increase in the salaries of the staff have been sanctioned and minute by the Committee.



e) Assets & Liabilities

- Report any old heavy arrears on account of fees, dormitory rents, etc. to the Managing Committee.
- 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.
- 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.
- Ascertain that the system ordering inspection on receipt and issue of provisions, foodstuffs, clothing and other equipment is efficient and all bills are duly authorized and passed before payment.
- 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.

f) Compliances

- Confirm that the refund of taxes deducted from the income from investment (interest on securities etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
- Verify annual statements of account and, while doing so examine that separate statements of account have been prepared as regards Economically-weak Students Fund, Games Fund, Hostel and Provident Fund of staff, etc.

Question 18. State the points which merit consideration in the audit of a CLUB w.r.t its members.

Answer.

Points which merit consideration in the audit of a CLUB w.r.t its members:

1) Entrance Fee: Vouch the receipt on account of entrance fees with:

- a) members' applications, counterfoils issued to them, as well as
- b) on a reference to minutes of the Managing Committee.

2) Subscriptions: Vouch members' subscriptions with the

- a) counterfoils of receipt issued to them,
- b) trace receipts for a selected period to the Register of Members;
- c) also reconcile the amount of total subscriptions due with the amount collected and that outstanding.

3) Arrears of Subscriptions: Ensure that:

- a) arrears of subscriptions for the previous year have been correctly brought over and
- b) 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 for med's se amount considered irrecoverable should be mentioned in the Audit Report.



- 6) 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.
- 7) 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.
- 8) Purchases:** Vouch purchase of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.
- 9) Margins earned:** Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale price so as to confirm that normal rates of gross profit have been earned on their sales. Inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.
- 10) 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.
- 11) Investments:** Inspect the share scrips and bonds in respect of investments, check their current values for disclosure in final accounts; also ascertain that the arrangements for their safe custody are satisfactory.
- 12) Management Powers:** Examine the financial powers of the secretary and, if these have been exceeded, report specific case for confirmation by the Managing Committee.



10

Audit of Banks

Question 1. Discuss outline of audit approach including audit procedures while auditing “provisions and contingencies” in financial statements of a bank.

OR

You are appointed as statutory audit of DEF Bank Limited for the year 2023-24. As an auditor how will | you verify provision created by DEF Bank Limited?

Answer.

Audit Procedure for Verification of Provisions and Contingencies

- (1) Ascertain compliance with the various regulatory requirements for provisioning as contained in the various circulars.
- (2) Obtain an understanding as to how the Bank computes provision on standard assets and non-performing assets. It includes the basis of the classification of loans into standard, sub-standard, doubtful and loss assets.
- (3) Obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balance with the general ledger.
- (4) Obtain statement of computation of tax provision 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.
- (5) Other provisions for expenditure should be examined 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.

Importance Of Implementation of KYC Norms

- 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 ("KYC 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.

Peculiarities Involved In Banking Operations

- Voluminous and complex transactions,
- Wide geographical spread of banking network,
- Diversified and large range of products and services offered,
- Extensive use of technology,
- Strict vigilance and compliance.

Question 4. Is statutory auditor of a bank required to report on the requirements relating to Companies (Auditor's Report) Order, 2020?

Answer.

Reporting On the Requirements Of CARO, 2020

Reporting requirements relating to the CARO 2020 is not applicable to a banking company.

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.

Out Of Order in Relation to Classification of Advances

- **An account should be treated as 'out of order' if:**
 - a) outstanding balance remains continuously in excess of the sanctioned limit/drawing power; or
 - b) if there are no credits continuously for 90 days as on the date of Balance Sheet; or
 - c) credits are not enough to cover the interest debited during the same period.
- **Example:** A Ltd. has been sanctioned a Cash Credit Facility by ADB Bank Ltd. for 50 lacs but as per the Stock Statements furnished for the last quarter the Bank has calculated the Drawing power to be 42 Lakhs.
- In this case, the account would be **termed as OUT OF ORDER if:**
 - a) outstanding balance remains continuously in excess of 50 lacs/42 lacs whatever the case may be; or
 - b) outstanding balance in the account is less than 42 lacs but there are no credits or any payments deposited into this account continuously for 90 days as on the date of Balance Sheet; or
 - c) credits are there upto say 2 lakhs but are not enough to cover the interest debited during the same period which is around 5 lakhs.

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.

Rbi - Regulating Body

In India, banking industry is regulated by the Reserve Bank of India (RBI) known as the Central Bank.

RBI is responsible for:

- (a) development and supervision of the banks and non-banking financial institutions
- (b) determining the monetary and credit policies.
- (c) to regulate the activities of commercial and other banks.

Important functions of RBI are:

- (a) issuance of currency;
- (b) regulation of currency issue;
- (c) acting as banker to the Central and State governments, commercial and other types of banks including term-lending institutions.

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 misstatements of the financial statements. All these discussions should be appropriately documented for future reference". Explain.

Answer.

Engagement Team Discussions

Engagement team should hold discussions to gain better understanding of banks 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 should be done on the susceptibility of the bank's financial statements to material misstatements. These discussions are ordinarily done at the planning stage of an audit.

Benefits Of Discussion:

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

Matters To Be Discussed

- 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.

Question 8. Write a short note on reversal of income under bank audit.

Answer.

Reversal Of Income:

- 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.
- 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.
- 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).
- 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.



11 Ethics and Terms of Audit Engagements

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

Answer.

Principles Based Approach Vs Rules Based Approach to Ethics:

- Ethical guidance may follow principles-based approach or rules-based approach.
- 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. Rules-based approach is somewhat rigid as it may not be possible to deal with every practical situation relying upon rules.

Question 2. How application of professional skepticism throughout audit is helpful in reducing audit risk?

Answer.

Professional Skepticism

Professional skepticism refers to an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

It Reduces risk of:

- a) Overlooking unusual circumstances.
- b) Over generalizing when drawing conclusions from audit observations.
- c) Using inappropriate assumptions in determining NTE of audit procedures & evaluating the results thereof.

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 of accepting initial audit engagement. Discuss responsibility of auditor in this regard in context of SA 210.

Answer.

Terms Of Engagement In Recurring Audits

- In case of recurring audits, 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.



- 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:
 - a) Any indication that the entity misunderstands the objective and scope of the audit.
 - b) Any revised or special terms of the audit engagement.
 - c) A recent change of senior management.
 - d) A significant change in ownership.
 - e) A significant change in nature or size of the entity's business.
 - f) A change in legal or regulatory requirements.
 - g) A change in the financial reporting framework adopted in the preparation of the financial statements.
 - h) A change in other reporting requirements.
- In the given case, auditor noticed that there is substantial change in management and also client has ventured into areas of business activity which were not present at time of accepting initial audit engagement.
- **Conclusion:** -Auditor may decide to send a new audit engagement letter.

Question 4. How does SQC 1 ensure that independence in engagements is not breached by an audit firm?

Answer.

Ensuring Independence

- As per SQC 1, firm should establish policies and procedures designed to provide it with reasonable assurance that the firm and its personnel maintain independence where required by the Code.
- **Such policies and procedures should enable the firm to:**
 - a) Communicate its independence requirements to its personnel
 - b) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.
- There should exist a mechanism in the firm by which EPs provide the firm with relevant information about client engagements and personnel of firm promptly notify firm of circumstances and relationships that create a threat to independence. All breaches of independence should be promptly notified to firm for appropriate action. Its objective is to ensure that independence requirements are satisfied.
- At least annually, the firm should obtain written confirmation of compliance with its policies and procedures on independence from all firm personnel required to be independent in terms of the requirements of the Code.

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?

Answer.

Leadership Responsibilities For Quality On Audits



As per SA 220 "Quality Control for an Audit of Financial Statements" the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. Actions of engagement partner and appropriate messages to the other members of the team, in taking responsibility for the overall quality on each audit engagement, emphasise:

- **The importance to audit quality of:**

- a) Performing work that complies with professional standards and regulatory and legal requirements;
- b) Complying with the firm's quality control policies and procedures as applicable;
- c) Issuing auditor's reports that are appropriate in the circumstances; and
- d) The engagement team's ability to raise concerns without fear of reprisals; and
- e) The fact that quality is essential in performing audit engagements.

