

CA INTER

Auditing

Learn Contextually

QUESTION BANK (ADDITIONAL QUESTIONS)



**Intensity,
Consistency**





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AUDIT - COMPLIER

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Questions From RTP's, MTP's, QP's

Question 20

(MTP 1 May '25)

An audit is a reasonable assurance engagement, whereas a review is a limited assurance engagement. Both types of assurance engagement provide assurance to users, but they differ in the degree of assurance offered.

In light of this, explain the difference between reasonable assurance engagement and limited assurance engagements, with examples.

Answer:

Difference between Reasonable Assurance Engagement and Limited Assurance Engagement:

Reasonable assurance engagement	Limited assurance engagement
Reasonable assurance engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement.
It draws reasonable conclusions on the basis of sufficient appropriate evidence.	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
Example of reasonable assurance engagement is an audit engagement, Audit of financial statements.	Example of limited assurance engagement is review engagement, Review of financial statements.

Question 21

(MTP 2 May '25)

The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. Explain.

Answer:

Inherent limitations of audit: The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error. These fundamental limitations arise due to the following factors: -

- Nature of financial reporting:** Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.
- Nature of Audit procedures:** The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence. For example, an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence.

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

carefully organized schemes.

3. **Not in nature of investigation:** Audit is not an official investigation. Hence, auditor **cannot obtain absolute assurance** that financial statements are free from material misstatements due to frauds or errors.
4. **Timeliness of financial reporting and decrease in relevance of information over time:** The relevance of information decreases over time and auditor cannot verify each and every matter. Therefore, a **balance** has to be struck **between reliability of information and cost** of obtaining it.
5. **Future events:** Future events or conditions may **affect an entity adversely**. Adverse events may seriously affect **ability of an entity to continue** its business. The business may **cease to exist** in future due to change in market conditions, emergence of **new business models or products** or **due to onset of some adverse events**.

Question 22

(Model TP 3 Marks)

PD & Co., Chartered Accountants, were **appointed as the statutory auditors** of MR Limited for the financial year 2023-24. **MR Limited included the following clause** in the appointment letter to the auditors: "The **Auditor shall be responsible for detecting the frauds** that may happen in the company during the financial year 2023-24."

The auditor **objected to inclusion of such a clause** in the appointment letter. Discuss in the light of scope of audit.

Answer:

Scope of Audit in detection of Fraud: In conducting audit of financial statements objectives of auditor, in accordance with SA 200, "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing" is **to obtain reasonable assurance** about whether the financial statements as a **whole are free from material misstatement**, whether due to fraud or error, thereby enabling the auditor to express an opinion.

An audit is **not an official investigation into alleged wrongdoing**. The auditor **does not have any specific legal powers of search** or recording statements of witness on oath which may be necessary for carrying out an official investigation.

Audit is **distinct from investigation**. Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.

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

Thus, **inclusion of such a clause** in the engagement letter is **uncalled for and outside the scope of audit**.

Question 23

(Model TP 4 Marks)

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

Answer:

In the given situation, Standards on Assurance Engagements will be applicable and such type of assurance

engagement provides only a "moderate" level of assurance.

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

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

Question 24

(Model TP 4 Marks)

RST Ltd., a mid-sized trading company, recently faced challenges in securing a bank loan due to doubts about the reliability of its financial statements. The management realised the importance of having audited accounts to build confidence among lenders and other stakeholders. Elucidate the benefits and need of an audit.

Answer:

Benefits and need of Audit:

- ✓ Audited accounts provide high quality information. It gives confidence to users that information on which they are relying is qualitative and it is the outcome of an exercise carried out by following Auditing Standards recognized globally.
- ✓ In case of companies, shareholders may or may not be involved in daily affairs of the company. The financial statements are prepared by management consisting of directors. As shareholders are owners of the company, they need an independent mechanism so that financial information is qualitative and reliable. Hence, their interest is safeguarded by an audit.
- ✓ An audit acts as a moral check on employees from committing frauds for the fear of being discovered by audit.
- ✓ Audited financial statements are helpful to government authorities for determining tax liabilities.
- ✓ Audited financial statements can be relied upon by lenders, bankers for making their credit decisions i.e. whether to lend or not to lend to a particular entity.

Question 25

(Model TP 3 Marks)

JK Ltd. was having a 'Pager' manufacturing plant and looking at the demand it was of the view that the company will grow continuously in future. But, with the introduction of mobile phones in the market, the plant was shut down completely. The shareholders of the company were of the view that auditor failed to perform their duty and have not informed to them about the company's inability to continue its business, otherwise they might not have suffered the loss. List down the factors giving rise to the inherent limitations due to which auditor cannot provide a guarantee that the financial statements are free from material misstatement due to fraud or error.

Answer: Already covered in MRP Qns

Question 26**(PYP Jan 25 5M)**

XYZ Ltd., a manufacturing company engaged in the production of various types of yarn, is planning to expand its operations into a new geographical market and also add new products. Company has prepared prospective financial information to be presented to potential investors and financial institutions to secure funding for the expansion.

XYZ Ltd. engages a firm of auditors to conduct an assurance engagement on this prospective financial information. During the engagement, the auditors reviewed the assumptions made by XYZ Ltd.'s management and issued a report.

Explain the key differences between prospective financial information and historical financial information. How does this distinction impact the level of assurance provided in an assurance engagement on prospective financial information? (5 Marks)

Answer:

Difference between "Historical financial information" and "Prospective financial information": The "Historical financial information" relates to information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods. The "Prospective financial information" relates to financial information based on assumptions about occurrence of future events and possible actions by an entity.

Therefore, historical financial information is rooted in past events which have already occurred whereas prospective financial information is related to future events.

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.

Prospective financial information relates to future events. While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future-oriented. The auditor is, therefore, not in a position to express an opinion as to whether the results shown in the prospective financial information will be achieved.

Therefore, in such assurance engagements, practitioner provides a report assuring that nothing has come to practitioner's attention to suggest that these assumptions do not provide a reasonable basis for the projection.

Hence, such type of assurance engagement provides only a "moderate" level of assurance.

Question 27**(PYP May 25 5M)**

Mention any three standards issued under authority of ICAI Council which are collectively known as 'Engagement Standards'.

Also mention the purpose of issue of these standards.

Answer:

Engagement and Quality control Standards: The following Standards issued under authority of ICAI Council are collectively known as Engagement Standards:

1. Standards on Auditing (SAs) which apply in audit of historical financial information.
2. Standards on Review Engagements (SREs) which apply in review of historical financial information.
3. Standards on Assurance Engagements (SAEs) which apply in assurance engagements other than

audits and review of historical financial information.

4. Standards on Related Services (SRSs) which apply in agreed upon procedures to information, compilation engagements and other related service engagements.

Questions From RTP'S, MTP'S, QP'S

ETHICS

Question 1

(RTP Nov '22, MTP Nov '23)

The auditor **cannot be expected to disregard** past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are **honest and have integrity** does not relieve the auditor of the **need to maintain professional skepticism**. Explain.

Answer:

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

Professional skepticism includes being alert to, for example:

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

Professional skepticism is necessary to the **critical assessment of audit evidence**. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in the case where **fraud risk factors exist** and a single document, of a nature that is **susceptible to fraud**, is the **sole supporting evidence** for a material financial statement amount. The auditor may accept **records and documents as genuine unless** the auditor has **reason to believe the contrary**. Nevertheless, the auditor is **required to consider the reliability** of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud, the SAs require that the auditor investigate further and determine **what modifications or additions to audit procedures are necessary** to resolve the matter.

The auditor **cannot be expected to disregard** past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a **belief that management and those charged with governance are honest and have integrity** does not relieve the auditor of the need to **maintain professional skepticism**.

Question 2

(RTP May '22)

The IESBA Code establishes the **fundamental principles of professional ethics** relevant to the auditor when conducting an audit of financial statements. Discuss and also explain the **meaning of ethics**.

Answer:

The auditor shall **comply with relevant ethical requirements**, including those pertaining to **independence**, relating to financial statement audit engagements. Relevant **ethical requirements** ordinarily comprise the

Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements. First, broadly understand what are ethics? "**Ethics**" are the principles of conduct governing an individual or group. Professions like law, medicine have their code of ethics. Auditing profession is no exception. Rather, in profession of auditing, **importance of ethics is manifold**.

The **IESBA Code** establishes the following as the **fundamental principles of professional ethics** relevant to the auditor when conducting an audit of financial statements. We shall understand broad meaning and intent of these fundamental principles as under:-

a. Integrity

Integrity requires auditor to be **straight forward** and **honest** in all professional and business relationships. It implies fair dealing and truthfulness. It effectively means that he shall not be associated with reports, returns, communications or other **information** which he believes contains a **materially false or misleading statement**; contains statements or information provided recklessly or omits required information where such omission could be misleading.

b. Objectivity

The principle of objectivity requires an auditor **not to compromise professional judgment** because of **bias, conflict of interest or undue influence** of others.

c. Professional competence and due care

It requires that auditor attains and maintains **professional knowledge and skill** at the level required to render competent professional service based on current technical and **professional standards** and **legislation** and **also to act diligently** and in accordance with **technical** and professional standards. Diligence includes responsibility to act carefully, thoroughly and on a timely basis in accordance with requirements of an assignment.

d. Confidentiality

Confidentiality principle requires an auditor to **respect the confidentiality** of information acquired as a result of professional or business relationships.

e. Professional behavior

It requires an auditor to comply with **relevant laws and regulations** and **avoid any conduct** that he knows or should know might discredit the profession.

Question 3

(RTP May '22, MTP Jan '25)

The auditor should be **straightforward, honest and sincere** in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and **both be and appear to be free of any interest** which might be regarded as being incompatible with integrity and objectivity. Many different circumstances, or combination of circumstances, may be relevant and accordingly it is **impossible to define** every situation that creates **threats to independence** and specify the appropriate mitigating action that should be taken. In addition, the **nature of assurance engagements** may differ and consequently **different threats** may exist requiring the **application of different safeguards**. Explain stating clearly the five types of threats as contained in Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC).

Answer:

The **auditor** should be **straightforward, honest and sincere** in his approach to his professional work. He must be **fair** and must **not allow prejudice or bias** to override his objectivity. He should maintain an **impartial attitude** and both be and appear to be **free of any interest** which might be regarded as being **incompatible with integrity and objectivity**. Many different circumstances, or combination of

circumstances, may be relevant and accordingly it is impossible to define every situation that creates **threats to independence** and specify the appropriate **mitigating action** that should be taken. In addition, the **nature of assurance engagements may differ and consequently different threats may exist** requiring the application of different safeguards.

Threats to Independence

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

1. **Self-interest threats**, which occur when an **auditing firm**, its **partner** or **associate** could benefit from a financial interest in an audit client. Examples include (i) **direct financial interest** or **materially significant** indirect financial interest in a client, (ii) **loan or guarantee** to or from the concerned client, (iii) undue dependence on a **client's fees** and, hence, concerns about losing the engagement, (iv) **close business relationship** with an audit client, (v) **potential employment** with the client, and (vi) **contingent fees** for the audit engagement.
2. **Self-review threats**, which occur when during a review of any **judgement** or **conclusion** reached in a **previous audit** or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was **previously a director or senior employee** of the **client**. Instances where such threats come into play are (i) when an auditor having recently been a **director or senior officer** of the company, and (ii) when auditors **perform services** that are themselves **subject matters of audit**.
3. **Advocacy threats**, which occur when the **auditor promotes**, or is perceived to promote, a client's opinion to a point where people may believe that **objectivity is getting compromised**, e.g. when an auditor deals with **shares or securities** of the audited company, or becomes the **client's advocate** in **litigation** and third party disputes.
4. **Familiarity threats** are **self-evident**, and occur when auditors form relationships with the client where they end up being too **sympathetic to the client's interests**. This can occur in many ways: (i) **close relative** of the audit team working in a **senior position** in the client company, (ii) **former partner** of the audit firm being a **director** or senior employee of the client, (iii) **long association** between specific **auditors** and their specific **client counterparts**, and (iv) **acceptance** of significant **gifts** or hospitality from the client company, its directors or employees.
5. **Intimidation threats**, which occur when auditors are **deterred from acting objectively** with an adequate degree of **professional skepticism**. Basically, these could happen because of **threat of replacement** over **disagreements** with the application of accounting principles, or **pressure** to **disproportionately reduce work** in response to **reduced audit fees**.

Question 4

(RTP May '23)

Chartered Accountant has a **responsibility to remain independent** by taking into account the context in which they practice, the **threats to independence** and the **safeguards** available to eliminate the threats. Explain the guiding principles in this regard.

Answer:

The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

The following are the guiding principles in this regard: -

1. For the public to have **confidence** in the **quality of audit**, it is **essential** that **auditors** should always be and **appears** to be **independent** of the entities that they are auditing.
2. In the case of audit, the key fundamental principles are **integrity**, **objectivity** and **professional skepticism**, which necessarily require the auditor to be **independent**.
3. **Before** taking on any work, an auditor must **conscientiously consider** whether it involves **threats** to his **independence**.
4. When such **threats exist**, the auditor should either **desist from the task** or put in place **safeguards** that **eliminate them**.
5. If the **auditor is unable to fully implement** credible and **adequate safeguards**, then he must **not accept** the **work**.

Question 5

(MTP Nov '22)

Examine with reasons (in short) whether the following statements are **correct** or **Incorrect**: **Confidentiality requires** an auditor to be **straight forward and honest** in all professional and business relationships.

Answer:

Incorrect: **Integrity** requires an auditor to be **straight forward** and **honest** in all professional and business relationships. It implies **fair dealing** and **truthfulness**. Confidentiality principle requires an auditor to respect the **confidentiality of information** acquired as a result of professional or business relationships.

Question 6

(MTP May '23)

Examine with reasons (in short) whether the following statements are correct or incorrect. Advocacy threat, is the threat which occur when an **auditing firm, its partner or associate could benefit** from a financial interest in an audit client.

Answer:

Incorrect: **Self-interest** threat is the threat which occur when an auditing firm, its partner or associate could benefit from a **financial interest** in an audit client. Further, **Advocacy threat** is the threat which occur when the auditor **promotes**, or is perceived to promote, a **client's opinion to a point** where **people** may **believe** that **objectivity** is **getting compromised**, e.g. when an auditor deals with shares or securities of the audited company or becomes the client's advocate in litigation and third party disputes.

Question 7

(RTP May '23)

Professional integrity and independence are considered essential characteristics of all the professions. There are **two** interlinked perspectives of independence of auditors, one, independence of **mind** and two, independence in **appearance**. Explain.

Answer:

Professional integrity and independence are considered **essential characteristics** of all the professions but are more so in the case of **accountancy profession**. Independence implies that the **judgement of a person is not subordinate** to the **wishes or direction of another person** who might have engaged him. It is **not possible** to define "independence" **precisely**. Rules of professional conduct dealing with

independence are framed primarily with a certain objective. The rules themselves **cannot create or ensure the existence** of independence. **Independence is a condition of mind** as well as personal character. It **should not be confused with the superficial and visible standards of independence** which are sometimes imposed by law.

There are **two interlinked perspectives** of independence of auditors, one, **independence of mind**; and two, **independence in appearance**. The Code of Ethics for Professional Accountants issued by International Federation of Accountants (IFAC) defines the term 'Independence' as follows: "Independence is:

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

Question 8**Exceptional****(MTP May '24)**

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

Answer:

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

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

Question 9**Exceptional****(MTP May 24)**

Professional Behaviour is one of the **fundamental principles** governing professional ethics. Explain its meaning. Also, give example of a situation where a Chartered Accountant fails to follow this principle.

Answer:

The Principle of **Professional Behaviour** requires an accountant to comply with **relevant laws and regulations** and avoid any conduct that the accountant knows or should know might **discredit the profession**. A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the **integrity, objectivity** or **good reputation** of the profession, and as a result would be incompatible with the fundamental principles.

Example

A Chartered Accountant **has conducted audit of accounts** of an entity for a particular year. ICAI has issued a **letter** to him relating to certain matters concerning audit. He **didn't even bother to reply** to

the letter despite reminders. Failure to reply to professional body shows lack of courtesy and professional responsibility. In the given case, Chartered accountant has not followed principle of Professional Behaviour.

Question 10**(MTP 1 May 25)**

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:

The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

This section of the auditor's report shall describe management's responsibility for:

- (i) **Preparing the financial statements** in accordance with the applicable financial reporting framework, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error:[because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and
- (ii) **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 11**(PYP Jan 25 5M)**

CA H is managing partner of HK & Co., a Chartered Accountant firm, having registered office at Delhi. With the annual task of reviewing whether any threat to independence is observed in the firm, CA H noted down the following observations received from the staff and partners of the firm for the F.Y. 2023-24 :

- i. CA J, partner of the firm, performed statutory audit as well as non audit engagement for M/s. Take Away Private Limited.
- ii. CA M, partner of the firm, who has done income tax audit for M/s. Happy Associates where in CA M has material significant indirect financial interest.
- iii. The costs of air travel and stay accommodation of family members of audit team for audit of Chennai was borne by the client stationed at Chennai.

- iv. One of the clients, M/s. Chalk Limited, threatened to replace them as auditors because the audit team insisted to make provision for expected credit loss which the company was not willing to provide.
- v. CA N, partner of the firm, who audited M/s. NM Private Limited became arbitrator for dispute between M/s. NM Private Limited and one of its vendors.
- vi. CA N accepted the assignment of Tax audit (on behalf of firm) of TRF Industries. Management agreed to pay him contingent fee for tax audit.

You are requested to help CA H in classifying the type of threats to independence in each of the above observation received from the staff and partners of the firm.

In case such threats exist, what should the auditor do?

Answer:

Type of Threats to Independence

S. No.	Situation	Threat to Independence
(i)	CA J, partner of the firm, performed statutory audit as well as non- audit engagement for Take Away Private Limited.	Self-review threats
(ii)	CA M, partner of the firm, who has done income tax audit for M/s. Happy Associates where in CA M has material significant indirect financial interest.	Self-interest threats
(iii)	The costs of air travel and stay accommodation of family members. of audit team for audit Chennai was borne by the client stationed at Chennai.	Familiarity threats
(iv)	One of the clients, Chalk Limited, threatened to replace them as auditors because the audit team insisted to make provision for expected credit loss which the company was not willing to provide.	Intimidation threats
(v)	CA N, partner of the firm, who audited NM Private Limited became arbitrator for dispute between NM Private Limited and one of its vendors.	Advocacy threats
(vi)	CA N accepted the assignment of Tax audit (on behalf of firm) of TRF Industries. Management agreed to pay him contingent fee for tax audit.	Self-interest threats

When such threats exist, the auditor should -

- (1) Either desist from the task or eliminate the threat or at the very least, put in place safeguards which reduce the threats to an acceptable level. All such safeguards' measures need to be recorded in a form that can serve as evidence of compliance with due process.
- (2) If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

Question 12

(PYP Jan 25 4M)

Identify and explain the fundamental principles being referred to in the following cases.

- (i) Professional accountants should act diligently and in accordance with applicable technical and professional standards while providing professional services.
- (ii) A professional accountant shall not knowingly be associated with reports where he believes that the information contains a materially false or misleading statement.

Answer:

Fundamental Principles:

- i. **Act diligently and in accordance with applicable technical and professional standards:** In the given case, **professional competence and due care** fundamental principle is being referred to since a professional accountant shall **comply with the principle of professional competence and due care**, which requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a **client or employing organization receives** competent professional service, based on **current technical and professional standards** and relevant legislation; and act diligently and in accordance with applicable technical and professional standards.
- ii. **A professional accountant shall not knowingly be associated with reports where he believes that the information contains a materially false or misleading statement:** In the given case, integrity fundamental principle is being referred to, it prescribes that a professional accountant shall comply with the **principle of integrity**, which requires an **accountant to be straightforward and honest in all professional and business relationships**. Integrity implies fair dealing and truthfulness.

SA 210- Agreeing The Terms Of Audit Engagements**Question 9****(MTP Jan '25 4M)**

Luck Ltd., a mid-sized manufacturing company, has approached CA S, a qualified Chartered Accountant, to conduct the audit for the financial year ended March 31, 2025. The company requests CA S to give acceptance for the audit so that audit can be commenced within time.

With reference to SA 210, how the auditor will establish that whether the preconditions for an audit are present?

Answer:

In order to establish whether the preconditions for an audit are present, CA S shall:

(I) Determine whether the financial reporting framework is acceptable and

(II) Obtain the agreement of management that it acknowledges and understands its responsibility:

- (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework including where relevant their fair representation;
- (ii) For such internal control as management considers necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
- (iii) To provide the auditor with:
 - Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - Additional information that the auditor may request from management for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

SQC 1- Quality Control For Firms Which Perform Audits And Reviews Of Historical Financial Information And Other Assurance And Related Service Engagements

Question 8

(MTP 1 May '25)

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

Answer:

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

- ✓ Integrity of Client
- ✓ Competence (including capabilities, time and resources) to perform engagement
- ✓ Compliance with ethical requirements

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

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

SA 220- Quality Control For An Audit Of Financial Statements

Question 4

(Model TP 3 Marks)

Mr. J is an articled clerk with a big Chartered Accountants' firm. He is a part of the engagement team which is conducting the **audit of a company for the first time**. They are assigned with the work of preparing the draft audit engagement letter. Mr. J is not sure how to go about with this work. Explain what is **Audit Engagement Letter and what are its contents?**

Answer:

Audit Engagement Letter: The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement are recorded in a letter or other the suitable form of written agreement. Such an agreement is known as Audit Engagement Letter. The audit engagement letter is sent by the auditor to his client. It is in the interest of both the auditor and the client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent.

Audit Engagement letter includes: -

- (1) The **objective and scope** of the audit of the financial statements
- (2) The **responsibilities** of the **auditor**
- (3) The responsibilities of **management**
- (4) **Identification of the applicable financial reporting framework** for the preparation of the financial statements and
- (5) Reference to the **expected form and content** of any reports to be **issued by the auditor** and a **statement** that there may be **circumstances in which a report may differ** from its expected form and content.

If **law or regulation prescribes in sufficient detail** the terms of the audit engagement, the auditor need **not record them in a written agreement**, except for the fact that such law or regulation applies, and that management acknowledges and understands its responsibilities.

Question 5

(Model TP 4 Marks)

CA P is a professional accountant in service. In terms of employment and professional relationships with employer he has to be alert to the **possibility of inadvertent disclosure** of any information outside the employing organization. However, in view of disclosure required by law, CAP had to divulge the **information and documents as evidence** in course of legal proceedings. Whether CA P **has violated any fundamental principle** governing professional ethics in this case? Explain.

Answer:

Confidentiality principle requires a professional accountant to **respect the confidentiality** of **information acquired as a result of professional** or business relationships. Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant with the understanding that the **information will not be disclosed to a third party**.

However, such confidential information **may be disclosed**, for example, when it is **required by law**, when it is **permitted by law** and is **authorised by the client or employer** or there is a **professional duty or right to disclose** when **not prohibited by law**.

In the given situation, CA P, who is a professional accountant in service, and in terms of employment and professional relationships with the employer he is **alert to the possibility of inadvertent disclosures** of

any information outside the employing organization. However, CA P had to divulge the information and documents as evidence in the course of legal proceedings and same was required by law. Therefore, CA. P will not be held responsible for violation of fundamental principle of "Confidentiality" governing professional ethics.

Question 6**(Model TP 5 Marks)**

Deepa Ltd., initially requested an audit engagement for the financial year 2023-2024. However, midway through the audit process, the management claims that they are unable to provide complete supporting documentation for a significant portion of their receivables. As a result, the management asks the auditor to change the audit engagement to a review engagement, arguing that it would prevent the issuance of a qualified opinion.

The auditor is now facing challenge in determining whether this change is justified or not. Comment in accordance with relevant SA.

Answer:

As per SA 210, "Agreeing the Terms of Audit Engagements", a request from the entity for the auditor to change the terms of the audit engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit as originally requested or a restriction on the scope of the audit engagement, whether imposed by management or caused by other circumstances.

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

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

In contrast, a change may not be considered reasonable if it appears that the change relates to information that is incorrect, incomplete or otherwise unsatisfactory. An example might be where the auditor is unable to obtain sufficient appropriate audit evidence regarding receivables and the entity asks for the audit engagement to be changed to a review engagement to avoid a qualified opinion or a disclaimer of opinion.

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

Question 7**(Model TP 3 Marks)**

A professional accountant is expected to comply with the fundamental principles of professional ethics at all times. Explain which fundamental principle governing professional ethics is violated in the following situations?

- (1) A chartered accountant in practice accepted the appointment as an auditor of a firm in which his sister was a partner.
- (2) A chartered accountant in practice was approached by his friend to seek some insider information about a company, which was a client of the chartered accountant. He could not refuse his friend's request.
- (3) A chartered accountant in practice failed to inform his client about the change in laws applicable to his client.

Answer:

Fundamental Principles:

- (1) **Objectivity:** The principle of objectivity requires that a professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity. Objectivity principle will be violated in the given situation where a chartered accountant in practice accepted the appointment as an auditor of a firm in which his sister was a partner.
- (2) **Confidentiality:** Confidentiality principle requires a professional accountant to respect the confidentiality of information acquired as a result of professional or business relationships. Confidentiality principle will be violated in the given situation where a chartered accountant in practice could not refuse his friends requested to seek some insider information about a client company of the chartered accountant.
- (3) **Professional Competence and Due care:** A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation and act diligently and in accordance with applicable technical and professional standards. Professional Competence and Due Care principle will be violated in the situation where a chartered accountant in practice failed to inform his client about the change in laws applicable to his client.

Question 8

(Model TP 4 Marks)

CA M is the engagement partner of the firm M/s Y2Z LLP and he is auditing the financial statements of a listed entity ABC Ltd. The audit firm has determined that an engagement quality control review is required for this assignment. Discuss the responsibilities of CA M as an engagement partner for engagement quality control review as per SA-220.

Answer:

Engagement Performance: As per SA 220, for audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the engagement partner shall:

- (i) Determine that an engagement quality control reviewer has been appointed.
- (ii) Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer.
- (iii) Not date the auditor's report until the completion of the engagement quality control review.
- (iv) If differences of opinion arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall follow the firm's policies and procedures for dealing with and resolving differences of opinion.

Question 9

(MTP 2 May '25)

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

Answer:

Professional skepticism includes being alert to, for example:

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

Question 10**(PYP May 25 5M)**

M/S ABC & Co., Chartered Accountants, have been appointed as the statutory auditors of DEF Ltd., which is a listed company, for the Financial Year 2024-25. CA X, a seasoned Chartered Accountant with over 15 years of experience has been assigned as the engagement partner for this audit. CA X takes responsibility for maintaining overall quality on this audit engagement in accordance with SA 220.

What do the actions of engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on audit engagement emphasize?

Answer: **Already covered in MRP Qns**

Questions From RTP'S, MTP'S, QP'S

SA 700- Forming An Opinion And Reporting On Financial Statements

Question 12:

(PYP Jan 25 4M)

Singh & Associates, while carrying out statutory audit of Rubber Industries Limited, observed that debtors are not making payments invoice wise. As the debtors constitute sixty percent of the total assets, so auditors requested management to provide external confirmations of all the debtors outstanding for an amount exceeding ₹ 1.00 Lac. However, management resisted and no external confirmations were made available. Auditor firm has decided to disclaim an opinion on the financial statements and seek your guidance on amendments that should be made in the "Basis for Opinion" section and elements required by SA 700 (Revised) which need not to be included in the auditor's report. Guide them suitably.

Answer:

In the given situation, since the audit firm has decided to disclaim an opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised) amend the heading "Basis for Opinion" to "Basis for Disclaimer of Opinion; and within this section, include a description of the matter giving rise to the modification.

Further, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include the following elements required by SA 700 (Revised):

- (i) A reference to the section of the auditor's report where the auditor's responsibilities are described; and
- (ii) A statement about whether the audit evidence obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

SA 701 - Communicating Key Audit Matters In The Independent Auditor's Report

Question 3:

(MTP 2 May '25)

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 in view of above?

Answer: Already covered in MRP Qns

Question 4:

(PYP May '25 5M)

SA 701 "Communicating Key Audit Matters in the Auditor's Report" deals with the auditor's responsibility to communicate key audit matters in the auditor's report.

Explain the definition of Key Audit Matter and how an auditor will determine the Key Audit Matters?

Answer:

Definition of Key Audit Matter: Key Audit Matters are those matters that, in the auditor's professional judgement were of most significance in the audit of the financial statements of the current period. Key audit matters are selected from matters communicated with those charged with governance.

Determining Key Audit Matters: The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- ✓ Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.
- ✓ Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- ✓ The effect on the audit of significant events or transactions that occurred during the period.

SA 710- Comparative Information—Corresponding Figures and Comparative Financial Statements

Question 3:

(PYP Jan 25 5M)

Oval Enterprises Limited (OEL) is under legal obligation to represent its current year's financial statements along with the previous year's financial statements (comparative financial statements). Karan & Associates, Chartered Accountants, has been appointed as the statutory auditor for the year. CA Karan noticed that the last year's financial statements contain an adverse opinion for the financial statement as a whole due to a misstatement in the evaluation and disclosure of the debtors. Guide CA Karan for his duty regarding the treatment and addressing the issue while drafting his audit report. What disclosures he is required to make in this regard?

Answer:

In the given case, CA Karan noticed that the last year's financial statements contain an adverse opinion for the financial statement whole due to a misstatement in the evaluation and disclosure of the debtors. If the auditor's report on the prior period, as previously issued, included an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

- (i) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
- (ii) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

Further, when comparative financial statements are presented, the auditor's opinion shall refer to each period for which financial statements are presented and on which an audit opinion is expressed. If the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, the auditor shall state in an Other Matter paragraph:

- (i) That the financial statements of the prior period were audited by a predecessor auditor;
- (ii) The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore; and
- (iii) The date of that report,

SA 299 Joint Audit of Financial Statements**Question 4:****(PYP May '25 5M)**

As per SA 299 "Joint Audit of Financial Statements", 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. Explain by stating any five advantages of joint audit.

Answer:

As per SA 299, "Joint Audit of Financial Statements", the advantages of Joint Audit are:

- (i) Sharing of expertise.
- (ii) Advantage of mutual consultation.
- (iii) Lower workload.
- (iv) Better quality of performance.
- (v) Improved service to the client.
- (vi) In respect of multi-national companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.
- (vii) Lower staff development costs.
- (viii) Lower costs to carry out the work.

CARO, 2020

Question 15:

(MTP 1 May '25)

SKN Ltd. a biopharma company and global manufacturers of select critical care medical products has been sanctioned **working capital limits of Rs.5.99 crores** from a nationalized bank on the basis of security of current assets. During the year under audit, the statutory auditor of SKN Ltd. considers that **inventory is material** to the financial statements and **performs audit procedures** over the company's final inventory records **to determine whether they accurately reflect actual inventory** count and without any major discrepancies for each class of inventory. **What are the reporting requirements** regarding physical verification of inventory under CARO 2020 in this case?

Answer: **Already covered in Illustration Qns**

Question 16:

(Model TP 3 Marks)

M/s. PQ Limited has a **turnover of Rs. 807 crores** during the financial year 2023-24. It has outstanding dues towards Goods and Services Tax (GST) of **Rs. 10 lakhs since June 2023**. When enquired by the auditor, the company's management informed him that they have filed an **objection letter for the said demand with the GST Authorities**, however, **no response** is received from the GST Department. State the reporting responsibility of the auditor under paragraph 3, **clause (vii)** of the Companies Auditor's Report Order, 2020 [CARO, 2020].

Answer: **Already covered MRP Qns**

Question 17:

(Model TP 3 Marks)

CA Ayush has recently qualified and has joined a CA Firm. On going through various audit reports, he observed that **different phrases were used to express an unmodified opinion** on the financial statements. On enquiring with a senior, he got to know that all those phrases can be regarded as being equivalent. Which phrases are appropriate and which phrases are inappropriate while drafting an unmodified opinion?

Answer:

Appropriate Phrases while drafting an Unmodified Opinion: When expressing an unmodified opinion on financial statements, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

- (i) In our opinion, the accompanying financial **statements present fairly**, in all material respects, [...] in accordance with [the applicable financial reporting framework]; or
- (ii) In our opinion, the accompanying financial statements **give a true and fair view** of [...] in accordance with [the applicable financial reporting framework].

The phrases **"present fairly, in all material respects,"** and **"give a true and fair view"** are regarded as **being equivalent**.

Inappropriate Phrases: When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as **"with the foregoing explanation"** or **"subject to"** in relation to the opinion, as these suggest a **conditional opinion or a weakening or modification** of opinion

Question 18:

(Model TP 5 Marks)

"When the **auditor modifies the audit opinion**, the auditor shall use the heading **"Qualified Opinion,"**

"Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section." Briefly explain when the auditor should express:

- (i) Qualified Opinion.
- (ii) Adverse Opinion and
- (iii) Disclaimer of Opinion.

Answer:

"When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section." The auditor should consider the following while expressing the opinion in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

(i) **Qualified Opinion :**

- The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, are material, but not pervasive or
- The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

(ii) **Adverse Opinion:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

(iii) **Disclaimer of Opinion:** The auditor shall disclaim an opinion when he is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and he concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

Question 19:

(Model TP 4 Marks)

Mr. L is a principal auditor of OP Ltd. There are several divisions of OP Ltd. that are audited by other auditors. State the procedures Mr. L should ordinarily perform to obtain sufficient and appropriate audit evidence that the work of other auditors is adequate for the principal auditor's purpose in the context of this assignment.

Answer:

The principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

- (i) Advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as are as requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and
- (ii) Advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.
- (iii) The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a

completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor.

Question 20:**(MTP 2 May '25)**

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

Answer: Already covered in MRP Qns

Question 21:**(PYP May 25 4M)**

TS Ltd. has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. The company had clearly outlined in its board resolution that these funds will be used for business expansion and diversification purposes only.

However, the company utilised these funds for repayment of long-term loans and advances rather than for the intended purpose of business growth and expansion.

State the reporting responsibility of the auditor under paragraph 3, clause (x) of the Companies Auditor's Report Order, 2020 (CARO 2020).

Answer: Already covered in TYK Qn 16

Questions From RTP'S, MTP'S, QP'S

SA 260- Communication with TCWG

Question 1:**(PYP Jan 25 5M)**

SRP Limited appointed M/s JK & Co. as its statutory auditors. Auditors while carrying out the audit observed that company has entered into a complex transaction having material effect on the financial statements. In order to have realistic information on the said transaction (relevant to the audit), audit team decided to take assistance from those charged with governance. Two of the team members were discussing as to who can be "Those charged with governance" but could not get a fair idea of the same. Can you guide them by explaining the same?

Answer:

Who are "Those Charged with Governance":

- ✓ The person(s) or organization(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process.
- ✓ For some entities, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.
- ✓ Governance structures vary by entities, reflecting influences such as different cultural and legal backgrounds, and size and ownership characteristics. For example, in some entities, a supervisory board exists that is separate from executive board.
- ✓ In other entities, both supervisory and executive functions are performed by a single board. In some entities, those charged with governance hold positions that are an integral part of the entity's legal structure. For example, company directors. In some cases, some or all of those charged with governance are involved in managing the entity. In others, those charged with governance and management comprise different persons.
- ✓ In most entities, governance is the collective responsibility of a governing body, such as a board of directors, a supervisory board, partners, proprietors, a committee of management, trustees, or equivalent persons.
- ✓ In some smaller entities, however, one person may be charged with governance, for example, the owner-manager where there are no other owners, or a sole trustee.
- ✓ Such diversity means that it is not possible to specify for all audits the persons with whom the auditor is to communicate particular matters. Also, in some cases, the appropriate persons with whom to communicate may not be clearly identifiable from the applicable legal framework or other engagement circumstances, for example, entities where the governance structure is not formally defined, such as some family-owned entities and some not-for-profit organizations.
- ✓ In such cases, the auditor may need to discuss and agree with the engaging party the relevant persons with whom to communicate. In deciding with whom to communicate, the auditor's understanding of an entity's governance structure and processes obtained in accordance with SA 315 is relevant. The appropriate persons with whom to communicate may vary depending on the matter to be communicated.

SA 570- Going Concern**Question 6:****(PYP May 25 5M)**

Give five examples of operating events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

Answer:

As per SA 570, "Going Concern", the following are examples of operating events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

- ✓ Management intentions to liquidate the entity or to cease operations.
- ✓ Loss of key management without replacement.
- ✓ Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- ✓ Labour difficulties.
- ✓ Shortages of important supplies.
- ✓ Emergence of a highly successful competitor.

SA 580- Written Representations

Question 11:

(MTP 1 May '25)

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

Answer:

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

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

Question 12:

(MTP 2 May '25)

Auditors are required to obtain an **understanding of internal control** relevant to the audit when **identifying and assessing its effectiveness and risk of material misstatement**. PDC Ltd. appointed CA Nikhil as auditor for the F.Y. 2023-24. During the audit, he observed that **significant deficiency exists** in the internal control system and he wants to **ascertain the same**. Elucidate the various **indicators of significant deficiencies** which will help you in assessing the **efficiency of internal control system** of the organisation.

Answer:

As per **SA 265**, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", Indicators of significant deficiencies in internal control include, for example:

- (i) **Evidence of ineffective aspects** of the control environment, such as: -
- **Indications that significant transactions** in which management is financially interested are not being appropriately scrutinised by those charged with governance.
 - **Identification of management fraud**, whether or not material, that was not prevented by the entity's internal control.
 - **Management's failure to implement** appropriate remedial action on significant deficiencies previously communicated.

- (ii) Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
- (iii) Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.
- (iv) Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
- (v) Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
- (vi) Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
- (vii) Evidence of management's inability to oversee the preparation of the financial statements.

Question 13:**(Model TP 4 Marks)**

CA Rashmi is the auditor of ABC Ltd. for the financial year ending 31/03/2024. The audit report for the year was signed by her on 19/04/2024.

On 25/4/2024, the company received a communication from the Central Government that an incentive amount of Rs. 5 crores pertaining to financial year 2023-24 was approved. It was paid to the company before the end of April 2024. The financial statements of the company were not yet issued to the shareholders.

The Board of Directors wished to include the incentive amount in the financial statements and requested the auditor to issue a fresh audit report for the year ended 31/03/2024.

Analyze the issue involved and give an overview of the auditor's responsibility in such a situation.

Answer:

Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued:

As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report.

However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall

- (i) Discuss the matter with management and, where appropriate, those charged with governance.
- (ii) Determine whether the financial statements need amendment and, if so,
- (iii) Inquire how management intends to address the matter in the financial statements.

If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment. Further, the auditor shall extend the audit procedures and provide a new auditor's report on the amended financial statements. However, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

In the instant case, ABC Ltd. received an amount of Rs. 5 crore on account of incentives pertaining to year 2023-24 in the month of April 2024 i.e. after finalisation of financial statements and signing of audit report but before the issuance of Financial Statements to stakeholders. The Board of Directors of ABC Ltd. wished to amend the financial statements and requested the CA. Rashmi (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2024. After applying the conditions given in SA 560, CA. Rashmi can issue new audit report subject to date of

audit report which should not be earlier than the date of approval of the amended financial statements.

Question 14:**(Model TP 4 Marks)**

CA Vasu was appointed as the statutory auditor of M/s. Pizza Limited for the financial year 2023-24. While reviewing the internal controls, he observed that the company has entered into many transactions with firms in which the directors are interested. The company's specified procedure was by-passed in such transactions. CA Vasu considered it as a significant deficiency in internal control over related party transactions. He communicated this deficiency to Those Charged With Governance (TCWG) as under, "Controls over significant transactions with related parties are weak." In view of the above, please explain:

- (i) What is meant by deficiency in internal control?
- (ii) As per SA 265, whether the significant deficiency communicated by CA Vasu to TCWG is appropriate? Explain.

Answer:

- (i) **Meaning of Deficiency in internal control:** This exists when -
 1. A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis or
 2. A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.
- (ii) As per SA 265, While pointing out significant deficiencies in internal control, auditor has not only to communicate significant deficiencies giving their description but also explain the potential effects and sufficient information to those charged with governance and management to understand context of communication.
Therefore, the above communication is not proper. Not only significant deficiency has to be communicated, it should also be explained to management the potential effects of transactions with firm in which the directors are interested. It should explain that such a significant deficiency can lead to misstatement of transactions with related party. Highlighting importance of such a control, it should be stated that responsibility be fixed for concerned persons for adhering to such an important control.

Question 15:**(Model TP 3 Marks)**

Mr. D an auditor, while auditing ACE Ltd., identified certain misstatements in relation to particular class of transactions and account balances. He had communicated same to those charged with governance and also taken written representation for the same. State the audit documentation required by the auditor regarding misstatements identified during the audit.

Answer:

Documentation regarding misstatements identified during audit: The audit documentation shall include:

- (i) The amount below which misstatements would be regarded as clearly trivial;
- (ii) All misstatements accumulated during the audit and whether they have been corrected; and
- (iii) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

Question 16:**(PYP May 25 5M)**

CA Pari is conducting the audit of Heavy Ltd., a company with large number of customers which are generally small retail shop owners. While verifying sundry debtors, CA Pari assesses the risk of material

misstatement (ROMM) as low and internal control is operating effectively.

With reference to SA 505 (External Confirmations):

- (i) Which type of confirmation request is most likely to be used by CA Pari in this scenario?
- (ii) What are the conditions necessary for using such a confirmation request effectively?

Answer:

- (i) CA Pari is most likely to use Negative Confirmation Request since she has assessed the risk of material misstatement as low and internal control is operating effectively.
- (ii) The auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:
 - ✓ The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
 - ✓ The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;
 - ✓ A very low exception rate is expected; and
 - ✓ The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

Question 17:

(PYP May '25 5M)

The Management of Sun Shine Ltd. has provided the auditor with a written representation regarding its responsibilities for the preparation of the financial statements. In addition to this, the auditor may request other written representations about the financial statements.

Mention such other representations which may supplement but do not form part of the written representation relating to management's responsibilities regarding preparation of financial statements.

Answer:

As per SA 580, "Written Representations", in addition to the written representation about management's responsibilities regarding preparation of financial statements, the auditor may consider it necessary to request other written representations about the financial statements.

Other representations which may supplement, but do not form part of the written representation relating to management's responsibilities regarding preparation of financial statements are the following:

- i. Whether the selection and application of accounting policies are appropriate; and
- ii. Whether matters such as the following, where relevant under the applicable financial reporting framework, have been recognized, measured, presented or disclosed in accordance with that framework:
 1. Plans or intentions that may affect the carrying value or classification of assets and liabilities;
 2. Liabilities, both actual and contingent;
 3. Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral; and
 4. Aspects of laws, regulations and contractual agreements that may affect the financial statements, including non-compliance.

Questions From RTP'S, MTP'S, QP'S

Question 17:
(MTP 1 May '25)

During an audit of MNT Ltd., CA Shubh, the auditor **discovers an issue with stock valuation**. To ensure the **accuracy and reliability** of his observations, CA Shubh **needs to document** the audit procedures, evidence **collected**, and his **observations thoroughly**.

In this situation, **how does audit documentation help CA Shubh support his findings** in audit in accordance with Standards on Auditing?

Answer:

During the audit of MNT Ltd., CA Shubh **identifies an issue with stock valuation**. To ensure the **accuracy and reliability of his observations**, it is crucial for him to document the audit procedures performed, the evidence obtained, and his findings in a structured manner.

Audit documentation plays a vital role in supporting CA Shubh's findings in accordance with the Standards on Auditing. Its key purposes include:

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

Question 18:
(Model TP 4 Marks)

M/s. PK & Company, Chartered Accountants, are the statutory auditors of JC Limited. CA Tarun, partner of M/s. PK & Company, **was entrusted to supervise** and **verify the inventory** items as on 31.03.2024. During the process of verification, a large chunk of draft inventory sheets were accumulated and then a **final inventory sheet was prepared**. The audit assistant has kept **all these drafts and the final inventory sheet** in the audit file. Is the approach of the audit assistant correct? Which papers/ documents **may not be included in the audit documentation**?

Answer:

In the given case, the audit assistant has kept a **large chunk of draft inventory sheets** and the final inventory sheet in the audit file which is **not correct as the auditor is not required to document draft inventory sheets**. Auditor should ensure that **only final inventory sheets** will form part of the audit documentation. Thus, approach of the audit assistant of filing draft and final inventory sheet **is not correct**.

As per SA 230, "Audit documentation", audit documentation may be **recorded on paper** or on electronic or other media.

The auditor **need not include in audit documentation**:

- ✓ **superseded drafts** of working papers and financial statements,
- ✓ **notes that reflect incomplete or preliminary thinking**,
- ✓ **previous copies of documents corrected** for typographical or other errors, and
- ✓ **duplicates** of documents.

Question 19:

(Model TP 3 Marks)

CA B, an auditor, after the completion of busy audit season, was occupied in assembling of final audit files of one of his client. First of all, he started preparing various documents of that client and then kept those documents in various folders. He was preparing documents as well as audit file in paper form because he believed that it is mandatory. He could complete documentation as well as assembling of final audit file of that client after three months from the date of audit report. Generally, he retains audit file of the clients for 4 years from the date of audit report. Check the validity of the action of CA B.

Answer: Already covered in MRP Qns

Question 20:

(PYP Jan 25 5M)

Z Ltd. engaged ABC & Co., Chartered Accountants, to conduct its statutory audit for the F.Y. 2023-24. The audit team developed an overall audit strategy and plan to address the risk. During the audit, several significant changes occurred, including the discovery of a material misstatement in inventory valuation and changes in the scope of audit procedures due to an unexpected acquisition by Z Ltd. The audit documentation for Z Ltd. should reflect these changes but the auditor of a company failed to document the audit strategy and the audit plan.

As a senior auditor of the firm briefly outline what should be included in the documentation of audit strategy and audit plan and how should the audit documentation address significant changes made during the audit engagement.

Answer:

The auditor shall document:

- (i) **The overall audit strategy:** The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team.
- (ii) **The audit plan:** The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.
- (iii) **Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes:** A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit.

Question 21:

(PYP May 25 4M)

M/s BPA & Associates, Chartered Accountants, was appointed as the auditors of Nissan Ltd., a company with PAN-India presence, for the financial year 2023-24. The audit report was issued on August 20, 2024. Following the issuance of audit report, CA P instructed junior team member Mr. Y to assemble the final audit file and prepare the Completion Memorandum.

- (i) Explain the meaning and significance of a Completion Memorandum.

- (ii) Team Member Y completed the assembly of the final audit file in March 2025 and handed it over to CA P. Was team member Y correct in his approach?

Answer:

- (i) **Meaning and Significance of Completion Memorandum:** The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes-

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

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

- (ii) **Assembly of the Final Audit File:** As per SQC 1, "Quality Control for Firms that perform Audits and Review of Historical Financial Information and other Assurance and related services", the auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.

In the given case, the audit report was issued on August 20, 2024 and CA P instructed team member Mr. Y to assemble the final audit file and to prepare completion memorandum. However, Mr. Y completed the assembly of the final audit file in the month of March 2025, i.e. more than 60 days, is non-compliance of SQC 1. Thus, the approach of team member Y is not correct.

Questions From RTP'S, MTP'S, QP'S

SA 500- Audit Evidence

Question 24**(MTP 2 May 25)**

Wire Limited, a company engaged in manufacturing of electric equipment, gets some part of its production processes outsourced from third parties. During the audit, the company had sent raw material to third parties for carrying out certain processes on these raw materials and such inventories worth Rs.1.50 crores (material to financial statements) were lying with different third parties as at year end. How can auditor obtain sufficient appropriate audit evidence in respect of existence and condition of inventories lying with third parties?

Answer: Already covered in MRP Qns

Question 25**(PYP Jan 25 4M)**

FRP & Associates are the statutory auditors of Paint Private Limited.

Company is into the business of trading and has operations across India. CA M, partner in charge of the audit, is carrying out the audit procedures with his audit team. He entrusted CA Ravi, one of the team members, the task of obtaining various audit evidences connected with the audit and submit the same to the engagement partner for finalizing the audit report. How can CA M ensure that the evidences collected by CA Ravi during the audit will be sufficient for the purpose of audit or not?

Answer:

The auditor has to obtain sufficient appropriate audit evidence to draw reasonable conclusions on financial statements. Sufficiency is the measure of the quantity of audit evidence.

CA M will ensure that the evidence collected by CA Ravi will be sufficient for the purpose of audit by considering following factors:

- (i) **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.
- (ii) **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, namely, inherent risk and control risk at the assertion level. 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.
- (iii) **Size of a population:** It refers to the number of items included in the population. Less evidence would be required in the case of smaller, more homogeneous populations but on the other hand in case of larger, more heterogeneous populations, more evidence would be required.

Question 26**(PYP Jan 25 5M)**

Identify and explain the assertions that the auditor will check by performing the following audit procedures-

- (i) Employee benefit expenses do not include the cost of any unauthorised personnel.
- (ii) All the items of inventory pertaining to the relevant year shall be included regardless of the location.
- (iii) Sales are recorded correctly in the books based on the invoices. Discounts have been properly

adjusted or accounted for.

- (iv) The entity owns or controls the inventory recorded in the financial statements. i.e. the purchase invoices have been made in the name of the client.
- (v) Inventory has been recognised at the lower of cost and net realizable value in accordance with AS 2 - Inventories.

Answer:

- (i) For Employee benefit expenses do not include the cost of any unauthorised personnel: The auditor will check the **occurrence assertion** for the same to ensure that transactions recognised in the financial statements have occurred and relate to the entity.
- (ii) All the items of inventory pertaining to the relevant year shall be included regardless of the location: The auditor will check the **cut-off assertion** to ensure that all assets and liabilities are reported in the appropriate period.
- (iii) Sales are recorded correctly in the books based on the invoices. Discounts have been properly adjusted or accounted for: The auditor will check **measurement assertion** to ensure transactions have been recorded accurately at their appropriate amounts in the financial statements. There have been **no errors while preparing documents** or in posting transactions to ledger. The figures and explanations are not misstated.
- (iv) The entity owns or controls the inventory recorded in the financial statements. i.e., the purchase invoices have been made in the name of the client: The auditor will check **rights & obligations assertion** to ensure that the entity has the right to assets (i.e. whether the entity has ownership and legal title to assets), and the **liabilities recognised in the financial statements** represent all the entity's obligations to repayment as at a given date.
- (v) Inventory has been recognised at the lower of cost and net realizable value in accordance with AS 2 - Inventories: The auditor will check **valuation assertion** to ensure assets, liabilities and equity balances have been valued appropriately i.e. the amounts at which they are recorded are appropriate. There has been no overstatement or understatement

SA 501 - Audit Evidence-Specific Considerations For Selected Items

Question 9

(PYP Jan 25 5M)

Fashion Garments Limited (FOL) is a company engaged in the manufacturing and sale of ready-made garments. The products manufactured by FGL cater to clothing requirements of men, women and kids section. Pearl & Associates, Chartered Accountants, is the statutory auditor of FGL. Partner CA Pearl asked her audit assistant to go through the segment information disclosed and presented in the financial statements. Assistant is new to the audit engagements and seeks her guidance on what is the key responsibility of the auditor in relation to segment information.

What should CA Pearl guide the assistant on the said matter ?

What audit procedures should CA Pearl perform to ensure that methods used by the management to present segment information are in accordance with the applicable financial reporting framework ?

Answer:

As per SA 501, "Audit Evidence-Specific Considerations for Selected Items", the auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:

- (1) Obtaining an understanding of the methods used by management in determining segment information, and
- (2) Performing analytical procedures or other audit procedures appropriate in the circumstances.

The auditor's responsibility regarding the presentation and disclosure of segment information is in relation to the financial statements taken as a whole. Accordingly, the auditor is not required to perform audit procedures that would be necessary to express an opinion on the segment information presented on a standalone basis.

Further, audit procedure performed by CA Pearl to ensure methods used by the management to present segment information are in accordance with the applicable financial reporting framework should include:

- ✓ Sales, transfers and charges between segments, and elimination of intersegment amounts.
- ✓ Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.
- ✓ The allocation of assets and costs among segments.
- ✓ Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

Question 10

(PYP Jan 25 4M)

NHG & Co., Chartered Accountants, is statutory auditor of M/s Backlog Private Limited (BPL) for the F.Y. 2023-24. BPL is engaged in providing telecom services and received a notice from telecom regulator to deposit fee for violating norms. BPL went into litigation and filed an appeal with telecom appellate authority and the matter is pending for decision as at the end of the financial year. However, the company has disclosed the same in financial statements. Audit team members have completed the audit procedures for the year 2023-24 and are in the process of drafting the audit report. Audit team leader knows that matter of norms violation and pending appeal need to be included in the audit report and seeks your guidance on how to report the matter in the auditor's report. Guide him suitably.

Answer:

As per SA 501 if the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel.

Further, as per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", the auditor shall report an uncertainty relating to the **future outcome of exceptional litigation or regulatory action**.

In addition to above, the auditor's report shall also state whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement as per Section 143(3) of the Companies Act, 2013.

In the given case, M/s BPL received a **notice to deposit fee** for violating norms. It went into litigation and **filed an appeal** which is pending for decision as at the end of the financial year. The company has **disclosed the same in the financial statements**. The auditor should assess that pending appeal requires adjustment in financial statements. He should ask **company management to make necessary adjustment** to the financial statements. If adjustment is **not made by management**, he should consider the **impact on auditor's report** and report accordingly.

Alternative Solution:

As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", the auditor shall **report an uncertainty** relating to the future outcome of exceptional litigation or regulatory action under Emphasis of Matter paragraph.

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- (i) Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "**Emphasis of Matter**";
- (ii) Include in the paragraph a **clear reference to the matter being emphasized** and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information **presented or disclosed** in the financial statements; and
- (iii) Indicate that the auditor's opinion is **not modified in respect of the matter emphasised**.

Question 11

(PYP May '25 5M)

T Ltd. has appointed NFO & Co., Chartered Accountants, as statutory auditors. Since **inventory is a material component** of the financial statements, CA F **plans to attend the physical inventory counting**. Provide any five matters that CA F **should consider when planning** their attendance at the physical inventory counting.

Answer:

Matters that CA F should consider when planning attendance at physical inventory counting are:

- (i) **Nature** of inventory.
- (ii) **Stages of completion** of work in progress.
- (iii) The **risks of material misstatement** related to inventory.
- (iv) The **nature** of the **internal control** related to inventory.
- (v) Whether adequate procedures are **expected to be established** and **proper instructions issued** for physical inventory counting.
- (vi) The **timing** of physical inventory counting.
- (vii) Whether the entity **maintains a perpetual inventory system**.
- (viii) 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
- (ix) **Whether** the assistance of an auditor's expert is needed to obtain SAAE.

SA 550- Related Parties**Question 4****(MTP 2 May '25)**

The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances.

During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the records or documents that may provide information about related party relationships and transactions. Explain in detail with examples.

Answer: Already covered in MRP Qns

SA 520 Analytical Procedures

Question 19

(MTP 2 May '25)

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

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

Answer:

- (i) The audit procedure used by auditor of ANT Limited is known as **Inspection** because inspection is an audit procedure in which complete documents and records of a company are checked in detail for the purpose of obtaining audit evidence.
- (ii) Mr. M is using **Observation** as audit procedure as Observation consists of looking at a process or procedure being performed by others.
- (iii) The audit procedure used by auditor is **Recalculation**. Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.
- (iv) CA Isha is using **Analytical Procedure** to obtain audit evidence. Analytical procedures consist of evaluations of financial information made by a study of plausible relationships among both financial and non-financial data. Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts.

SA 610 Using the Work of Internal Auditors

Question 3

(Model TP 4 Marks)

Auditors **cannot normally examine all the information** available to them as it would be impracticable to do so and using audit sampling will **produce valid conclusions**. Samples should be selected in such a manner that it is representative of the population from which the sample is being selected.

Which sample selection method is used in the following two cases? Identify and explain them briefly.

- (i) Auditor **divided the trade receivables** in three groups: balances above Rs. 20 lakhs, balances between Rs. 10 lakhs to Rs. 20 lakhs and balances below Rs. 10 lakhs. He selected **different percentages of items** from each group.
- (ii) Auditor uses the **sample of 50 consecutive cheques** to test whether the **cheques are signed by authorized signatories**, rather than picking 50 single cheques throughout the year.

Answer:**Sample Selections Methods:**

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

In the given case, Auditor divided the trade receivables in three groups i.e. balances above Rs. 20 lakhs, balances between Rs. 10 lakhs to 20 lakhs and balances below Rs. 10 lakhs and he selected different percentages of items from each group will be considered as Stratified Sampling.

- (ii) **Block Sampling:** This method involves **selection of a block(s) of contiguous items** from within the population. Usually, a **range of continuous transaction** shall have similar characteristics, therefore, selection of a **group at one time** will **not give a reasonable basis** for opinion on the overall population as different types of transactions and unusual transactions may **not be covered in the group taken all at once**.

In the given case, the auditor uses the sample of 50 consecutive cheques to test whether the cheques are signed by authorized signatories, rather than picking 50 single cheques throughout the year is Block Selection Method.

Question 4

(Model TP 3 Marks)

You are the statutory auditor of NP Ltd. Looking at the **huge size of similar transactions**, you directed your team members to **use statistical sampling**. One of the team members, Mr. Q, wants to select samples based upon his **personal experience & knowledge** as he is **not aware of statistical sampling**. You are required to explain to Mr. Q **why the use of statistical sampling method is more scientific and appropriate**.

Answer:

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

Statistical Sampling is **more scientific and appropriate** as:

Audit testing done through this approach 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.

There is no personal bias of the auditor in case of statistical sampling. Since it is scientific, the results of samples can be evaluated and projected on the whole population in a more reliable manner.

In larger organisations, with huge transactions, statistical sampling is always recommended as it is unbiased, and the samples selected are not prejudged

Question 5

(Model TP 3 Marks)

During the audit of accounts for the year ended 31.03.2024, the auditor of FD Limited wanted confirmation from a Trade Receivable, which was outstanding for more than six months, amounting to Rs. 4,25,000/-. The auditor sent a Confirmation letter to the party requesting them to respond directly to him, whether or not they agree with the amount outstanding from them.

That trade receivable confirmed to the auditor of FD Limited, that they were required to pay an amount of Rs. 4,20,000 to FD Limited as per their books of accounts.

State and explain the type of Confirmation Request sent by the auditor and the course of action that he should take on the confirmation received from the trade receivable.

Answer:

Positive confirmation request: A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request or providing the requested information.

Exception - A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party. The exception needs to be assessed to the entire population after analyzing the reason for difference.

In the given situation, the auditor has sent the positive confirmation request for the amount of 4,25,000 to a trade receivable which was outstanding for more than 6 months, however, due to difference between information requested to be confirmed, or contained in the entity's records (i.e. 4,25,000), and information provided by the confirming party (i.e. 4,20,000) is forming situation of exception confirmation.

The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been obtained or whether performing further audit procedures is necessary, as required by SA 330 in case a response is indicating an exception.

The company should be asked to investigate and reconcile the discrepancy indicated by the confirming party.

Question 6

(Model TP 4 Marks)

The management of D. Ltd. have engaged an actuary-expert to ascertain actuarial valuation of gratuity for provision to be made in the accounts. As an auditor of D. Ltd., you plan to use the report of the said expert as audit evidence for ascertaining appropriate valuation of provisions. As an auditor, what will you do to evaluate the competence, capabilities, objectivity and an understanding of the work of the actuary-expert who has carried out actuarial valuation of gratuity?

Answer:

As per SA 500, "Audit Evidence", issued by ICAI, when using the work of a management's expert as audit evidence the auditor should evaluate the competence, capabilities and objectivity of that expert that:

- ✓ Whether the expert is employed by the entity or is an outside party.
- ✓ Whether the expert is independent in respect of the entity.
- ✓ Auditor's previous experience of the work of the expert.
- ✓ Knowledge of the expert, his qualification, membership of a professional body or industry association, etc.

The auditor should also obtain an understanding of the work of that expert that:

- ✓ Whether the auditor has expertise to evaluate the work of the expert.
- ✓ Evaluating the assumptions and methods used by the management.
- ✓ Evaluating the nature of internal / external data used by the expert.

Question 7**(Model TP 5 Marks)**

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

Answer: Already covered in MRP Qns

Question 8**(Model TP 4 Marks)**

CA Z, the auditor of MNO Ltd., during the course of audit, assesses a risk of material misstatements regarding the litigations and claims involving the company. CA Z is not convinced with the management's explanations regarding the status of the litigations or claims. It is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general enquiry. The auditor sent a letter of specific enquiry requesting the entity's external legal counsel to communicate directly with the auditor. List out the inclusions in the letter of specific enquiry.

In certain circumstances the auditor may judge it necessary to meet with entity's external legal counsel to discuss the likely outcome of the litigations or claims. What will be auditor's reporting responsibility if the management refuses to give permission to the auditor to communicate or meet with the external legal counsel?

Answer:

A letter of specific inquiry includes:

- (i) A list of litigation and claims;
- (ii) Where available, management's assessment of the outcome of each of the identified litigation and claims and its estimate of the financial implications, including costs involved; and
- (iii) A request that the entity's external legal counsel confirm the reasonableness of management's assessments and provide the auditor with further information if the list is considered by the entity's external legal counsel to be incomplete or incorrect.

In certain circumstances, the auditor also may judge it necessary to meet with the entity's external

legal counsel to discuss the likely outcome of the litigation or claims. Further, if management refuses to give the auditor permission to communicate or meet with the entity's external legal counsel, or the entity's external legal counsel refuses to respond appropriately to the letter of inquiry, or is prohibited from responding, and the auditor is unable to obtain sufficient appropriate evidence by performing alternate audit procedures, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

Alternatively, if the auditor is able to perform alternate audit procedures and can obtain sufficient and appropriate audit evidence to resolve the issue, then he can give an unmodified opinion.

Question 9**(Model TP 3 Marks)**

M/s PSR & Associates are the auditors of The Saturn Hotel, a chain of five-star hotels. Since the nature of their business is prone to frauds, the company has appointed internal auditors at various locations. The company has also devised a system of effective and efficient internal controls. The auditors, M/s PSR & Associates, want to use the work of the internal auditors. In order to ensure effectiveness, what kind of coordination should be there between the external auditor and the internal audit function?

Answer:

As per SA 610, "Using the Work of Internal Auditors", coordination between the external auditor and the internal audit function is effective when, for example;

- (i) Discussions take place at appropriate intervals throughout the period.
- (ii) The external auditor informs the internal audit function of significant matters that may affect the function.
- (iii) The external auditor is advised of and has access to relevant reports of the internal audit function and is informed of any significant matters that come to the attention of the function when such matters may affect the work of the external auditor so that the external auditor is able to consider the implications of such matters for the audit engagement.

Question 10**(MTP 1 May '25)**

CA T, the statutory auditor of a company, is in the process of designing external confirmation requests to be sent to trade receivables outstanding as of March 31, 2024. As properly designed confirmation requests are essential to ensure the reliability and effectiveness of the audit evidence obtained. Further, well-structured requests help in reducing the risk of misstatements, non-responses, or misunderstandings by the recipients.

In this context, explain why designing a proper confirmation request is necessary and discuss the key factors an auditor should consider when designing confirmation requests.

Answer:

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

Factors to be considered when designing confirmation requests include:

- (i) The assertions being addressed.
- (ii) Specific identified risks of material misstatement, including fraud risks.
- (iii) The layout and presentation of the confirmation request.
- (iv) Prior experience on the audit or similar engagements.

- (v) The **method of communication** (for example, in paper form, or by electronic or other medium).
- (vi) Management's **authorisation or encouragement** to the confirming parties to respond to the auditor. Confirming parties may **only be willing to respond** to a confirmation request containing management's authorisation.
- (vii) The **ability of the intended confirming party** to confirm or provide the requested information (for example, individual invoice amount versus total balance).

Question 11**(MTP 2 May '25)**

Identify and explain the **assertions** that the **auditor will check** by performing the **following audit procedures**-

- (i) **Inventory recognised in the balance sheet** actually existed as at the period end.
- (ii) **All the items of inventory** pertaining to the relevant year shall be included regardless of the location.
- (iii) All goods **dispatched prior to the period/** year-end have been invoiced and included in debtors on a test check basis.
- (iv) **Examine client correspondence**, sales and receivables records, purchase documents.
- (v) Verifying that the entity has **charged depreciation on all items of PPE** unless any item of PPE is **non-depreciable like freehold land**.

Answer:

- (i) The auditor will check the **Existence Assertion to ensure Assets**, liabilities and equity balances exist as at the period end.
- (ii) The auditor will check the **Cut-off assertion** to ensure that all assets and liabilities are reported in the **appropriate period**.
- (iii) The auditor will check **Completeness Assertion** to ensure all Trade receivable balances that were supposed **to be recorded have been recognized** in the financial statements.
- (iv) The auditor will check **Rights & Obligations assertion** to ensure that the entity has **valid legal ownership rights** over the inventories claimed to be held by the entity and recorded in the financial statements.
- (v) The auditor will check **Valuation assertion** to ensure PPE have been **valued appropriately** and as per generally accepted accounting policies and practices

Question 12**(PYP Jan 25 5M)**

PQR & Co., Chartered Accountants, has been appointed as statutory auditor of MGM Ltd. The financial statements of the company have **material amount outstanding as debtors**. Ageing of debtors is being **done by the internal auditors** and is **given by them in their monthly report**. This issue was also discussed with the management. The engagement partner from PQR & Co. **decided to give the age wise debtors** as per the **report of internal auditor** due to shortage of time. After the audit report was released, the engagement partner realized that the disclosure of the debtors is **misleading and the ageing was not done** by the internal auditor on correct principles due to which the **provision made against old debtors** was wrong. The engagement partner held the **internal auditor responsible** for this. Is he correct in making statement that the internal auditor is **responsible for false provisioning**? What considerations PQR & Co. should have undertaken **before relying on the work** of internal auditor?

Answer:

In the given situation, the engagement partner has taken the **age wise debtor report** from the reports

of the internal auditor due to shortage of time and provided the same in the audit report. However, after the issuance of audit report, engagement partner felt that disclosure of debtors is misleading and ageing was not done on the basis of correct principles due to which wrong provisions are made.

Contention of the engagement partner for holding internal auditor responsible for the same is not correct as the external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement.

Before relying on the work of internal auditor, PQR & Co. should consider the following:

- (i) To determine whether the work of the internal audit function or direct assistance from internal auditors can be used, and if so, in which areas and to what extent; and having made that determination;
- (ii) If using the work of the internal audit function, to determine whether that work is adequate for purposes of the audit and
- (iii) If using internal auditors to provide direct assistance, to appropriately direct, supervise and review their work
- (iv) The extent to which the internal audit function's organizational status and relevant policies and procedures support the objectivity of the internal auditors
- (v) The level of competence of the internal audit function and
- (vi) Whether the internal audit function applies a systematic and disciplined approach, including quality control.

Questions From RTP'S, MTP'S, QP'S

Question 46:

(MTP 1 May '25)

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

Answer: Already covered in MRP Qns

Question 47:

(MTP 1 May '25)

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

Answer: Already covered in MRP Qns

Question 48:

(MTP 2 May '25)

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:

While planning the audit, the auditor may concentrate on the following:

- (i) **Knowledge of the NGO's work**, its mission and vision, areas of operations and environment in which it operate.
- (ii) **Updating knowledge of relevant statutes** especially with regard to recent amendments, circulars, judicial decisions viz. The Foreign Contribution (Regulation) Act 1976, The Societies Registration Act, 1860, The Income-tax Act 1961 etc. and the Rules related to the statutes.
- (iii) **Reviewing the legal form of the Organisation** and its Memorandum of Association, Articles of Association, Rules and Regulations.
- (iv) **Reviewing the NGO's Organisation chart**, then **Financial and Administrative Manuals**, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
- (v) **Examination of minutes of the Board/Managing Committee/Governing Body/ Management and Committees** thereof to ascertain the impact of any decisions on the financial records.
- (vi) **Study the accounting system, procedures**, internal controls and internal checks existing for the NGO and verify their applicability.
- (vii) **Setting of materiality levels** for audit purposes.
- (viii) **The nature and timing of reports** or other communications.
- (ix) **The involvement of experts** and their reports.
- (x) **Review** the previous year's **Audit Report**.

Question 49:

(MTP 2 May '25)

While auditing a renowned four-star hotel in Pune, CA Shrey **observes a gift shop** operating within the

hotel premises. On further enquiries, he comes to know that stocks in gift shop belong to gift shop owner and hotel receives rent for letting out this space. Discuss, how, auditor can verify payment of common amenities used by gift shop owner to the hotel.

Answer:

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

- ✓ The auditor should obtain and examine the rental/lease agreement entered into between the hotel and the gift shop owner.
- ✓ The auditor should verify rent receipts. This would enable the auditor to ensure that controls regarding revenue cycle are in order.
- ✓ The auditor should satisfy himself that all taxes collected from gift shop have been paid over to the proper authorities.
- ✓ Evaluate internal controls related to monitoring of utility consumption and collection of recoveries from tenants or concessionaires (like gift shops).
- ✓ Verify the hotel's utility bills (electricity bill, water bill etc.) and assess whether cost sharing with the gift shop is proportionate and reasonable.
- ✓ The auditor should verify that amounts charged for such amenities have been appropriately recorded in the hotel's books and that collections are reconciled with receipts.
- ✓ The auditor should see that costs of repairs and minor renovation and redecoration are treated as revenue expenditure, where as costs of major alterations and additions to the hotel building and facilities capitalised.

Question 50:

(MTP 2 May '25)

As per Multi-state Co-operative Societies Act, 2002, the auditor shall make a report to the members of the multi-state co-operative society on the accounts examined by him and on every balance sheet and profit and loss account and on every other document required to be part of or annexed to the balance sheet or profit and loss account. Explain.

Answer:

As per sub-section (3) & (4) of section 73 of the Multi-state Co-operative Societies Act, 2002, the auditor shall make a report to the members of the Multi-State Co-operative society on the accounts examined by him and on every balance-sheet and profit and loss account and on every other document required to be part of or annexed to the balance-sheet or profit and loss account, which are laid before the Multi-State co-operative society in general meeting during his tenure of office, and the report shall state whether, in his opinion and to the best of his information and according to the explanation given to him, the said account give the information required by this act in the manner so required, and give a true and fair view:

- (i) In the case of the balance-sheet, of the state of the Multi-State co-operative society's affairs as at the end of its financial year; and
- (ii) In the case of the profit and loss account, of the profit or loss for its financial year.

The auditor's report shall also state:

- (i) Whether he has obtained all the information and explanation which to the best of his knowledge and belief were necessary for the purpose of his audit.
- (ii) Whether, in his opinion, proper books of account have been kept by the Multi - State co-operative society so far as appears from his examination of these books and proper returns adequate for the purpose of his audit have been received from branches or offices of the Multi-State co-operative society not visited by him.
- (iii) Whether the report on the accounts of any branch office audited by a person other than the Multi - State co-operative society's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.
- (iv) Whether the Multi - State co-operative society's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and return.
- (v) Where any of the matters referred to in sub-section (3) or (4) is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

Question 51:**(Model TP 3 Marks)**

You have been appointed as an auditor of Co-operative society. During the course of audit, you have noticed some serious irregularities in the working of the society. Enumerate those special matters for reporting to the Registrar.

Answer:

Special report to the Registrar: During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society he may report these special matters to the Registrar, drawing his specific attention to the points. The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance, a special report may become necessary:

- i. Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.
- ii. Detection of fraud relating to expenses, purchases, property and stores of the society.
- iii. Specific examples of mis-management - Decisions of management against co-operative principles.
- iv. In the case of urban co-operative banks, disproportionate advances to vested interest groups, such as relatives of management, and deliberate negligence about the recovery thereof. Cases of reckless advancing, where the management is negligent about taking adequate security and proper safeguards for judging the credit worthiness of the party.

Question 52:**(Model TP 3 Marks)**

P Financial Services Ltd. (PFSL) is a leasing & hire purchase company. You, as an auditor of PFSL, are in the process of examining finance lease agreements executed by them for equipment given on lease. Which points shall be noted by you while examining a particular finance lease agreement entered into by PFSL in respect of a leasing transaction?

Answer:

The lease agreement should be examined, and the following points may be noted:

- i. the description of the lessor, the lessee, the equipment and the location where the equipment is to be installed. (The stipulation that the equipment shall not be removed from the described location except for repairs. For the sake of identification, the lessor may also require plates or markings to

be attached to the equipment).

- ii. the amount of tenure of lease, dates of payment, late charges, deposits or advances etc. should be noted.
- iii. whether the equipment shall be returned to the lessor on termination of the agreement and the cost shall be borne by the lessee.
- iv. whether the agreement prohibits the lessee from subletting the equipment and authorises the lessor to do so.

Question 53:
(Model TP 5 Marks)

You are appointed as an auditor of "The Prestigious Township Club". As the auditor of "The Prestigious Township Club" for the financial year 2023-24, what are the key points you would consider while auditing the income and expenditure items of the club?

Answer:

The following points need to be considered while auditing income and expenditure items of a club: -

- (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) **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 54:
(Model TP 5 Marks)

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

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

(I) Mr. Dhairya, a member of society, holds 200 shares amounting to ₹ 2000 from the previous year.

(II) Upon verifying the society's borrowings, the auditors found that Cooperative Society had accepted a loan from Mr. Shivam, a non-member. The auditors did not find any restrictions regarding this in the society's bye laws.

Comment on the above transactions of the society with reference to the Co-operative Societies Act, 1912.

Answer:

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

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

In the given situation, Mr. Dhairya, a member of the society, is holding 200 shares amounting to ₹ 2000 from the previous year. In view of the aforementioned restriction on shareholding by a member, Mr. Dhairya is allowed to hold a maximum of 100 shares according to the Act.

Further, Aman Co-operative Society had accepted a loan from Mr. Shivam, a non-member. Since, there are no restrictions regarding the acceptance of loan received from non-member in the society's bye-laws, the loan received from Mr. Shivam is permissible.

Question 55:

(Model TP 4 Marks)

Sanskar Foundation is a Non-Governmental Organisation (NGO) for orphan children. They have received voluntary contribution of Rs. 50 lacs from the promoters, specifying that Rs. 20 lacs are towards the Corpus contribution and Rs. 30 lacs are towards Revolving fund. Explain the terms "Corpus contribution" and "Revolving fund".

Answer:

A contribution made towards the capital or the corpus of an NGO is known as corpus contribution. The donors are generally required to specify whether the donation/grant given by him shall form part of the corpus of the NGO. Such contributions are generally given with reference to the total funds required by an NGO.

The objective of a contribution or grant towards a Revolving Fund is to rotate the amount by giving temporary loans from the fund to other NGO or beneficiaries for their projects and then recover the loan so as to give temporary loans again and so on. However, any interest earned from the beneficiary on such temporary loans from the revolving fund could be either added back to the fund or credited to the Income and Expenditure Account depending on restrictions laid down by the authority providing the contribution (for the revolving fund) or by the rules and regulations laid down by the concerned NGO in this regard.

Question 56:

(PYP Jan 25 4M)

Helping Hands Co-operative society is working for the welfare of its members since last 10 years. Governing body observed that the society had some idle funds during the F.Y. 2023-24 and considering the equity markets growth, decided to invest the same in blue chip mutual funds. Decision brought fortune and society earned handsome return on the investment made. Auditor of the society however gave a qualified opinion. Management has hired you to guide where they went wrong. Give your comments considering section 32 of the Central Act?

Answer:

According to section 32 of the Central Act, a society may invest its funds in any one or more of the following:

- (i) In the Central or State Co-operative Bank.
- (ii) In any of the securities specified in section 20 of the Indian Trusts Act, 1882.
- (iii) In the shares, securities, bonds or debentures of any other society with limited liability.
- (iv) In any co-operative bank, other than a Central or State co-operative bank, as approved by the Registrar on specified terms and conditions.
- (vi) In any other moneys permitted by the Central or State Government.

In the given case, Helping Hands Co-operative society invested the funds in blue chip mutual funds due to which auditor gave a qualified opinion. Helping Hands Co-operative society should invest the funds in accordance with Section 32 of Central Act as investment in blue chip mutual funds is not permissible.

Question 57:

(PYP Jan 25 5M)

CA P was consulted by one of his friends, Mr. Robin. Robin informed him that he wants to enter in education sector and invest in one of the schools being operated in the city. The operations of the school will be managed by Robin only and the proposed investment will be made once CA P confirms the revenue figures given to him (Robin) by existing management of the school. CA P said that main source of revenue to school is fee from students and that will be verified.

What special steps are involved in the verification of fees collected from students?

Answer: Already covered in TYK Qn

Question 58:

(PYP May 25 5M)

M/S PQ & Co., Chartered Accountants have been appointed as statutory auditors of CBD Multiplex Cinema Ltd. The audit team started the audit and verified the ledger and other books of accounts for the F.Y. 2024-2025. However, one of the team members is of the view that the internal control mechanism of the company should also be verified.

Can you guide the audit team about the areas that will be covered in verifying the internal control mechanism?

Answer: Already covered in MRP Qns

Questions From RTP'S, MTP'S, QP'S**Question 35:****(MTP 1 May '25)**

As the auditor of CRT Ltd., a construction company, for the year 2023-24, you are preparing an audit programme to systematically guide the audit procedures. A well-structured audit programme not only ensures efficient execution but also serves as documentary evidence in case of any allegations of negligence against the auditor. In this context, briefly explain advantages of audit programme that will supports the auditor during the audit of CRT Ltd.

Answer: Already covered in MRP Qns

Question 36:**(MTP 1 May '25)**

Jay & Associates, a Chartered Accountant firm is appointed as an auditor of XYZ Ltd., a manufacturing company with multiple branches across the region. CA Jay, Partner in firm, is conducting the audit of financial statements of XYZ Ltd. for the financial year 2023-24. As the lead auditor assigned to this engagement, Jay is responsible for planning the audit in accordance with SA 300. Briefly explain why it is necessary to plan the audit of XYZ Ltd.'s financial statements?

Answer: Already covered in MRP Qns

Question 37:**(MTP 2 May '25)**

The assistant of CA Bhavik is assigned responsibility of drafting "audit programme" relating to purchases appearing in financial statements of Arya Industries, a partnership firm for F.Y. 2023-24. The said firm is a GST registered taxpayer and is engaged in manufacturing of packing boxes from a special type of paper taxable under GST. Draft a sample audit programme for purchases.

Answer: Already covered in MRP Qns

Question 38:**(MTP 2 May '25)**

CA Tina, the auditor of SKY Ltd., asks its finance and audit head to prepare audit strategy for conducting audit of SKY Ltd. CA Tina also insists him to draw detailed audit procedures. In response to the auditor's request, the finance head of the company completes the audit strategy as well as audit procedures. Subsequently, the auditor realises that the effectiveness of the audit is compromised and it was his responsibility to prepare the overall audit strategy. Comment.

Answer: Already covered in MRP Qns

Question 39:**(Model TP 4 Marks)**

EFG Ltd. has appointed M/s. MN & Co., Chartered Accountants, as the statutory auditors for the year 2024-25. CA N, the engagement partner, completed his risk assessment procedure. However, he is concerned about the management of human resources to be employed to conduct the audit. For this purpose, he wants to establish an overall audit strategy for setting the scope, timing and direction of the audit. Describe how the process of establishment of overall audit strategy will assist him in managing deployment of his human resources for various audit areas.

Answer:

Establishing the overall audit strategy- Assistance for the auditor: Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan. The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

The **process of establishing** the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as: -

1. The **resources to deploy** for specific audit areas, such as the **use of appropriately experienced team members** for **high-risk areas** or the **involvement of experts** on complex matters
2. The **amount of resources to allocate** to specific audit areas, such as the **number of team members** assigned to observe the **inventory count at material locations**, the extent of review of other auditors' work in the case of group audits, or the **audit budget in hours** to allocate to high risk areas
3. **When these resources are to be deployed**, such as whether at an interim audit stage or at key cut-off dates
4. **How such resources are managed, directed and supervised**, such as when team briefing and debriefing meetings are expected to be held, **how engagement partner and manager reviews** are expected to take place (for example, on-site or off-site), and **whether to complete engagement quality control reviews**.

Question 40:**(Model TP 3 Marks)**

The engagement partner, of a firm of auditors, is **explaining to his audit team**, undergoing practical training, the **inter relationship between audit strategy and audit plan**. Discuss the points which the engagement partner will explain to his team in this regard.

Answer:**Relationship between audit strategy and audit plan**

- Audit strategy sets the **broad overall approach** to the audit whereas audit plan **addresses the various matters identified** in the overall audit strategy.
- Audit strategy determines **scope, timing and direction** of audit. Audit plan describes **how strategy is going to be implemented**.
- The audit plan is **more detailed** than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. **Planning** for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.
- Once the overall audit **strategy has been established**, an audit plan can be developed to address the **various matters** identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.
- The establishment of the overall audit strategy and the detailed audit plan are **not necessarily discrete or sequential processes** but are **closely inter-related** since changes in one may result in consequential changes to the other.

Question 41:**(Model TP 4 Marks)**

M/s. PP & Co, a firm of Chartered Accountants, has been auditing the books of accounts of KALI Ltd. for the past 3 years. The company has recently made some **major changes in its business policies**. While planning to start the audit for the 4th year i.e. for financial year 2024-25, the audit manager of the firm, as per the **routine practice, handed over the previous years' audit programme** as it is to the audit team with the **instructions to adhere unfailingly** to the said audit programme. Evaluate the decision of

the audit manager with reference to the use of audit programme.

Answer:

Review of the audit programme: There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions. Unless this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an obsolete programme and, for this negligence, the whole audit may be held as negligently conducted and the auditor may have to face legal consequences.

The utility of the audit programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed.

Audit programme not only lists the tasks to be carried out but also contains a few relevant instructions, like the extent of checking, the sampling plan, etc. So long as the programme is not officially changed by the principal, every assistant deputed on the job should unfailingly carry out the detailed work according to the instructions governing the work. Many persons believe that this brings an element of rigidity in the audit programme. This is not true provided the periodic review is undertaken to keep the programme as up-to-date as possible and by encouraging the assistants on the job to observe all salient features of the various accounting functions of the client.

In the given situation, Ms. PP & Co., a firm of Chartered Accountants has been auditing the books of accounts of KALI Ltd. for the past 3 years and the Company has recently made major changes in its business policies, therefore, it is very essential to review the audit programme. Thus, contention of the audit manager to adhere with the instructions of following the same audit programme as per routine practice is not correct.

Question 42:

(Model TP 4 Marks)

Lotus Ltd., a rapidly growing manufacturing company, appointed Ridhi & Co., as statutory auditor. The engagement team of Ridhi & Co. identified key areas requiring scrutiny, such as revenue recognition, inventory valuation, and related party transactions. Based on his professional judgment, CA Ravi, the engagement partner, directed the engagement team to focus on these critical areas, emphasising the need for detailed testing to ensure accuracy and compliance. Give some examples of the factors need to be considered by CA Ravi for establishing the audit strategy.

Answer:

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

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

Examples of the factors that need to be considered by CA Ravi for establishing audit strategy are: -

- ✓ Volume of transactions which may determine whether it is more efficient for the auditor to rely on internal control.
- ✓ Significant industry developments such as changes in industry regulations and new reporting requirements.

- ✓ Significant changes in the financial reporting framework, such as changes in accounting standards.
- ✓ Other significant relevant developments, such as changes in the legal environment affecting the entity.

Question 43:**(Model TP 5 Marks)**

The engagement partner, of a firm of auditors, is explaining to his audit team, undergoing practical training, the inter relationship between audit strategy and audit plan. Discuss the points which the engagement partner will explain to his team in this regard.

Answer: Already covered in MRP Qns

Question 44:**(PYP Jan 25 5M)**

AP & Co., Chartered Accountants, are appointed as statutory auditor of Heavy Industries Limited, a listed company engaged in manufacturing of electric vehicles, for the F.Y. 2023-24. As per the recent guideline issued by the regulatory authority, every listed company is required to maintain the digital database of all those personnel who could access the books of the company to avoid Insider Trading. In case of non-compliance, hefty fines may be imposed on the company. CA P is the engagement partner from auditor firm for the audit of Heavy Industries Limited. During planning, CA P planned that he would inquire from in-house IT Head of the company about the maintenance of the digital database to identify and assess the risk of non-compliance with regulatory guidelines. In the light of above facts, explain :

- i. Whether CA P is required to consider about the maintenance of digital database while framing audit strategy ?
- ii. Whether the procedures planned by CA P are in line with SA-300 ?

Answer:

- (i) As per SA 300, "Planning an Audit of Financial Statements", the auditor should establish an overall audit strategy that sets the scope, timing, and direction of the audit, and that guides the development of the audit plan. The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, key resources to be employed to conduct audit.

The auditor shall take following factors into consideration while establishing or framing audit strategy viz. identify the characteristics of the engagement that define its scope, consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts, etc.

In the given situation, the regulatory guideline requires Heavy Industries Ltd., a listed company, to maintain a digital database of all those personnel who could access the company's books to prevent insider trading. Further, hefty fines may be imposed in case of non-compliance with this guideline. Therefore, it is very essential that auditor while establishing overall audit strategy evaluate whether the company maintains such a database and complies with the regulatory requirement.

Thus, in view of above, it can be concluded that CA P should incorporate the assessment of digital database maintenance into the overall audit strategy.

- (ii) As per SA 300, "Planning an Audit of Financial Statements", planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework, etc.

In the given situation, CA P planned to inquire from in-house IT Head of the company regarding maintenance of the digital database to identify and assess the risk of non-compliance with regulatory

guidelines. Inquiry with the IT Head regarding the maintenance of the digital database is an appropriate procedure to understand whether the company complies with the regulations. This inquiry will help CA P in obtaining a general understanding of the legal and regulatory framework applicable to the company and how the entity is complying with that framework and other risk assessment procedures.

Thus, the planned inquiry with the IT Head is in line with SA 300.

Question 45:**(PYP May 25 5M)**

M/s YZW & Co., Chartered Accountants, have been appointed as the statutory auditors of First Health Private Limited for the financial year 2024-25. CA Y is the engagement partner for this assignment. First Health Private Limited operates in the business of hospitals and pharmaceuticals, with 60 hospitals and 200 pharmacy stores across the country. The company has a turnover of ₹ 680 crores and PAT of ₹ 32 crores in the current year.

While verifying the assertions about book debts, CA Y was informed about the availability of the client's ledger invoices, debit notes, and credit notes as audit evidence. CA Y accepts these documents as audit evidence, considering them to be "available."

- (i) Is this decision correct, based on the meaning of the term "available"?
- (ii) Also, explain how an auditor should select the most appropriate evidence when testing the accuracy of any assertion to form an opinion.

Answer:

- (i) In the given situation, M/s YZW & Co., Chartered Accountants, have been appointed as statutory auditor of First Health Private Limited which operates in business of hospitals and pharmaceuticals, with 60 hospitals and 200 pharmacy stores across the country. CA. Y, the engagement partner for this assignment, was informed about the availability of the client's ledger invoices, debit notes, credit notes as audit evidence. He accepted these documents as audit evidence, considering them to be "available". For verifying assertions about book debts, the client's ledger invoices, debit notes, credit notes, monthly accounts statement sent to the customers are all evidence: some of these are corroborative, other being complementary. In addition, balance confirmation procedure is often resorted to obtain greater satisfaction about the reliability of the assertion.

The word "available", does not mean that the evidence available with the client is the only available evidence. The auditor should know what normally should be available in the context of the transaction having regard to the circumstances and usage.

In view of the above, it can be concluded that decision of CA. Y to consider clients' ledger invoices, debit notes, credit notes as audit evidence, considering them to be available, is not correct.

- (ii) Evidence is the very basis for formulation of opinion and an audit programme is designed to provide for that by prescribing procedures and techniques. What is best evidence for testing the accuracy of any assertion is a matter of expert knowledge and experience. Transactions are varied in nature and impact; procedures to be prescribed depend on prior knowledge of what evidence is reasonably available in respect of each transaction.

In most of the assertions much of the evidence be drawn and each one should be considered and weighed to ascertain its weight to prove or disprove the assertion. In this process, an auditor would

be in a position to identify the evidence that brings the highest satisfaction to him about the appropriateness or otherwise of the assertion.

An auditor picks up evidence from a variety of fields and it is generally of the following broad types:

- i) Documentary examination
- ii) Physical examination
- iii) Statements and explanation of management, officials and employees
- iv) Statements and explanations of third parties
- v) Arithmetical calculations by the auditor
- vi) State of internal controls and internal checks
- vii) Inter-relationship of the various accounting data
- viii) Subsidiary and memorandum records
- ix) Minutes
- x) Subsequent action by the client and by others.

Question 46:**(PYP May '25 4M)**

The auditor shall take into consideration the reporting objectives of the engagement so as to plan timing of different audit procedures and also nature of communications while establishing audit strategy. Give any four instances of reporting objectives.

Answer: Already covered in MRP Qns

Questions From RTP'S, MTP'S, QP'S

Question 82:

(MTP 1 May '25)

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

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

Answer: Already covered in MRP Qns

Question 83:

(MTP 1 May '25)

Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority.

Explain the same in view of above.

Answer: Already covered in MRP Qns

Question 84:

(MTP 2 May '25)

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

- (i) GHK Private Limited is a start-up engaged in providing comprehensive solutions to the issue of paddy stubble burning, mainly catering to the needs of farmers of North-western India. Due to the importance given by governments to this issue, companies have entered the market in the past few years. Many of these companies have not been successful and have gone bust.
- (ii) A company has devised a control that its inventory of perishable goods is stored in appropriate conditions in a controlled environment to prevent any damage to inventory. Responsibility is fixed on two people to monitor the environment using sensors and to report on deviations.
- (iii) Shree Foods Private Limited is engaged in the manufacturing of garlic bread. The auditors of the company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that the misstatements in revenue recognition are not identified by planned audit procedures.

Answer: Already covered in Illustration Qns

Question 85:

(MTP 2 May '25)

While it is true that companies can benefit immensely from the use of data analysis in terms of increased profitability, better customer service, etc. Analyse various functions that an auditor can perform using Data Analytics tools and techniques to obtain good results.

Answer:

In today's digital age when companies rely on more and more on IT systems and networks to operate

business, the amount of data and information that exists in these systems is enormous. The combination of **processes, tools and techniques** that are used to tap vast amounts of electronic data to obtain meaningful information is called data analytics. While it is true that companies **can benefit immensely from the use of data analytics** in terms of increased profitability, better customer service, gaining competitive advantage, more efficient operations, etc., even auditors can make use of similar tools and techniques in the audit process and obtain good results.

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

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

Question 86:

(Model TP 4 Marks)

CA B, was the auditor of Star Limited. He wanted to ensure that the company **had correctly reconciled its bank accounts** and also wanted to understand **whether and how far the internal control system** was operating in the company. What kind of test of control was CA B performing? What are the other procedures that can be applied **while undertaking test of controls**?

Answer:

Inquiries of Management and Others Within the Entity: After assimilating the internal control system, the auditor needs to examine whether and how far the same is actually in operation. Test of controls are performed to obtain audit evidence about the effectiveness of the: -

- (i) **Design of the accounting** and internal control system
- (ii) **Operation** of the internal control throughout the period

In the given case, CA B was performing **Re-performance**. It involves the auditor's **independent execution of procedures** or controls that were **originally performed** as part of the entity's internal control, for example, reconciliation of bank accounts, to ensure they were correctly performed by the entity.

Other procedures that can be applied while undertaking test of controls are:

- ✓ **Inspection of documents** supporting transactions and other events to gain audit evidence that internal controls have operated properly, for example, verifying that a transaction has been authorised.
- ✓ **Inquiries about, and observation of, internal controls** which **leave no audit trail**, for example, determining who actually performs each function and not merely who is supposed to perform it.
- ✓ **Testing of internal control operating** on specific computerised applications or over the overall information technology function, for example, access or program change controls.

Question 87:**(Model TP 4 Marks)**

CA Amit is the auditor of LMN Ltd. While conducting the audit, he wanted to analyze the different components of internal control of the company. Identify and explain which component of internal control he is trying to understand in the following two cases: -

- (i) Whether controls in LMN Ltd. are operating as intended and they are modified as appropriate for change in conditions.
- (ii) Whether there exists proper segregation of duties in the company and the person responsible for recording a transaction is different from the person authorizing it.

Answer:

- (i) In this case, CA. Amit is trying to understand that whether controls in the LMN Ltd. are operating as intended and they are modified as appropriate for change in conditions: He is gaining the understanding of the Monitoring of controls component of internal control. Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It helps in assessing the effectiveness of controls on a timely basis and taking necessary remedial actions. It includes considering whether controls are operating as intended and that they are modified as appropriate for change in conditions.
- (ii) In the given situation, CA Amit is trying to understand that whether there exists a proper system of segregation of duties in the company and the person responsible for recording a transaction is different from the person authorising it. He is gaining an understanding of internal control of the company. In particular, he is understanding "control activities". When a person recording a transaction is different from one authorizing it, he gains confidence that there exists a system for preventing misstatements. It helps him in gaining insight into the internal control system of the company.

Question 88:**(Model TP 3 Marks)**

Z and Associates are the auditors of Realton Ltd., an export-oriented unit, which specializes in manufacturing oil extraction plants. Since many complex processes are involved, they are digitizing their operations. They are restructuring their business models which are driven by technology. Since most of the operations of the company are automated, Z and Associates are planning to do Digital Audit. Explain the use of digital technology in the conduct of an audit.

Answer:

Use of Digital Technology in the conduct of an audit: Entities are embracing digitization as part of their operations to keep pace with changing times. New technologies are helping companies revamp their operations and rethink the way business is conducted. Companies are restructuring their business models driven by technology. Automation is key to digitization.

In such a business environment, use of digital technology is being made by auditors right from planning to expression of final opinion.

- ✓ Auditors are making use of artificial intelligence, data analytics and other latest technologies to help understand business processes in a better way.
- ✓ By using such tools, auditors can conduct audits in a better way and devote more attention to areas requiring greater focus.
- ✓ Digital audit is helping auditors to better identify risks making use of technology

Question 89:**(Model TP 4 Marks)**

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

Answer:

As per SA 315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment", the auditor **shall obtain an understanding of the relevant industry, regulatory and other external factors** including the applicable financial reporting framework. Relevant industry factors include industry conditions such as the competitive **environment, supplier and customer relationships**, and technological developments.

- ✓ Examples of matters the auditor may consider include **market and competition**, whether entity is engaged in **seasonal activities**, product technology relating to the entity's products. The industry in which the entity operates may give rise to **specific risks of material misstatement arising from the nature** of the business or the **degree of regulation**.
- ✓ Relevant regulatory factors **include the regulatory environment**. The regulatory environment includes, among other matters, the applicable financial reporting framework and the legal and political environment.
- ✓ Examples of matters the auditor may consider include **accounting principles and industry specific practices**, regulatory framework for a regulated industry, legislation and regulation that significantly affect the entity's operations, including **direct supervisory activities, taxation, government policies currently affecting the conduct** of the entity's business, environmental requirements affecting the industry and the entity's business.
- ✓ Examples of other external factors affecting the entity that the auditor may consider include the **general economic conditions, interest rates and availability** of financing and inflation etc.

Question 90:**(Model TP 3 Marks)**

Mr. Z, at the time of appointment as an independent director in EF Ltd. a listed company, came to know that the Companies Act, 2013 has placed a **greater emphasis on the effective implementation and reporting on internal controls** for a listed Company. He wants to know the responsibilities as casted under Companies Act, 2013 with regards to Internal Financial Control for (1) Directors (2) Independent directors and (3) Audit committee as per **section 134(5)(e), 149(8) & 177(4) (vii)** respectively of the Companies Act, 2013.

Answer:

Internal financial controls as per regulatory requirements: The Companies Act, 2013 has placed a greater emphasis on the effective implementation and reporting on the internal controls for a company. The term "**internal financial controls**" is used at some places in Companies Act, 2013 casting responsibilities as under: -

Relevant provision of Companies Act, 2013	Nature of Responsibility
Section 134(5)(e)	In case of listed Companies, the Directors' responsibility statement shall state that the Directors had laid down Internal financial controls to be

	followed by the company and that such Internal financial controls are adequate and were operating effectively.
As per Section 149(8) of the Act	The company and independent directors shall abide by the provisions specified in Schedule IV which lays down the Code for independent Directors. As per this code, the role and functions of independent directors include that they shall satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible.
Section 177(4)(vii) of the Act	Every audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include - evaluation of internal financial controls and risk management systems.

Question 91:**(Model TP 3 Marks)**

You are appointed as the auditor of a company manufacturing paints. The company has a robust system of internal control. Most of the controls in the company are automated and they are working effectively. However, in certain situations, manual elements in internal controls are more suitable. What are the circumstances where manual elements in internal controls may be more suitable?

Answer:

Manual elements vs automated elements in entity's internal control: Manual elements in internal control may be more suitable in the following circumstances:

- ✓ Where judgment and discretion are required.
- ✓ Large, unusual or non-recurring transactions.
- ✓ Circumstances where errors are difficult to define, anticipate or predict.
- ✓ In changing circumstances that require a control response outside the scope of an existing automated control.
- ✓ In monitoring the effectiveness of automated controls.

Question 92:**(PYP Jan 25 4M)**

Spare Parts Limited received an input from internal auditors that internal controls implemented by the company appears to be reasonable but not so strong that any fraudulent activity can be prevented or timely detected by such controls. Accordingly a qualified person should head the internal controls department. CA Raj has been appointed as an Internal Control Head of the company. His scope of work includes development of internal controls in various departments/areas of the company. On his joining, he studied the various verticals and after identifying the important areas (prone to fraud) implemented strong controls in those areas. In his meeting with senior management and statutory auditors, he assured that satisfactory control environment exists and fraud cannot happen. Whether existence of a satisfactory control environment can be considered as an absolute deterrent to fraud ?

Answer:

- ✓ Existence of a satisfactory control environment is not an absolute deterrent to fraud. The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement.
- ✓ However, although it may help reduce the risk of fraud, a satisfactory control environment is not an absolute deterrent to fraud.

- ✓ Conversely, deficiencies in the control environment may undermine the effectiveness of controls, in particular in relation to fraud. For example, management's failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or to data, or unauthorised transactions to be processed.
- ✓ The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls.
- ✓ For example, the monitoring of controls and the operation of specific control activities and thereby, the auditor's assessment of the risks of material misstatement.

Question 93:**(PYP Jan 25 4M)**

In an automated environment, there are generally four types of audit tests available. As a senior auditor, it's crucial to guide your team in selecting the appropriate audit tests based on the situation. Explain the types of audit tests commonly used in an automated setting and provide insights on how to determine when and which tests to apply, emphasizing the role of professional judgment in making these decisions.

Answer:

There are basically four types of audit tests that should be used are inquiry, observation, inspection and reperformance.

Inquiry is the most efficient audit test, but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient.

Reperformance is most effective as an audit test and gives the best audit evidence. However, testing by reperformance could be very time consuming and least efficient most of the time.

Generally, applying inquiry in combination with inspection gives the most effective and efficient audit evidence. However, which audit test to use, when and in what combination is a matter of professional judgement and will vary depending on several factors including risk assessment, control environment, desired level of evidence required, history of errors/misstatements, complexity of business, assertions being addressed. The auditor should document the nature of test (or combination of tests) applied along with the judgements in the audit file.

Question 94:**(PYP May 25 5M)**

Mention the types of control in an automated environment.

Identify the type of control in the following table in Column B against Column A which contains areas where controls are to be implemented in an automated environment.

Column A	Column B
Access security	?
Sequence number checks	?
Data centre and network operations	?
Mandatory data fields	?

Answer:

Types of Controls in an automated environment: Controls in an automated environment can be categorised as under: -

- (i) General IT controls

- (ii) Application controls
(iii) IT-dependent controls

Column A - Areas where Controls to be implemented	Column B - Type of Controls
Access security	General IT controls
Sequence number checks	Application controls
Data centre and network operations	General IT controls
Mandatory data fields	Application controls

Questions From RTP'S, MTP'S, QP'S

Question 35:

(MTP 1 May '25)

Advances generally constitute a major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors. Explain the broad considerations about which the auditor is primarily concerned with obtaining evidence in carrying out audit of advances.

Answer: Already covered in MRP Qns

Question 36:

(MTP 2 May '25)

During the audit of Grace Pvt. Ltd., CA Tanu notices that significant amount of depreciation and amortisation charges are reflected in financial statements of the company. Which attributes need to be considered by him while verifying such depreciation and amortisation charges?

Answer:

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

- ✓ Obtain the understanding of entity's accounting policy related to depreciation and amortisation.
- ✓ Ensure the Company policy for charging depreciation and amortisation is as per the relevant provisions of Companies Act/ applicable accounting standards.
- ✓ The accounting policy has been applied consistently year on year. Any change in the accounting policy has been adequately disclosed.
- ✓ Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.
- ✓ Whether depreciation and amortisation charges are valid.
- ✓ Whether depreciation and amortisation charges are accurately calculated and recorded.
- ✓ Whether all depreciation and amortisation charges are recorded in the appropriate period.
- ✓ Whether each part of an item of PPE with a cost that is significant in relation to the total cost of the item have been depreciated separately.
Example: It may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.
- ✓ Whether the most appropriate depreciation method for each separately depreciable component has been used.

Question 37:

(MTP 2 May '25)

CAR Ltd., an automotive parts manufacturer, appointed Amit & Associates as auditors for F.Y. 2023-24. During the audit, CA Amit noticed a significant rise in raw material consumption (steel and aluminium) despite a decrease in production. This discrepancy led to detailed reviews of vendors supplying these raw materials. While verifying the existence of vendors and the actual receipt of goods or raw materials by the company, which assertion is being verified by CA Amit. Explain the procedure for the same.

Answer:

CA Amit is verifying Occurrence Assertion while verifying the existence of vendors and the actual receipt of goods or raw materials by the company.

The audit procedures generally required to be **undertaken while verifying Occurrence Assertion**:

Ensure purchases are not understated/ overstated by performing following audit procedures:

- ✓ Whether any **fictitious vendors have been booked** or purchases have been recorded by reviewing the vendor selection process followed by the entity and also performing procedures to ensure existence of the vendors.
- ✓ Whether the goods were **received at the factory gate** and whether there exists an entry in the security gate inward register.
- ✓ Whether **quality inspection of goods** was done.
- ✓ Whether a goods receipt note was **prepared and signed** by an appropriate client personnel.
- ✓ Whether the **purchase invoice was approved** as per delegation of authority and whether a 3 or 2-way match was done.
- ✓ Whether **stock record has been updated** by the stores personnel.

Special considerations during audit of purchases:

- ✓ The purchase invoice received should be the "**Original**" copy (and not photocopy/ carbon copy) against which the entity has recorded the purchase in its books of account.
- ✓ Purchase invoice should have been **booked only once** risk and reward incidental to ownership has been transferred to the entity. **Specific consideration** for cases where the **terms of delivery** as agreed with vendor are F.O.B., C.I.F. etc.
- ✓ **Purchase invoice should be in the name of entity**. However, in case of different branches, it should be addressed to the appropriate branch.
- ✓ Input tax component should have been **booked in the input tax ledger**. The auditor should **obtain tax returns filed with the authorities and tally** the input tax as reflected in the books to the amount disclosed in the returns.
- ✓ In case of **purchases made from related parties** or allied and associated concerns, the auditor needs to verify if **requisite approval from Board of Directors** (appropriate authority) has been **obtained** and should **verify the selected samples** and perform **analytical procedures** in relation to price of goods to confirm that the price **charged is at arm's length**.
- ✓ The auditor should **review whether purchases should be capitalized or expensed off** in Statement of Profit and loss according to his professional judgement.
- ✓ **Review journal entries for unusual transactions**.

Question 38:

(Model TP 4 Marks)

Alfa Limited **has availed bank overdraft facility** from a nationalized bank. The company received balance confirmation certificate for bank overdraft balance as on 31.03.2024 from the bank.

Particulars	Amount (Rs.)
Bank overdraft balance as per Bank Certificate	25,66,200/-
Bank overdraft balance as per Ledger	26,45,300/-

How will you **vouch/verify borrowings from Bank** taken by Alfa Limited?

Answer:

Vouching /Verification of borrowings from Bank: The auditor is required to roll out and obtain independent balance confirmations in respect of all the borrowings from the lender (banks/ financial institutions etc.) and perform the following:

- ✓ **Ascertain that the confirmation asks** for all information **likely to be relevant** to the tests of debt and related interest balances (e.g., applicable interest rates, due dates, collateral and security interests).
- ✓ **Send reminders** for non-replies.
- ✓ Compare the **balances as per the confirmations** obtained to the books of the accounts. Ask for reconciliations, if there are any differences and test the supporting documents for the reconciling items on a test check basis.
- ✓ **Reconcile the balances** in the overdrafts or loan accounts with that shown in the pass book(s) and confirm the last-mentioned balance by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.
- ✓ **Obtain independent balance confirmation** from the bank showing balances, particulars of securities deposited with the bank as security for the loans or of the charge created on an asset and confirm that the same has been **correctly disclosed** and **duly registered with Registrar** of Companies and recorded in the Register of charges.
- ✓ **Verify the authority** under which the **loan or draft has been raised**. In the case of a company, **only the Board of Directors** is authorised to raise a loan or borrow from a bank.
- ✓ Confirm, in the case of a company, that the **restraint contained in Section 180** of the Companies Act, 2013 as regards the maximum amount of loan that the company can raise **has not been contravened**.
- ✓ Ascertain the **purpose for which loan has been raised** and the **manner** in which it has been **utilised** and that this **has not prejudicially affected** the entity.

Question 39:

(Model TP 3 Marks)

K Ltd. is **availing cash credit limit** of Rs. 25 crores from LMN Bank Ltd. The drawing power of the company range between Rs. 22 crores and Rs. 25 crores during the year 2023-24. The **limit availed** by the company **remained less than Rs. 20 crores** during all the days of the financial year 2023-24. The company **has not deposited any amount** in the cash credit account and there are **no other credits** to this account during the **last two quarters**. How will this account be classified in the books of LMN Bank Ltd. as on 31-03-2024? Explain.

Answer: **Already covered in MRP Qns**

In the given case, K Ltd. is availing cash credit limit of Rs. 25 crores from LMN Bank Ltd and the drawing power of the company range between Rs. 22 crores and Rs. 25 crores during the year 2023-24. The limit availed by K Ltd. **remained less than Rs. 20 crores** during all the days of the financial year 2023-24 and the company **has not deposited any amount in the cash credit account** and there are **no other credits** to this account during the last two quarters.

Thus, account should be **treated as out of order** in the books of LMN Bank Ltd. as the outstanding balance in the principal operating account (Rs. 20 crore) is less than the sanctioned limit/drawing power (Rs. 22 cores and Rs. 25 crores), but there are **no credits continuously for 90 days** as on the date of Balance Sheet.

Question 40:

(Model TP 4 Marks)

You are the auditor of Plus Bank Limited. The bank has made following provisions for the year ended on 31.03.2024:

Particulars	Amount (Rs. In crores)
Provision for Bad Debts	66
Provision for Sub-standard Assets	78
Provision for Expenses	24
Provision for Income Tax	55

You are in the process of verifying the provisions and contingencies of the bank. What audit approach and procedures will you adopt to verify the above?

Answer: Already covered in MRP Qns

Question 41: (Model TP 3 Marks)

LD Ltd. has given below loans to the following borrowers during the financial year 2023-24. Mr. B an auditor wants your guidance regarding additional regulatory information required to be provided under the Companies Act, 2013:

Borrowers	Maximum Loan granted during the year 2023- 2024 (Rs. in Lakh)	Outstanding Loan as at 31/03/2024 (Rs. in Lakh)
X (Promoter)	20	15
Y (Director)	30	25
Z (KMP)	10	05
A (Related Party)	20	10
Others	80	65
Total	160	120

Answer:

As additional regulatory requirements, following disclosures shall be made where Loans or Advances in the nature of loans are granted to promoters, Directors, KMPs and the related parties (as defined under Companies Act, 2013,) either severally or jointly with any other person, that are:

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

Type of Borrower	Amount of loan or advance in the nature of loan outstanding (Rs. In Lakhs)	Percentage to the total Loans and Advances in the nature of loans (Rs. in Lakhs)
X (Promoter)	15	12.5% = $15/120 \times 100$
Y (Director)	25	20.833% = $25/120 \times 100$
Z (KMP)	05	4.167% = $5/120 \times 100$
A (Related Party)	10	8.333% = $10/120 \times 100$

Question 42: (PYP May '25 4M)

Compute the Drawing power for Cash Credit limit granted to S Ltd. by Trust Bank for the month of March 2025 from the following information:

Particulars	Amount in (Rs.)
Value of stocks	50,000

Value of debtors (including debtors of 5,000 for an invoice dated 17.11.2024)	45,000
Value of creditors for goods	15,000
Sanctioned limit	45,000

Margin on stock is 20% and on debtors is 50%.

Note: Debtors older than 3 months are ineligible for calculation of D.P.

Answer:

Computation of Drawing power of S Ltd. for the month of March 2025:

Value of stocks	Rs. 50,000
Less: creditors for goods	Rs. 15,000
Value of Paid stocks	Rs. 35,000
Less: Margin @ 20%	Rs. 7,000
Drawing power (A)	Rs. 28,000
Value of debtors	Rs. 45,000
Less: debtors exceeding 90 days	Rs. 5,000
	Rs. 40,000
Less: Margin @ 50%	Rs. 20,000
Drawing Power (B)	Rs. 20,000
Drawing Power (A+B)	Rs. 48,000

The sanctioned limit given in the question is Rs. 45000 whereas drawing power as per the above working is Rs. 48000. Accordingly, drawing power for Cash Credit Limit granted to S Ltd. by Trust Bank for the month of March 2025 would be restricted to sanctioned limit i.e Rs. 45000.

Questions From RTP'S, MTP'S, QP'S

Question 59:

(MTP Mar '25)

CA T is the statutory auditor of QRS Ltd. While performing testing of additions during the year, he wanted to verify that:

- (i) All PPE (property, plant and equipment) are in the name of the entity he is auditing.
- (ii) For all additions to land and building in particular, the auditor desires to have concrete about the ownership.
- (iii) CA T also wants to know whether the entity has valid legal ownership rights over the PPE, where it is kept as security for any borrowings.

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

Answer: Already covered in MRP Qns

Question 60:

(MTP Mar '25)

WEQ Ltd. has issued shares for cash at a premium. In accordance with section 52 of the Companies Act, 2013, the company is required to transfer the premium received from the issuance of shares to the securities premium account. What are the specific applications allowed for the funds in the securities premium account, as per the provisions of the Companies Act, 2013?

Answer: Already covered in TYK Qns

Question 61:

(MTP Mar '25)

SRT Pvt. Ltd., based in Mumbai, is engaged in export of brassware goods. The company has huge export receivables as on 31st March 2024. It is also analysed from Export Sales account of the company that large number of small shipments were almost despatched daily during the month of March 2024. The auditor is ensuring that all goods despatched prior to the year-end have been invoiced. Which assertion concerning trade receivables is being verified by auditor? List out few audit procedures you would adopt as an auditor to verify this assertion.

Answer:

In the given situation, the auditor is verifying Completeness assertion by ensuring that all goods despatched prior to the year-end have been invoiced.

Audit procedures to be adopted by the auditor to verify the Completeness assertion are as under:

- ✓ Check that in respect of invoices raised in last few days nearing the cut-off date, goods have been actually dispatched and not lying with the company.
- ✓ Test invoices listed in receivable report. Select few invoices from the accounts receivable ageing report and compare them to supporting documentation to see if they were billed with the correct amounts, to the correct customers, and on the correct dates.
- ✓ Match invoices to shipping/ dispatch log. Match invoice dates to the shipment dates for those items in the shipping/ dispatch log, to see if sales are being recorded in the correct accounting period. This can include an examination of invoices issued subsequent to the period being audited, to see if they should have been included in the period under audit.
- ✓ Assess bill and hold sales. If there is a situation where the Company is billing customers for sales despite still retaining the goods on-site (known as "bill and hold"), examine supporting documentation

to determine whether a sale has actually taken place or not.

- ✓ Review the receiving log to see if the Company has recorded an inordinately large amount of customer returns after the audit period, which would suggest that the Company may have shipped more goods near the end of the audit period than what the customers had authorized to inflate the profits of the company.
- ✓ Review the process of giving discounts/ incentives and check whether the same were given as per the Company's policy/ general industry trends.

Question 62:

(Model TP 3 Marks)

Schedule III of the Companies Act, 2013 prescribes disclosure of certain ratios as a part of Additional Regulatory Information. Mention any 3 ratios that should be disclosed along with the Rules relating to disclosure of these ratios.

Answer:

Disclosure of Ratios as a part of Additional Regulatory Information as per Schedule III of the Companies Act 2013 and its Rules relating to disclosure are:

1. Current Ratio,
2. Debt-Equity Ratio,
3. Debt Service Coverage Ratio,
4. Return on Equity Ratio,
5. Inventory turnover ratio,
6. Trade Receivables turnover ratio,
7. Trade payables turnover ratio,
8. Net capital turnover ratio,
9. Net profit ratio,
10. Return on Capital employed,
11. Return on investment.

Rules relating to disclosures of Ratios: The company shall explain the items included in the numerator and denominator for computing the above ratios.

Further explanation shall be provided for any change in the ratio by more than 25% as compared to the preceding year.

Question 63:

(Model TP 4 Marks)

JB Limited has invested huge sums of money on establishment of new Property, Plant and Equipment during the year under audit. They have incurred an amount of Rs. 5,70,000/- on dismantling of an old plant, which had become obsolete, so that a new plant can be set up at the existing location. The Auditor is in the process of verifying the cost incurred towards addition to Property, Plant and Equipment. What should be the accounting treatment of the amount spent on dismantling of old plant in the financial statements? Which elements of cost should be considered for valuing Property, Plant and Equipment?

Answer:

In the given situation, JB Limited has invested huge sums of money on establishment of new Property, Plant and Equipment and incurred an amount of Rs. 5,70,000 on dismantling of old plant which had become obsolete so that new plant can be set up at the existing location. An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost. The costs of dismantling,

removing the item and restoring the site on which it is located referred to as decommissioning will form part of the new Property, Plant and Equipment.

Elements of Cost: The cost of an item of property, plant and equipment comprises:

- (i) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- (ii) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
- (iii) the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as decommissioning, restoration and similar liabilities', the obligation for which an enterprise incurs either when the item is acquired or/as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Question 64:

(Model TP 4 Marks)

Kyte Private Limited acquired an immovable property of substantial value during the financial year 2023-24, which is recorded in the financial statements as an addition in the Schedule of PPE. The auditor also observed that this immovable property has been mortgaged to a bank for availing credit facilities. How should the auditor verify the rights and obligations assertion for this property to ensure the entity's legal ownership and identify any charges against it?

Answer: Already covered in TYK Qns

Question 65:

(Model TP 4 Marks)

ABC & Co. are in the business of manufacturing toys. The stock taking process has been done by the company as on 31.3.2024. The company has used FIFO method for valuation of its inventories. The cost of inventory as on 31.3.24 is Rs. 25,25,000/- and the net realizable value of the inventory on the same date is Rs. 25,24,000/-.

The cost of inventory includes the following:

- (1) Material purchase cost - Rs. 25,05,000/-
- (2) Allocated transport cost - Rs. 18,000/-
- (3) Abnormal wastage - Rs. 2,000/-

The management seeks your advice in arriving at the value of inventory to be shown in the financial statements of the company. What should be the value of inventory in accordance with AS-2?

Answer:

Value of Inventory: Inventory to be recognized at the lower of cost and net realizable value in accordance with AS 2 - Inventories. Further, any costs that could not be reasonably allocated to the cost of production (e.g. general and administrative costs) and any abnormal wastage have been excluded from the cost of inventory. An acceptable valuation basis (e.g. FIFO, Weighted average etc.) has been used to value inventory as at the period-end.

In the given situation, ABC & Co. is using FIFO method for valuation of its inventories. Further, cost of inventory as on 31.03.2024 is rupees 25,25,000 which includes material purchase cost of rupees 25,05,000, allocated cost of transport of rupees 18,000 and abnormal wastage of rupees 2,000. Net realizable value of said inventory is Rs. 25,24,000. In view of provisions of AS 2, cost allocated to transport for inventory is relating to bringing the inventory to the location, thus it will be added in cost of material. However, abnormal wastage of rupees 2000 should be excluded from cost of inventory.

Thus, cost of inventory will be Rs. 25,25,000 - Rs. 2,000 = 25,23,000 rupees and Net realizable value of inventory is Rs. 25,24,000.

For valuation in accordance with AS 2, "Inventory", lower of cost and net realizable value will be considered. Accordingly, **Rs. 25,23,000 to be considered as value of inventory** in the given situation.

Question 66:**(Model TP 4 Marks)**

HR & Associates are the auditors of a large manufacturing company. The company has recently **invested huge amount** in Property, Plant and Equipment (PPE) **for its new unit**. They have added many **incidental expenses to the cost of PPE**. The junior audit team members are **not sure about which costs should be excluded from the cost of PPE**. Give examples of costs that should not form part of costs of PPE.

Answer:

Examples of costs that are not costs of an item of property, plant and equipment are:

- (i) **costs of opening a new facility** or business, such as, inauguration costs;
- (ii) **costs of introducing a new product** or service (including costs of advertising and promotional activities);
- (iii) costs of **conducting business in a new location** or with a new class of customer (including costs of staff training); and
- (iv) **administration** and other **general overhead costs**.

Question 67:**(PYP Jan 25 5M)**

ABC & Co., a Chartered Accountant firm, has been appointed as the statutory auditors of Pen Private Limited for the F.Y. 2023-24. During audit, one of the team members, Mr. R noticed that Pen Private Limited **has purchased software** amounting to Rs.2.00 crore and the said software is **not an integral part of the related hardware**. Mr. R further observed that Pen Private Limited has conducted some research of an internal project work **amounting to Rs.1.00 crore**. Pen Private Limited, following Indian GAAP, has presented the aforesaid details in the Balance Sheet as on 31st March, 2024 as follows:

Property, Plant, and Equipment	Rs.
- Software	2.00 crore
- Research	1.00 crore

Mr. R approached the engagement partner with above details and enquired about the **correctness of the presentation** made by Pen Private Limited in terms of Schedule III to the Companies Act, 2013. Mr. R further wanted to ensure that **all additions to Intangible assets** during the year 2023-24 have been **recorded appropriately** in the financial statements of Pen Private Limited. Guide Mr. R.

Answer:

Where the software is **not an integral part** of the related hardware, computer software is treated as an intangible asset. Thus, purchase of software, which is not an integral part of related hardware, amounting to Rs.2 crore by Pen Private Limited **should be presented in the Balance Sheet under the head intangible asset not under the head Fixed Asset**.

Further, Expenditure on research (or on the research phase of an internal project) should be **recognised as an expense** when it is incurred. Therefore, presentation of research amounting to Rs.1 crore of an integral project work by Pen Private Limited under the head Property, Plant and Equipment as Research is not correct as it should be recognised as an expense.

Audit Procedure for ensuring **all additions to Intangible assets** during the year have been recorded appropriately in the financial statements of Pen Private Limited:

- ✓ For all material additions, verify whether such expenditure meets the criterion for recognition of an intangible asset as per AS 26.
- ✓ Ensure that no intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred.
- ✓ Check the certificate or report or other similar documentation maintained by the entity to verify the date of use of the intangible which could be linked to date of commencement of commercial production/ economic use to the entity, for all additions to intangible assets during the period under audit.
- ✓ Verify whether the additions (acquisitions) have been approved by appropriate entity's personnel.
- ✓ Verify whether proper internal processes and procedures like inviting competitive quotations/ proper tenders etc. were followed prior to finalizing the vendor for procuring item of intangible assets by testing those documents on a sample basis.

Question 68:**(PYP Jan 25 5M)**

Projects India Limited (PIL) is engaged in manufacturing and trading of disposable glasses and plates used in social gatherings/functions. XYZ & Co., Chartered Accountants, is the statutory auditor of PIL for the F.Y. 2023-24. Analytical procedures carried out by the audit team, headed by CA Z, indicate that company's business is going downward and PIL could achieve only 50% of total revenue of F.Y. 2022-23. Management has not taken any steps to increase the revenue or add new products or customers to stabilize the revenue and profitability. Also the suppliers are demanding cash payment at the time of purchase of raw material. Before finalizing the audit report, audit in charge asked for a cash flow forecast from management for the next 12 months from the end date of financial statements. Keeping in view the above facts, answer the following:

- (i) What can be the likely purpose of CA Z in the above situation?
- (ii) State any two audit procedures in relation to the cash flow forecast likely to be performed by CA Z.

Answer:

- (i) In the given situation, CA Z indicated that the company's business is going downward and 50% of total revenue is also being achieved, further, no steps are being taken by the management to stabilize the revenue and profitability. Accordingly, auditor in-charge asked for a cash flow forecast from management for the next 12 months to analyse as it is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions. Thus, likely purpose of CA Z in the given situation are:
 - (1) to obtain sufficient appropriate audit evidence regarding and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;
 - (2) to conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and
 - (3) to report in accordance with SA 570.
- (ii) Audit procedures in relation to the cash flow forecast and analysis likely to be performed by CA Z are:

- (1) Evaluating the **reliability of the underlying data generated** to prepare the forecast; and
- (2) Determining whether there is **adequate support for the assumptions** underlying the forecast.

Question 69:**(PYP May 25 5M)**

LMN Ltd., a mid-sized manufacturing company, generates revenue primarily through the **sale of consumer electronics in domestic and international market**. The company reported **sales of Rs. 2 crores** in the Financial Year 2024-25. The company **generates revenue through sale of standard electronics devices, customized product orders with specific delivery terms and extended warranties and after-sales services**.

The auditor has to **verify that all sales are accurately measured** as per applicable accounting standards and correctly **journalized, summarized and posted** in the financial statements,

Explain the audit procedures to ensure the same. (5 Marks)

Answer: Already covered in MRP Qns

Question 70:**(PYP May 25 4M)**

While **auditing the accounts** of PQR Ltd., a member of the audit team wants to **carry out test of controls** for checking the **effectiveness of internal control** over sales as a **part of debtor's audit procedure**. State any **four points** that need to be considered in respect of trade receivables.

Answer:

To **carry out test of controls** for checking the effectiveness of internal control over sales as a part of the debtors' audit procedure, **following points need to be considered** in respect of trade receivables by audit team of PQR Ltd:

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

Question 71:**(PYP May 25 4M)**

As an auditor of Star Ltd., a company **covered under Section 135 of the Companies Act, 2013**, what matters should auditor verify to ensure that proper disclosures regarding Corporate Social Responsibility (CSR) activities is made in **Additional Information to notes to account**.

Mention any four such matters.

Answer:

As an auditor of Star Ltd., a company covered under Section 135 of the Companies Act, 2013, the auditor should verify the following matters to ensure that proper disclosures regarding Corporate Social Responsibility (CSR) activities is made in "Additional Information" to notes to account are:

- i. amount required to be spent by the company during the year.
- ii. amount of expenditure incurred.
- iii. shortfall at the end of the year.
- iv. total of previous years shortfall.
- v. reason for shortfall.
- vi. nature of CSR activities.
- vii. details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard.
- viii. where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately.



WINNER!

Let's aim Exemption in Auditing! Yes, it's absolutely achievable, and I'm ready to put in the work for you. But remember, it takes two hands to clap. So, come on—join me! Together, we can conquer this and achieve success.

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