

**For CA INTERMEDIATE  
PAPER 5**

**AUDITING  
AND  
ETHICS**

**VOLUME – III**

**CHAPTER WISE COMPILER**

**(INCLUDING PAST YEAR PAPERS, RTPs & MTPs)**

**Edition – 9**

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## 1. NATURE, OBJECTIVE AND SCOPE OF AUDIT

Q.1. 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? [JAN 25] (05)

Q.2. 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. [SEPT 24] (03)

Q.3. 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. [MAY 24] (03)

Q.4. XYZ Ltd., a manufacturing company based in India, operates multiple plants across the country and deals in complex machinery, which requires specialized maintenance and

valuation expertise. XYZ Ltd. appointed CA Dhruv as Statutory auditor. During the audit, he observed that the management consistently applied the same method for valuation of inventory over the past few years, but this year, without proper disclosure, they switched to a different valuation method, which resulted in higher reported profits. Does such a matter fall within scope of audit? [RTP MAY 25]

Q.5. RST Ltd., a retail company, has set up internal controls requiring all invoices to be stamped and signed by an authorised person in "Goods Receiving Section" of the company stating the date and time of receiving goods in premises to ensure that only those purchase bills are produced for payment for which goods have been actually received.

During the audit, the auditor finds that two employees - a purchasing manager and an accounts clerk - have worked together to bypass this control, submitting fake invoices that resulted in payments for goods that were never received. You are required to state the objectives of an audit, as per SA 200, when it comes to ensuring the reliability of financial statements? Also explain, why auditor can provide only reasonable, rather than absolute, assurance that the financial statements are free from material misstatement due to fraud or error in the context of the given situation? [RTP JAN 25]

Q.6. Kriti, a CA student, has joined articles in a reputed audit firm. She considers audit engagement to be an "assurance engagement". Her understanding is that audit engagement is the only kind of assurance engagement in which practitioner gives a written assurance report in appropriate form. However, her friend Somaya, does not agree with her. She is of the view that assurance engagements are not restricted to audit alone. Besides, Somaya also thinks that assurance engagements can also relate to matters other than historical financial information. Whose view appears to be correct? State with reasons. [RTP SEPT 24]

Q.7. M Motors Ltd is a leading Indian automobile manufacturer with many offerings across commercial, passenger and electric vehicles. The Company is pioneering India's electric vehicle transition and enjoys considerable advantage in one of the fastest growing automotive markets.

GR & Associates have been appointed as its statutory auditors for financial year 2022-23. J and K are newly appointed audit assistants in the firm and are part of engagement team constituted for purpose of audit of M Motors Ltd. However, they are confused about what such an audit tends to achieve. They perceive audit as a guarantee against possible errors or frauds in financial statements. Do you agree with perception of both the assistants? In this context, outline objectives of an independent audit conducted in accordance with Standards on Auditing.

[RTP MAY 24]

Q.8. Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information." Explain in detail giving examples.

[RTP MAY 24]

Q.9. An audit is a reasonable assurance engagement, whereas a review is a limited assurance engagement. Both types of assurance engagements provide assurance to users, but they differ in the degree of assurance offered.

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

[MTP - I MAY 25] (04)

Q.10. 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.

[MTP - II MAY 25] (04)

Q.11. 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.

[MTP - I JAN 25] (04)

Q.12. 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. [MTP - II JAN 25] (05)

Q.13. 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.

[MTP - II JAN 25] (04)

Q.14. The management of Cool Drinks Limited suspects that some employees of the company may be involved in making fraudulent payments to dummy workers at its various plants in the country. Therefore, they are considering appointment of a firm of auditors to conduct audit involving detailed examination of accounts. However, one senior person among Board members, Mr. P, objects to use of word "audit" in proposed assignment. Comment. Also, discuss how audit is different from investigation. [MTP - I SEPT 24] (04)

Q.15. Truthful Products Private Limited is engaged in trading stationery items. During the year 2023-24, there was a huge fire in one storage location of the company resulting in loss of inventories of ₹ 5 crores. As a result, the operations of the company were badly affected for about two months. Unfortunately, the insurance claim of the company was rejected due to certain defects in the policy issued and loss was booked by company in the year 2023-24 itself. There was no change in nature of business of company in relation to the last year. The draft financial statements of the company reflect following information:

Particulars	FY 2022 - 23	FY 2023 - 24
Revenue from Operations	80	100
Net profit before tax	6	10

CA D who has been the statutory auditor for past three years, has decided to rely upon the same tests of details as performed in previous years. In the given situation what is lacking on part of the auditor? Discuss. [MTP - II SEPT 24] (04)

Q.16. "Assurance engagement" means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. In this context, give three examples of assurance engagements highlighting difference in nature of assurance provided by such engagements. [MTP - II SEPT 24] (05)

Q.17. 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. Give one example each for such practical and legal limitations. [MTP - I MAY 24] (03)

Q.18. The auditor should decide whether relevant information is properly disclosed in the financial statements. Explain with reference to scope of audit. [MTP - I MAY 24] (03)

Q.19. KST Limited is engaged in manufacturing business. It appoints CA T to provide it an assurance report on its financial statements prepared on the basis of historical financial information. The characteristic of such an engagement is that it involves gathering of sufficient appropriate evidence on basis of which limited conclusions can be drawn up by practitioner. Identify type of engagement. Which are two other features of such an engagement? [MTP - II MAY 24] (03)

Q.20. Nature of financial reporting itself is one of causes of inherent limitations of audit of financial statements. Explain. [MTP - II MAY 24] (03)

Q.21. Mention any three standards issued under authority of ICAI Council which are collectively known as 'Engagement Standards'. (03)

Also mention the purpose of issue of these standards. [MAY 25] (02)

## ANSWERS

1. 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 futureoriented. 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.

2. **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 & 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.

3. **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:-

(1) **Nature of financial reporting:** Preparation of financial statements involves making many judgements 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.

(2) **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.

4. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. The scope of audit of financial statements includes coverage of all aspects of entity, reliability and sufficiency of financial information and proper disclosure of financial information.

In the given situation, CA. Dhruv observed that the management consistently applied the same method for valuation of inventory over the past few years, but this year, without proper disclosure, they switched to a different valuation method, which resulted in higher profits. Since proper disclosure of financial information is covered under the scope of audit, thus, the auditor should decide whether relevant information is properly disclosed in the financial statements. He should also keep in mind applicable statutory requirements in this regard.

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

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

Thus, it can be concluded that proper disclosure of financial information is well within scope of audit.

5. 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" are: -

- (a) 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 on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- (b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

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 factors such as nature of financial reporting, nature of audit procedures, not in the nature of investigation, timeliness of financial reporting and decrease in relevance of information over time and future events.

Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, the auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors. One of the premises for conducting an audit is that management acknowledges its responsibility of preparation of financial statements in accordance with applicable financial reporting framework and for devising suitable internal controls. However, such controls may not have operated to produce reliable financial information due to their own limitations.

In the context of RST Ltd., the management designed a control requiring that all invoices be stamped and signed by an authorized person in the Goods Receiving Section to confirm receipt of goods. However, collusion between two employees—the purchasing manager and the accounts clerk—allowed them to bypass this control by submitting fake invoices for payment. Collusion is a significant limitation of internal controls, as it overrides controls designed to prevent such fraud.

Given these factors, the auditor cannot provide absolute assurance that the financial statements are entirely free from material misstatements due to fraud or error.

6. Audit engagement is an assurance engagement. However, assurance engagements are not restricted to auditing alone. There are other assurance engagements too like review engagements, engagements providing assurance involving prospective financial information, engagements providing assurance on internal controls in an entity. Assurance engagements provide assurance to users. The difference is of degree. Whereas an audit provides reasonable assurance which is a high level of assurance, review provides lower level of assurance as compared to audit. There are also assurance engagements which relate to matters other than historical financial information like providing assurance on matters involving prospective financial information and providing assurance on internal controls in an entity. 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.

In the given case, Kriti is of the view that audit engagement is the only kind of assurance engagement in which practitioner gives a written assurance report in appropriate form whereas is of the view that assurance engagements are not restricted to audit alone. Thus, view of Somaya is correct.

7. 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" are:-

(a) 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 on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

(b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

An analysis of above brings out following points clearly: -

(1) Auditor's objective is to obtain a reasonable assurance whether financial statements as a whole are free from material misstatement whether due to fraud or error.

Reasonable assurance is to be distinguished from absolute assurance. Absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements. However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance but it is not complete assurance.

Audit of financial statements is carried out by the auditor with professional competence and skills in accordance with Standards on Auditing. Audit procedures are applied in accordance with SAs, audit evidence is obtained and evaluated. On the basis of that, conclusions are drawn and opinion is formed. It leads to high level of assurance which is called as reasonable assurance but it is not absolute assurance.

- (2) Misstatements in financial statements can occur due to fraud or error or both. The auditor seeks to obtain reasonable assurance whether financial statements as a whole are free from material misstatements caused by fraud or error. He has to see effect of misstatements on financial statements as a whole, in totality.
- (3) Obtaining reasonable assurance that financial statements as a whole are free from material misstatements enables the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
- (4) The opinion is reported and communicated in accordance with audit findings through a written report as required by Standards on Auditing.  
Therefore, perception of both assistants is not proper. Auditor of financial statements does not seek to provide guarantee that financial statements are free from material misstatements caused by frauds or errors. He obtains reasonable assurance.

8. It is to be understood that Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information". Remember that Standards on auditing apply in "audit" of historical financial information which is a reasonable assurance engagement whereas Standards on Review Engagements apply in "review" of historical financial information which is a limited assurance engagement only.  
"Historical financial information means" information expressed in financial terms in relation to a particular entity, derived primarily from that entity's accounting system,

about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past.

Here, we have to broadly understand that “audit” and “review” are two different terms. Audit is a reasonable assurance engagement, and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, “review” is a limited assurance engagement, and its objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement. Standards on Auditing have been issued on wide spectrum of issues in the field of auditing including (but not limited to) overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit evidence, audit sampling, going concern and forming an opinion and reporting on financial statements.

**Some examples of Standards on Auditing are:**

- (i) SA 200 Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing
- (ii) SA 230 Audit Documentation
- (iii) SA 315 Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment
- (iv) SA 500 Audit Evidence
- (v) Revised SA 700 Forming an Opinion and Reporting on Financial Statements

Examples of Standards on Review engagements are

- (i) SRE 2400 (Revised) Engagements to Review Historical Financial Statements
- (ii) SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

9. 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.

10. 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: -

- The Nature of Financial Reporting:** The preparation of financial statements involves judgment 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.
- The Nature of Audit Procedures:** There are practical and legal limitations on the auditor's ability to obtain audit evidence such as:
  - Possibility that management or others may not provide, intentionally or unintentionally, the complete information relevant for preparation and presentation of FS.
  - Fraud may involve sophisticated and carefully organised schemes.
- Not in the nature of Investigation:** An audit is not an official investigation into alleged wrongdoing. Hence, auditor cannot obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.
- Timeliness of financial reporting and decrease in relevance of information over time:** Relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.
- Future events:** Future events or conditions may affect an entity adversely. Adverse events may seriously affect ability of an entity to continue its business.

11. 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.

12. 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.

13. 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.

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

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

15. Maintaining professional skepticism throughout audit is necessary if auditor is to reduce risks of overlooking unusual circumstances & using inappropriate assumptions in determining the nature, time & extent of audit procedures & evaluating results thereof.

In the given situation, revenue from operations of the company have increased from ₹ 80 crores to ₹ 100 crores despite its operations being affected by fire for about two months. Further, despite loss of inventories to the tune of ₹ 5 crores, financial statements reflect increase in net profit before tax from 7.5% in year 2022-23 to 10% in year 2023-24. Thus, approach of CA D lacks professional skepticism.

In spite of these unusual circumstances, the auditor has decided to rely upon same tests of details as performed in the previous years. The nature and extent of audit procedures need to be suitably altered considering changed circumstances. He may include substantive analytical procedures to analyse variations and seek necessary explanations from management. In case of doubt about the reliability of information or indications of possible fraud, Standards on Auditing require auditor to determine what modifications or additions to audit procedures are necessary to resolve the matter. CA D, the auditor of a listed company, shall document the overall audit strategy, the audit plan and any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

16. Three examples of assurance engagements are as under:-

(i) **Audit of financial statements**

An audit of financial statements provides 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 on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

(ii) **Review of financial statements**

Review provides lower level of assurance than audit. Further, review involves fewer procedures and gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up.

(iii) **Examination of prospective financial information**

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. Such type of assurance engagement provides a moderate assurance.

17. **Example of practical limitation on ability of auditor to obtain audit evidence**

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.

**Example of legal limitation on ability of auditor 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.

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

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

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

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

19. **As given above, the engagement involves gathering of sufficient appropriate evidence on the basis of which limited conclusion can be drawn up. It is a limited assurance engagement like review. Other two features of such type of engagement are:-**

(1) It provides lower level of assurance than reasonable assurance engagement.

(2) It performs fewer procedures than reasonable assurance engagement.

20. Preparation of financial statements involves making many judgments by management.

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

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

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

## 2. AUDIT STRATEGY, AUDIT PLANNING AND AUDIT PROGRAMME

Q.1. 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 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? (03)

(ii) Whether the procedures planned by CA P are in line with SA - 300? [JAN 25] (02)

Q.2. 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. [JAN 25] (05)

Q.3. 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. [SEPT 24] (03)

Q.4. 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. [SEPT 24] (04)

Q.5. 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 4<sup>th</sup> 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. [SEPT 24] (04)

Q.6. APR & Associates, a Chartered Accountant firm, are appointed as the auditors of Time Ltd. and Bakes Ltd. The volume and nature of business of both the companies are entirely different. CA R is the engagement partner for Bakes Ltd. CA P is the engagement partner for Time Ltd. CA R formulates an Audit Programme for conducting the audit of Bakes Ltd. He suggests CA P to use the same audit programme for Time Ltd. But CA P is of the opinion that this audit programme will not be useful for the audit of Time Ltd. [MAY 24] (04)

In light of the above, mention the matters that should generally be considered while preparing an Audit Programme. Is CA P correct in emphasizing for a different Audit Programme for Time Ltd.?

Q.7. B Ltd. is a company manufacturing bed-sheets and pillow covers. They have appointed M/s C & Co., Chartered Accountants, as their auditors. The auditor is establishing audit strategy with his team members. As the work progressed, they came to know that the company has diversified its business and now they are also planning to

manufacture wooden furniture. The auditor, in his professional judgment, considers this to be a significant factor in directing the engagement team's efforts. Give examples of factors that, in auditor's professional judgement, are significant in directing the engagement team's efforts. [MAY 24] (03)

Q.8. CA E is auditor of LM Ltd. Before commencing with current year's audit, he initiated planning for the audit. Planning includes the need to consider certain matters, prior to the identification and assessment of the risk of material misstatements. Enumerate such matters. [MAY 24] (04)

Q.9. ATL Pvt. Ltd., a leading manufacturing company, appointed CA Atul as an auditor for the year 2023-24. Given the complexity of the company's operations and the need for a systematic approach, he plans to design a detailed audit programme to ensure the accuracy of financial assertions. As a CA student, if you were assisting CA Atul in constructing this audit programme, what are the points you will keep in mind? [RTP MAY 25]

Q.10. During the audit of ABC Ltd., a medium-sized manufacturing company, the engagement partner is responsible for directing and supervising the work of the engagement team. The team includes both experienced members and several new trainees. Additionally, certain areas of the audit have been identified as high-risk, such as revenue recognition and inventory valuation, due to recent changes in ABC Ltd.'s accounting policies. What factors should the engagement team members consider when determining the nature, timing, and extent of direction, supervision, and review of the engagement team's work? [RTP JAN 25]

Q.11. CA N, engagement partner of LPS & Associates, is planning for audit of a large company. As part of preliminary engagement activities being performed in this regard, he wants to ensure that compliance with independence requirements is adhered. How shall he form a conclusion that audit firm complies with independence requirements? [RTP SEPT 24]

Q.12. Preliminary engagement activities include certain activities to be performed by an auditor while planning an audit. Discuss such activities briefly. How performing such activities assists an auditor? [RTP MAY 24]

Q.13. The assistant of CA K is assigned responsibility of drafting "audit programme" relating to purchases appearing in financial statements of "Broad Industries", a partnership firm. The said firm is a GST registered tax payer and is engaged in manufacturing of packing boxes from a special type of paper taxable under GST. Help him by drafting a sample audit programme for purchases. [RTP MAY 24]

Q.14. 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. [MTP - I MAY 25] (04)

Q.15. 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? [MTP - I MAY 25] (05)

Q.16. 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. [MTP - II MAY 25] (05)

Q.17. 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. [MTP - II MAY 25] (04)

Q.18. 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.

[MTP - I JAN 25] (04)

Q.19. Audit programme is a list of examination and verification steps to be applied and set out in such a way that the inter-relationship of one step to another is clearly shown and designed, keeping in view the assertions apparent in the statements of account produced for audit or based on an appraisal of the accounting records of the client. For example, while auditing a company's inventory, the program may include steps to verify physical stock counts, ownership rights, and valuation. What are the advantages of an audit programme? [MTP - I JAN 25] (05)

Q.20. "In establishing the overall audit strategy, the auditor shall, among other considerations, ascertain the nature, timing and extent of resources necessary to perform the engagement". Explain those considerations in detail. [MTP - II JAN 25] (04)

Q.21. 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. [MTP - II JAN 25] (05)

Q.22. Subodh has recently joined an audit firm as an articled clerk. He was in process of assembling audit working papers in audit file of Cop Limited, as per the instructions of his senior. While assembling, he noticed following working paper in audit file:-

**Timing of Audit Activities**

Activity	Expected Timing
Audit Planning	July 1, 2023 - July 5, 2023
Review by EQCR	July 6, 2023 - July 7, 2023
Audit Field Work	July 10, 2023 - August 20, 2023
Review by Manager	August 21, 2023
Review by Engagement Partner	August 22, 2023 - August 25, 2023
Review by EQCR	August 26, 2023 - August 27, 2023
Response on Audit Memo	August 28, 2023
Review by Partners - internally post response on audit memo	August 29, 2023
Review by EQCR	August 30, 2023
Finalization of Audit Report and Financial Statements	September 01, 2023 - September 02, 2023
Issuance of Audit Report and Financial Statements	September 03, 2023

The above working paper lists certain factors which are considered by the auditor while establishing audit strategy. Explain how these considerations highlighted in above working paper could have helped the auditor? [MTP - I SEPT 24] (05)

Q.23. Sanjana is of the view that there exist some disadvantages in the use of audit programmes but most of these can be removed by following some concrete steps. Do you agree with her perspective? Comment. [MTP - I SEPT 24] (04)

Q.24. CA D is planning an audit of a listed company. List specific documentation requirements in accordance with SA 300 in relation to planning such an audit. How such planning documentation is useful? [MTP - II SEPT 24] (04)

Q.25. M/s TP & Co., a firm of Chartered Accountants, has been conducting audit of KSR Ltd. since last 4 years. KSR Ltd. has diversified their business into newer areas during the last year. The senior member of the audit team handed over the standard audit programme of earlier years to the audit assistants and instructed them to follow the same. The assistants are conducting the audit accordingly. Whether the attitude of the audit assistants is justified? Guide them. [MTP - II SEPT 24] (05)

Q.26. Adequate planning benefits the audit of financial statements in several ways. Explain. [MTP - I MAY 24] (04)

Q.27. Auditor shall develop an audit plan that includes description of audit procedures. Specify requirements in this regard. [MTP - I MAY 24] (03)

Q.28. The ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications. Give three instances to explain. [MTP - II MAY 24] (03)

Q.29. The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant. Preliminary identification of material classes of transactions, account balances and disclosures help auditor in establishing overall audit strategy. More energies need to be devoted to significant matters to obtain desired outcomes. Give three examples to explain the above situation.

[MTP - II MAY 24] (03)

Q.30. 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.

[MAY 25] (04)

## ANSWERS

1. 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 noncompliance 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.

2. 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.

**3. 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.

**4. 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:-

- (i) 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
- (ii) 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

- (iii) When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates
- (iv) 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.

5. **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.

6. Following matters should be considered generally while preparing an Audit Programme:

- (1) Stay within the scope and limitation of the assignment.
- (2) Prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.
- (3) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
- (4) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
- (5) Include the audit objectives for each area and sufficient details which serve as a set of instructions for the assistants involved in audit and help in controlling the proper execution of the work.
- (6) Consider all possibilities of error.
- (7) Co-ordinate the procedures to be applied to related items.

**Evolving one audit programme – Not Practicable for All Businesses:** Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable.

In view of above mentioned provisions, CA. P is correct in emphasizing for a different audit programme for Time Ltd.

7. Consider the factors that, in the auditor's professional judgement, 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 & disclosures help auditor in establishing overall audit strategy. More energies need to be devoted to significant matters to obtain desired outcomes. Few examples are listed as under:-

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

(iii) Significant changes in the financial reporting framework, such as changes in accounting standards.

(iv) Other significant relevant developments, such as changes in the legal environment affecting the entity.

8. **Nature of Audit Planning – A Continuous and iterative process:** Planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:-

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

9. For the purpose of programme construction, the following points should be kept in mind:

- (i) Stay within the scope and limitation of the assignment.
- (ii) Prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.
- (iii) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
- (iv) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
- (v) Include the audit objectives for each area and sufficient details which serve as a set of instructions for the assistants involved in audit and help in controlling the proper execution of the work.
- (vi) Consider all possibilities of error.
- (vii) Co-ordinate the procedures to be applied to related items.

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

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

1. The size and complexity of the entity.
2. The area of the audit.
3. The assessed risks of material misstatement.
4. The capabilities and competence of the individual team members performing the audit work.

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

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

12. Preliminary engagement activities

Preliminary engagement activities include following activities: -

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

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

13. Sample audit programme pertaining to purchases

Name of Concern : Broad Industries

Financial Year : 20XX-XX

Prepared by : Name of person with date

Reviewed by : Name of person with date

Approved by : Name of person with date

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

14. The advantages of an audit programme are:

- (i) It provides the assistant carrying out the audit with total and clear set of instructions of the work generally to be done.
- (ii) It is essential, particularly for major audits, to provide a total perspective of the work to be performed.
- (iii) Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.
- (iv) Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, such danger is significantly less, and the audit can proceed systematically.
- (v) The assistants, by putting their signature on programme, accept the responsibility for the work carried out by them individually and, if necessary, the work done may be traced back to the assistant.

- (vi) The principal can control the progress of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
- (vii) It serves as a guide for audits to be carried out in the succeeding year.
- (viii) A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of professional auditor.

15. Planning an audit is necessary to carry out it effectively in a timely manner. Besides ensuring compliance with professional standards, it helps in performing audit engagement effectively.

Adequate planning benefits the audit of financial statements in several ways, including the following: -

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

Therefore, planning an audit ensures that audit risk is reduced to an acceptable low level. When audit work is adequately and properly planned, it reduces the risk of inappropriate opinion by the auditor.

16. Sample audit programme pertaining to purchases

Name of Concern : Arya Industries

Financial Year : 2023-24

Prepared by : Name of person with date

Reviewed by : Name of person with date

Approved by : Name of person with date

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

17. 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 auditor plans what type of audit procedures are to be performed, their timing and how much work should be done taking into account sample size etc.

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

In the given case, CA Tina, auditor of SKY Ltd. asks its finance and audit head to prepare audit strategy and to draw detailed audit procedures. On Auditor's request, finance head completes the audit strategy as well as audit procedures.

In view of above, CA Tina should prepare overall audit strategy and detailed audit procedures. Therefore, approach of CA Tina was wrong.

18. 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.

19. The advantages of an audit programme are:

- It provides the assistant carrying out the audit with total and clear set of instructions of the work generally to be done.
- It is essential, particularly for major audits, to provide a total perspective of the work to be performed.
- Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.
- Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a risk of ignoring or overlooking certain books and records. Under a properly framed programme, such risk is significantly less and the audit can proceed systematically.
- The assistants, by putting their signature on programme, accept the responsibility for the work carried out by them individually and, if necessary, the work done may be traced back to the assistant.
- The principal can control the progress of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
- It serves as a guide for audits to be carried out in the succeeding year.
- A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill & care that was expected of professional auditor.

20. In establishing the overall audit strategy, the auditor shall:

- Identify the characteristics of the engagement that define its scope;
- Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;

- (iii) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
- (iv) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- (v) Ascertain the nature, timing & extent of resources necessary to perform the engagement.

**21. 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.

**22. 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. One of the factors to be taken into consideration while establishing audit strategy relates to ascertaining of reporting objectives of engagement to plan the timing of the audit and the nature of the communications required. Some of the instances are given under:**

- The entity's timetable for reporting
- Organization of meetings to discuss of nature, timing and extent of audit work with management.

- Discussion with management regarding the expected type and timing of reports to be issued including the auditor's report
- Discussion with management regarding the expected communications on the status of audit work throughout the engagement.
- Expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed.

In the given case, working paper highlights that auditor has taken into account expected timelines to plan the audit and nature of the communications required. Since the working paper relates to the statutory audit of a company, the ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications.

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

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

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

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

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

It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

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

25. In the given situation, the senior member of the audit team handed over the standard audit programme of earlier years to the audit assistants and instructed them to follow the same. The assistant to keep an open mind as follows:

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

Thus, the attitude of assistants of TP & Co. is not justified. They should keep an open mind and go beyond the programme to take care of newer areas of the business of KSR Ltd. into which the Company has diversified.

26. **Adequate planning benefits the audit of financial statements in several ways, including the following:**

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

27. SA 300 states that auditor shall develop an audit plan that shall include description of

- (i) The nature, timing and extent of planned risk assessment procedures
- (ii) The nature, timing and extent of planned further audit procedures at assertion level
- (iii) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

28. The ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications. Some of the instances are given under:-

- The entity's timetable for reporting
- Organization of meetings to discuss of nature, timing and extent of audit work with management
- Discussion with management regarding the expected type and timing of reports to be issued including the auditor's report

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

29. 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 helps auditor in establishing overall audit strategy. More energies need to be devoted to significant matters to obtain desired outcomes. Few examples are listed as under:-

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

### 3. RISK ASSESSMENT AND INTERNAL CONTROL

Q.1. 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?

[JAN 25] (04)

Q.2. 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.

[JAN 25] (04)

Q.3. 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?

[SEPT 24] (04)

Q.4. 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.

[SEPT 24] (04)

Q.5. 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.

[SEPT 24] (03)

Q.6. 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.

[MAY 24] (03)

Q.7. CA Q is the engagement partner for the audit of a Departmental store. As a part of the risk assessment procedure, he wants to make inquiries of the management & others within the entity. What kind of information can the auditor get by inquiring from the following?

- (i) Internal audit personnel
- (ii) In-house legal counsel
- (iii) Marketing or sales personnel
- (iv) Information systems personnel

[MAY 24] (04)

Q.8. 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?

[MAY 24] (03)

Q.9. In an automated environment, General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. It includes access security as well as program change. What are the objectives and activities included in access security and program change? [RTP MAY 25]

Q.10. The auditor of EFG Ltd, a company engaged in the Tours & Travel business, needs to obtain an understanding of the company's control environment. To do this, the auditor evaluates whether:

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

[RTP JAN 25]

Q.11. Companies are increasingly using data analytics for managing their operations. Auditors can also obtain good results by using data analytics. What are the tools and techniques used by auditors in applying the principles of Data Analytics and in which areas data analytics can be used by auditors? [RTP SEPT 24]

Q.12. Satranga Foods Private Limited is engaged in manufacturing of pickles. The auditors of the company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that misstatements in revenue recognition are not identified by planned audit procedures. Identify and explain that particular risk in detail. [RTP MAY 24]

Q.13. IT related risks can have an impact on audit. In what different ways, such risks can have an impact on audit of financial statements? [RTP MAY 24]

Q.14. 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. [MTP - I MAY 25] (05)

Q-15. 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.

[MTP - I MAY 25] (05)

Q-16. 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.

[MTP - II MAY 25] (05)

Q-17. 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.

[MTP - II MAY 25] (05)

Q.18. CA Srishti, while auditing KSM Private Limited for the first time, utilised software to analyse financial data, comparing amounts recorded in the financial statements for the current audit year with the preceding two years. Her objective was to evaluate the risk of material misstatement.

Identify the type of audit procedure performed by CA Srishti in the given case, discuss its relevance, and explain whether an auditor's opinion can solely rely on such procedures.

[MTP - 1 JAN 25] (04)

Q.19. SA 330 states that auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to operating effectiveness of relevant controls. Briefly discuss when such tests are to be designed and performed in accordance with SA 330?

If an auditor intends to place greater reliance on effectiveness of a control, state its likely effect on audit evidence to be obtained as a result of such tests of controls. Why a higher level of assurance may be sought by an auditor about the operating effectiveness of controls?

[MTP - 1 JAN 25] (05)

Q.20. KR & Associates, an auditor of FDP Ltd., observed that the company has implemented various internal controls addressing financial reporting, operational efficiency, and compliances during their preliminary evaluation. CA Karan suggests that all controls should be assessed to mitigate the risk of material misstatement in the financial statements, while CA Rajat is of the view that only those controls deemed relevant to the audit should be assessed based on professional judgment.

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

[MTP - 1 JAN 25] (05)

Q.21. Calen Retail Ltd. is preparing its annual financial statements, and the auditors are tasked with determining materiality. The company has used revenue as the benchmark, as it is a key indicator of performance. However, Calen Retail has recently opened new stores and closed underperforming ones, which could significantly affect both

revenue and profitability. As per given case, what factors should the auditors consider when selecting the most appropriate benchmark for materiality?

[MTP - II JAN 25] (04)

Q.22. Knowledge of the Client's business play an important role in developing an overall audit. In fact, without adequate knowledge of the client's business, a proper audit is not possible. As per SA 315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework. Substantiate with the help of examples.

[MTP - II JAN 25] (04)

Q.23. While conducting the audit of Zeena Limited, CA E is trying to obtain understanding of different components of internal controls of the company. Such an understanding is necessary & is required to be documented in accordance with Standards on Auditing. In this context, how he shall obtain understanding of the risk assessment process of the company & how is this understanding important for the auditor? [MTP - I SEPT 24] (05)

Q.24. CDE Private Limited, a manufacturing company, had made investment in shares of some blue-chip companies. Additionally, it had temporarily deposited some of its extra funds in fixed deposits with a scheduled bank. Dividend from shares amounting to ₹ 1.80 lakhs (net of TDS, TDS = ₹ 0.20 lakhs) and bank interest of ₹ 2.70 lakhs (net of TDS, TDS = ₹ 0.30 lakhs) were credited in bank account of the company. During the year 2023-24, it has also sold some shares resulting in net gain of ₹ 5 lakhs. The company has shown above incomes under head "Other income" for consolidated amount of ₹ 9.50 lakhs in the statement of Profit and Loss. No other information is furnished in the financial statements put up for audit. As the auditor of the company, discuss whether the above situation constitutes "misstatement" in the financial statements of the company. Also state, few examples of misstatements. [MTP - II SEPT 24] (05)

Q.25. CA Y, statutory auditor of a company, is in process of determining materiality for financial statements while planning audit. Since materiality is a matter of professional

judgment and is affected by auditor's perception of financial information needs of users of financial statements, he is reasonably making certain assumptions about users of financial statements. Which reasonable matters are likely to be assumed by him in respect of users?

[MTP - II SEPT 24] (04)

Q.26. While planning the audit of Me Limited, CA M has planned nature, timing and extent of risk assessment procedures to identify and assess risks of material misstatements. How risk should be assessed by the auditor CA M? It is also well known that assessment of risks is a matter of professional judgment. Which specific matters are not included in audit risk? Additionally, CA K, one of the team members of CA M, is of the view that Materiality and Audit Risk are only considered at planning stage of an audit. Comment. [MTP - II SEPT 24] (05)

Q.27. The objective of an auditor in accordance with SA 315 is to identify and assess risks of material misstatement at financial statement level and assertion level. Which specific activities an auditor is required to perform for the purpose of identifying and assessing risks of material misstatement? [MTP - I MAY 24] (04)

Q.28. Given below is a table containing Column A and Column B. Column A contains description of certain controls in an automated environment. Complete Column B by stating appropriate type of control. [MTP - I MAY 24] (03)

Column A (Description of control in an automated environment)	Column B (Type of control)
Reasonableness checks	?
Controls over Data centre and network operations	?
Controls over application system acquisition, development and maintenance	?
Program change controls	?

Q.29. Planning includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures.

For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, certain matters. Discuss those matters.

[MTP - II MAY 24] (04)

Q.30. Internal Control Questionnaire is a comprehensive series of questions concerning internal control. A company is engaged in business of manufacturing of chemicals. It has two plant locations in city "A" and one plant location in city "B" involving huge value of assets. Building at three locations is owned by the company. The company earns handsome profits and does not want to suffer losses due to business interruptions. It has a dedicated department for looking after insurance matters. As an auditor, prepare an internal control questionnaire concerning this department for obtaining staff responses.

[MTP - II MAY 24] (03)

Q.31. It is important to carry out the Tests of Controls for checking effectiveness of internal control over sales as a part of the debtors' audit procedure. In above context, state the points which need to be considered in respect of trade receivables.

[MTP - II MAY 24] (04)

Q.32. Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit. State few areas in which such an understanding is helpful to auditor.

[MTP - II MAY 24] (04)

Q.33. Auditor of Sunshine Ltd. is of the view that due to greater management intervention to specify accounting treatment, the risk of material misstatement is greater for non-routine transactions. Is view of the auditor correct? Specify the other matters due to which the risk of material misstatement is greater for significant non-routine transactions.

[MTP - II MAY 24] (04)

Q.34. 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. (01)

Column A	Column B
Access security	?
Sequence number checks	?
Data centre and network operations	?
Mandatory data fields	?
	[MAY 25] (04)

Q.35. 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 procedures. State any four points that need to be considered in respect of trade receivables. [MAY 25] (04)

## ANSWERS

- 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.

2. 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 etc. The auditor should document the nature of test (or combination of tests) applied along with the judgements in the audit file.

3. **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.

4. (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.

5. **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.

6. **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, <i>inter alia</i> , include - evaluation of internal financial controls and risk management systems.

7. **Inquiries of Management and Others within the Entity:**

- (i) Inquiries directed toward internal audit personnel may provide information about internal audit procedures performed during the year relating to the design and effectiveness of the entity's internal control and whether management has satisfactorily responded to findings from those procedures.
- (ii) Inquiries directed toward in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or

suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contract.

- (iii) Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
- (iv) Inquiries directed to information systems personnel may provide information about system changes, system or control failures, or other information system-related risks.

8. **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 required a control response outside the scope of an existing automated control.
- In monitoring the effectiveness of automated controls.

9. **Access Security in Automated Environment:**

The objective of Access Security is to ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives.

Activities:

- (i) Security Organization & Management
- (ii) Security Policies & Procedures
- (iii) Application Security
- (iv) Data Security
- (v) Operating System Security
- (vi) Network Security
- (vii) Physical Security

**Program Change in Automated Environment:**

The objective of program change controls is to ensure that modified systems continue to meet financial reporting objectives. It includes activities such as change in

management process, recording, managing and tracking change requests, making and testing changes etc.

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

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

The control environment includes:

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

**Elements of the Control Environment**

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

(a) **Communication and enforcement of integrity and ethical values**

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

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

(c) **Participation by those charged with governance:** It includes attributes of those charged with governance such as their independence from management, their experience and

stature, the extent of their involvement and the information they receive and the scrutiny of activities.

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

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

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

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

11. The tools and techniques that auditors use in applying principles of data analytics are known as Computer Assisted Auditing Techniques (CAATs). Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets & 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.

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

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

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

Detection risk comprises sampling and non-sampling risk.

(a) Sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. It simply means that the sample was not representative of the population from which it was chosen.

(b) Non-sampling risk is the risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk. Like an auditor may reach an erroneous conclusion due to application to some inappropriate audit procedure.

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

**Impact on substantive checking**

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

**Impact on controls**

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

### **Impact on reporting**

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

14. As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

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

15. **Inquiries of Management and Others within the Entity:** 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.

- Inquiries directed toward internal audit personnel may provide information about internal audit procedures performed during the year relating to the design and effectiveness of the entity's internal control and whether management has satisfactorily responded to findings from those procedures.
- Inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.

- Inquiries directed toward in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contract.
- Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
- Inquiries directed to the risk management function (or those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.
- Inquiries directed to information systems personnel may provide information about system changes, system or control failures, or other information system- related risks.

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

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

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

17. 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

18. In the given case, CA Srishti is performing analytical procedures as risk assessment procedures. Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information.

Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

Risk assessment procedures are a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.

Thus, it can be concluded that auditor's opinion cannot be solely based upon such procedures.

19. The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:-

(i) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures) or

(ii) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence, the greater the reliance the auditor places on the effectiveness of a control. A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular, where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

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

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

- Materiality.
- The significance of the related risk.
- The size of the entity.
- The nature of the entity's business, including its organisation & ownership characteristics.
- The diversity and complexity of the entity's operations.
- Applicable legal and regulatory requirements.
- The circumstances and the applicable component of internal control.
- The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.

- Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

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

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

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

- The elements of the financial statements like assets, liabilities, equity, revenue, expenses.
- Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused. For example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets.
- The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates, the entity's ownership structure and the way it is financed. For example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings.
- The relative volatility of the benchmark.

22. 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.

23. CA E, the auditor of Zeena Limited, shall obtain an understanding of whether the entity has a process for:-

- (a) Identifying business risks relevant to financial reporting objectives
- (b) Estimating the significance of the risks
- (c) Assessing the likelihood of their occurrence
- (d) Deciding about actions to address those risks

The entity's risk assessment process forms the basis for the risks to be managed. If that process is appropriate, it would assist the auditor in identifying risks of material misstatement. Risks can arise or change due to factor such as new technology, new business models, products or activities, changes in operating environment etc. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment.

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

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

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

(a) Interest Income of ₹3 lakhs

(b) Dividend Income of ₹2 lakhs

(c) Net gain on sale of investments of ₹ 5 lakhs

Few examples of misstatements are:

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

25. The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, it is reasonable for CA Y, the auditor, to assume that users:-

(a) Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence

(b) Understand that financial statements are prepared, presented and audited to levels of materiality

- (c) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events and
- (d) Make reasonable economic decisions on the basis of the information in the financial statements.

26. The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement. Audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements. For the purpose of the Standards on Auditing, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant.

In the given case, CA K is of the view that materiality and audit risk are only considered at planning stage of an audit. The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report. Thus, the view of CA K is not correct.

27. For the purpose of identifying and assessing the risks of material misstatement, the auditor shall:

- (i) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements.
- (ii) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions.
- (iii) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test and
- (iv) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

28.

<i>Column A</i> <i>(Description of control in an automated environment)</i>	<i>Column B</i> <i>(Type of control)</i>
Reasonableness checks	Application controls
Controls over Data centre and network operations	General IT controls
Controls over application system acquisition, development and maintenance	General IT controls
Program change controls	General IT controls

29. Prior to auditor's identification and assessment of risks of material misstatement, planning includes the need to consider following matters:

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

30. *Internal Control Questionnaire*

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

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

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

32. Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when:

1. Assessing risks of material misstatement of the financial statements
2. Determining materiality in accordance with SA 320
3. Considering the appropriateness of the selection and application of accounting policies
4. Identifying areas where special audit consideration may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions
5. Developing expectations for use when performing analytical procedures
6. Evaluating the sufficiency and appropriateness of audit evidence obtained such as the appropriateness of assumptions and of management's oral and written representations.

33. **Risk of Material Misstatement - Greater for Significant Non-Routine Transactions:**

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.

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

- (a) Greater management intervention to specify the accounting treatment.
- (b) Greater manual intervention for data collection and processing.
- (c) Complex calculations or accounting principles.
- (d) The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.
- (e) Keeping in view above, view of Auditor of Sunshine Ltd is correct.

## 4. AUDIT EVIDENCE

Q.1. Fashion Garments Limited (FGL) 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? [JAN 25] (05)

Q.2 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? [JAN 25] (04)

Q.3. 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?

[JAN 25] (05)

Q.4. 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 ₹ 20 lakhs, balances between ₹ 10 lakhs to ₹ 20 lakhs and balances below ₹ 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.

[SEPT 24] (04)

Q.5. 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.

[SEPT 24] (03)

Q.6. 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?

[SEPT 24] (04)

Q.7. 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 ₹ 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 ₹ 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.

[SEPT 24]

Q.8. 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?

[MAY 24] (04)

Q.9. 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?

[MAY 24] (03)

Q.10. M/s KLM & Co. Chartered Accountants, a partnership firm, while designing tests of controls and tests of details in MN Ltd. has to determine the items for testing that can be effective in meeting the purpose of the audit procedure. For this, they decided to select specific items from a population. State the factors that can be considered by the audit firm for selecting specific items from a population and also state the specific items that can be included for such testing. [MAY 24] (04)

Q.11. XY and Associates are auditors of PQR Ltd., which provides electrical components on project basis. The purchases are huge and the auditor wants to make sure that all the purchases made during the period are recorded and there is no understatement or overstatement. For this purpose the audit team have performed procedures like cut-off tests, correct treatment of goods in transit, obtaining written representations and performing analytical procedures. What are the analytical procedures required to be performed to obtain audit evidence as to overall reasonableness of purchase quantity and price? [MAY 24] (03)

Q.12. Grape Limited presented its financial statements for the F.Y. 2023-24 to its auditor for expressing an opinion thereon. The auditor while carrying out the audit started comparing various items of profit and loss account of the year under audit with previous financial years. What is auditor trying to achieve by carrying out those comparisons? [RTP MAY 25]

Q.13. CA Mukul is the external auditor of Beige Ltd., a large company, engaged in the manufacturing of fast-moving consumer (FMCG) goods. After assessing the internal audit function of the company, CA Mukul decided to use the internal auditor of the company to provide direct assistance. In this context, what is meant by direct assistance under relevant Standard on Auditing? Also comment whether prior to using internal auditor for direct assistance for the purpose of audit, CA Mukul is required to obtain any written agreements or not. Give examples of procedures in which CA Mukul shall not use an internal auditor to provide direct assistance. [RTP JAN 25]

Q.14. Quality Products Limited is engaged in manufacturing of bicycles. As part of manufacturing activities, it sends raw material to some business entities and procures finished components from them. As on 31<sup>st</sup> March 2024 inventories lying with such business entities are material. Being statutory auditor of Quality Products Limited, how you will obtain sufficient appropriate audit evidence regarding existence and condition of inventories lying with such business entities? [RTP SEPT 24]

Q.15. CA Kanika audited books of accounts of Engineering Ltd. for the financial year 2022-2023. The auditor used an audit procedure according to which all the documents and records maintained by the company were checked in detail to obtain audit evidence. Explain the audit procedure used by the auditor. Comment on reliability of audit evidence obtained by performing such an audit procedure in some situations. [RTP MAY 24]

Q.16. CA J is conducting statutory audit of Gemini Ltd engaged in manufacturing of pharma products. The company is fairly large one and has a well-functioning internal audit department. While considering sending out external confirmation requests to trade receivables outstanding as on date of financial statements, CA J has delegated the process of choosing trade receivables, designing requests and receiving responses from customers to internal audit department. The responses are also received on the mail id of internal audit department. Is the approach of CA J proper? [RTP MAY 24]

Q.17. The newly appointed auditor of BTN Limited wants to obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements. What audit procedures should he perform for this purpose? [RTP MAY 24]

Q.18. SPR Ltd has been into the media business since 2001. During the F.Y 2022-2023, many notices were received by the company for hurting public sentiments and financial claims were filed against the company. As an auditor of the company, you requested the management for arranging the meeting with company's external legal counsel. Management is of the view that such meetings are necessary in certain circumstances only. Can you list down such circumstances? [RTP MAY 24]

Q.19. While conducting the audit of Pummy Limited, the statutory auditors collected written representations from the Management. The audit was finalised in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, elaborate "inquiry" as one of the methods of collecting Audit Evidence. [MTP - I MAY 25] (04)

Q.20. 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. [MTP - I MAY 25] (05)

Q.21. 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 Ration of the company. She also compared GP ratio of TUV. With the other companies operating in similar industry. [MTP - II MAY 25] (04)

Q.22. 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. [MTP - II MAY 25] (05)

Q.23. 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 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? [MTP - II MAY 25] (04)

Q.24. 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. [MTP - II MAY 25] (05)

Q.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 aluminum) 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. [MTP - II MAY 25] (04)

Q.26. CA Shubham, the auditor of Sigma Limited, is performing tests of controls and tests of details using audit sampling. During these procedures, he observed deviations in compliance with management's prescribed procedures for sales transactions of small values of a product at one location during tests of controls. Additionally, misstatements were identified in the sample related to these small-value sales transactions during tests of details. How should he proceed to analyse the nature and cause of the deviations and misstatements observed in the sample results? [MTP - I JAN 25] (05)

Q.27. The reliability of audit evidence depends on its source, nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance. Although exceptions may exist, few generalisations can be made about reliability of audit evidence. Considering above discuss such generalisations that can be made about the reliability of audit evidence. [MTP - I JAN 25] (05)

Q.28. CA Rishi is appointed as an auditor of AIR Ltd. for the financial year ending on March 31, 2024. During the audit, he observed that the company's books of accounts reflect a significant number of trade payables and receivables as on the balance sheet date. To verify the accuracy of the trade receivables, CA Rishi decided to send confirmation requests to some of trade receivables. However, the management refused to permit him to send these confirmation requests to the selected parties. How should the auditor proceed in the given situation? [MTP - II JAN 25] (05)

Q.29. During the audit of HST Ltd., CA Mukund, the auditor, observed a significant volume of unsold electronic parts as inventory that had remained stagnant for more than two years. He noted that the company was facing difficulty selling these items due to the changes in the market. Additionally, some parts were damaged, and others were discontinued models. CA Mukund also ensured that the inventory was accurately valued to ensure proper financial reporting. You are required to outline the detailed audit procedures that are generally undertaken when auditing such inventories which at the time of observance of physical counting were noted as being damaged or obsolete. [MTP - II JAN 25] (05)

Q.30. 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? [MTP - 11 JAN 25] (05)

Q.31. When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls. Discuss the matters the auditor may consider in determining the extent of test of controls [MTP - 11 JAN 25] (05)

Q.32. CA Tina, while inspecting financial statements of a company, notices that gross profit ratio of company has increased from 14% in year 2022-23 to 24% in year 2023-24. Considering the above, she has assessed the risk of material misstatement to be high with respect to assertions relating to revenue and various direct expenses. CA Tina wants to know few possible reasons which could have led to abnormal jump in gross profit ratio. During the discussion among engagement team members, her junior Ms. Tisha, expressed her view that detection risk in this engagement should be kept at high level.

- (i) List out a few possible reasons which could have led to abnormal jump in gross profit ratio.
- (ii) Do you agree with viewpoint of Tisha? Provide reasons for your answer.

[MTP - 1 SEPT 24] (05)

Q.33. Expert Industries Limited is engaged in petrochemical business. Due to nature of its business, the company has hired PQR Associates, a reputed firm of chartered engineers, to determine the quantity and valuation of inventories for preparation of financial statements. The auditor of Expert Industries Limited want to use the same as audit evidence. Before using the work of PQR Associates, management's expert, what aspects should be taken care by auditor? [MTP - 1 SEPT 24] (04)

Q.34. Zed Limited is engaged in the manufacturing and export of shoes. The statutory auditor of the company wants to reasonably ensure that only the inventories recorded in the financial statements are exclusively owned by the company and do not include any inventories that belong to third parties but includes inventories owned by the company but lying with third party. Advise the auditor on the audit procedures to be performed to achieve this assurance. [MTP - 1 SEPT 24] (05)

Q.35. CA X is contemplating the use of negative confirmation requests as the sole substantive audit procedure to verify certain accounts payable balances reflected in financial statements of a company. Which conditions need to be met to use negative confirmation requests as stated above? Additionally, CA X is of the view that negative confirmations provide same level of persuasive audit evidence as in case of positive confirmations. Do you agree with his viewpoint? Provide reasons for your answer. [MTP - 1 SEPT 24] (05)

Q.36. While performing audit of financial statements of a listed company, statutory auditor needs to maintain an attitude of professional skepticism for related party information. State examples of the records or the documents that may provide information about related party relationships and transactions. [MTP - 1 SEPT 24] (05)

Q.37. During the audit of a company, CA Z is using a software to select samples pertaining to sales records of the company. While performing this process, a window opens in software prompting the user to enter certain information. CA Z is in the process of entering information in this regard as given under:-

Selection Interval	?
Number of records to select	100
Starting record number to select	1
Ending record number to select	1000
File name	Sales

Going through the above fields, which method of sampling is likely being used in the software? Discuss. Which foremost consideration should be kept in mind by auditor for selecting samples in such a manner?

Additionally, partner of CA Z suggested him to select the first 200 sales invoices from the sales book of the last month. Which method of sampling is being suggested by partner of CA Z?

[MTP - II SEPT 24] (05)

Q.38. CA M, auditor of a company, has planned to use substantive analytical procedures during course of audit. In this regard, he has decided to use such procedures in following areas:-

(i) For testing relationship between sales and cost of sales

(ii) For testing rights over certain assets forming part of account balances

Comment upon his approach along with reasons.

[MTP - II SEPT 24] (04)

Q.39. Suniti, a CA student, is part of an engagement team conducting audit of a company TIM Private Limited. According to audit programme, she is responsible for verifying purchases and PPE items appearing in books of accounts from records/bills of company. Besides, she has also been entrusted responsibility to obtain written representation from management regarding carrying out of physical verification of inventories during the year. During course of her work, she finds that:

(i) One purchase bill amounting to ₹ 5.00 lacs pertaining to TIM Industries has been entered in books of TIM Private Limited.

(ii) The management has refused to provide a written representation relating to physical verification of inventories during the year. She has brought it to knowledge of engagement partner who has decided to use lack of such a representation as audit evidence.

Discuss whether each of above constitutes audit evidence. State reasoning for your answer.

[MTP - I MAY 24] (04)

Q.40. While performing statutory audit of Contra Industries Private Limited, a company engaged in manufacturing and assembling of LED lights, CA Varun has decided to attend physical inventory count process of the company on 30th and 31st March, 2024. The inventories are lying at three different locations - two such locations A and B are in one city and third location C is in another city. Further, company also sends inventories to some service providers for quality control and testing as such facilities are not available with the company.

CA Varun is well-versed with this type of industry and has prepared a list of following matters which could be relevant to him in planning attendance at physical inventory count process for discharging his responsibilities in accordance with SAs:-

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

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

[MTP - 1 MAY 24] (04)

Q.41. CA Z is appointed as statutory auditor of BETA Private Limited for the year 2023-24. There exists an internal audit function in the company headed by its Chief Internal Auditor, CA K. Valuation of trade receivables of company is assessed as area of higher risk by statutory auditor. He wants to take direct assistance of Chief Internal Auditor in respect of above matter. Discuss along with reasons whether it would be proper for statutory auditor to:-

- assign checking of accuracy of aging of trade receivables to Chief Internal Auditor?
- assign evaluation of adequacy of provision based on aging of trade receivables to Chief Internal Auditor?

[MTP - 1 MAY 24] (04)

Q.42. Sanjeev, an articled clerk in an audit firm, is part of an engagement team conducting audit of a company for year 2023-24. It is a small company having a turnover of about ₹25 crores. During the course of audit, he notices that senior team member has taken following approach for selecting items for testing reflected in financial statements to obtain audit evidence:-

- He has selected to test items debited under the head "Machinery repair & maintenance" as expenditure relating to it during year 23-24 has increased

considerably as compared to last year.

- Out of purchases, he has selected to test purchases from related parties amounting to ₹ 5 crores.
- He has also selected to test all individual items of expenditure exceeding ₹ 5 lakhs.
- Besides, he has also selected amount of ₹ 0.50 lakhs debited under head "legal expenses" to know purpose of payment made to external legal counsel.

Sanjeev understands that senior team member is using "audit sampling" for selecting items for testing. Do you agree with him? Which risk is involved in above approach? Discuss with reasons.

[MTP - II MAY 24] (04)

Q.43. In an initial audit engagement, in the case of inventories, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, in such a case, additional audit procedures become necessary so that auditor may obtain sufficient appropriate audit evidence. Discuss those additional audit procedures.

[MTP - II MAY 24] (03)

Q.44. Being statutory auditor of JAL Limited, a company engaged in manufacturing of chemicals, CA Gopika has understood that company is expected to have material work-in-progress as on 31st March, 2024.

State few audit procedures to verify existence and valuation assertions for work-in-progress.

[MTP - II MAY 24] (04)

Q.45. 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"? (03)

(ii) Also, explain how an auditor should select the most appropriate evidence when testing the accuracy of any assertion to form an opinion. [MAY 25] (02)

Q.46. 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? (01)

(ii) What are the conditions necessary for using such a confirmation request effectively? [MAY 25] (04)

Q.47. 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. [MAY 25] (05)

## ANSWERS

1. 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.

2. 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.

3. 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.

#### 4. Sample Selection 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 ₹ 20 lakhs, balances between ₹ 10 lakhs to ₹ 20 lakhs and balances below ₹ 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*.

5. **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.

6. 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 or external data used by the expert.

7. **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.

8. **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 & claims & 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.

9. 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.

10. The auditor may decide to select specific items from a population. In making this decision, factors that may be relevant include:

- (i) the auditor's understanding of the entity.
- (ii) the assessed risks of material misstatement, and
- (iii) the characteristics of the population being tested.

Specific items selected may include:

- **High value or key items:** The auditor may decide to select specific items within a population because they are of high value, or exhibit some other characteristic.
- **All items over a certain amount:** The auditor may decide to examine items whose recorded values exceed a certain amount so as to verify a large proportion of the total amount of a class of transactions or account balance.
- **Items to obtain information:** The auditor may examine items to obtain information about matters such as the nature of the entity or the nature of transactions.

11. **The auditor should perform analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price which may include:**

- (i) **Consumption Analysis:** Auditor should scrutinize raw material consumed as per manufacturing account and compare the same with previous years with closing stock and ask for the reasons from the management, if any significant variations are found.
- (ii) **Stock Composition Analysis:** Auditor to collect the reports from management for composition of stock i.e., raw materials as a percentage of total stock and compare the same with previous year & ask for reasons from management in case of significant variations.
- (iii) **Ratios:** Auditor should compare the creditors turnover ratios and stock turnover ratios of the current year with previous years.
- (iv) **Quantitative Reconciliation:** Auditor should review quantitative reconciliation of closing stocks with opening stock, purchases and consumption.

12. **Purpose of Applying Analytical Procedure:** Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. The auditor of Grape Ltd. would achieve the following by carrying out the comparison stated in the question:

- (i) If balances included in the Statement of Profit and Loss of an entity are compared with those contained in the Statement of Profit and Loss with that of the previous period, it would be possible to find out the reasons for increase or decrease in the amount of profits of those years.
- (ii) By setting up certain expenses' ratios on the basis of balances included in the Statement of Profit and Loss, for the year under audit, comparing them with the

same ratios for the previous year, it is possible to ascertain the extent of increase or decrease in various items of expenditure in relation to sales and that of trading profit in relation to sales.

- (iii) If differences are found to be material, the auditor would ascertain the reasons thereof and assess whether the accounts have been manipulated to inflate or suppress profits.
- (iv) It may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications.

13. As per SA 610, "Using the work of Internal Auditor", direct assistance refers to the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

Prior to using internal auditors to provide direct assistance for purposes of the audit, CA Mukul, the external auditor shall: -

- (a) Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor and
- (b) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

Examples of procedures in which CA Mukul shall not use internal auditor to provide direct assistance to him are: -

- (a) Procedures which involve making significant judgments in the audit;
- (b) Procedures relating to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited.
- (c) Procedures relating to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
- (d) Procedures relating to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

74. In accordance with requirements of SA 501, "Audit Evidence- Specific Considerations for Selected Items", when inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

(a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.

(b) Perform inspection or other audit procedures appropriate in the circumstances.

Other audit procedure may include -

- Inspecting documentation regarding inventory held by third parties
- Requesting confirmation from other parties when inventory has been pledged as collateral.
- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
- Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.

15. **Audit Procedure:**

Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. In view of above, it can be concluded that CA Kanika used Inspection as an audit procedure. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.

Example of inspection used as a test of controls is inspection of records for evidence of authorisation.

Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a inventory or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition. Inspection of tangible assets may provide reliable audit evidence with

respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

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

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

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

17. **Audit Procedure Regarding Opening Balances:** The newly appointed auditor of BTN Ltd shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures.

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

- (1) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss.
- (2) Determining whether the opening balances reflect the application of appropriate accounting policies; and
- (3) Performing one or more of the following:

- (i) Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements.
- (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

18. Circumstances when it becomes necessary to meet with company's external legal counsel:

In the given case of SPR Ltd., Auditor requested the management for meeting with SPR's external legal counsel.

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.

This may be the case, for example, where:

- (i) The auditor determines that the matter is a significant risk.
- (ii) The matter is complex.
- (iii) There is disagreement between management and the entity's external legal counsel.

Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

19. Inquiry, as a method of obtaining audit evidence, is explained in accordance with SA 500, "Audit Evidence," as follows:

- Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures.
- Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
- Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

- Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited.

In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

20. 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).

21. (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.

22. (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.

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

(i) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.

(ii) Perform inspection or other audit procedures appropriate in the circumstances. Other audit procedure may include -  
For example,

- Inspecting documentation regarding inventory held by third parties, example, warehouse receipts.
- Requesting confirmation from other parties when inventory has been pledged as collateral.
- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.

- Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.

24. During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the following records or documents that may provide information about related party relationships and transactions, for example:

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and those charged with governance.
5. Records of the entity's investments and those of its pension plans.
6. Contracts and agreements with key management or those charged with governance.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Specific invoices and correspondence from the entity's professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.
11. Internal auditors' reports.
12. Documents associated with the entity's filings with a securities regulator e.g, prospectuses).

25. 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.

26. In the given case, while performing tests of details on a sample in respect of sales, misstatements have been found by CA Shubham in selected sample pertaining to the sales transactions of small values. This indicates observance of deviations and misstatements while performing tests of controls and tests of details respectively in selected samples. As per SA 530, “Audit Sampling”, in analysing the deviations and misstatements identified, the auditor may observe that many have a common feature, for example, type of transaction, location, product line or period of time.

In such circumstances, the auditor may decide to identify all items in the population that possess the common feature, and extend audit procedures to those items. In addition, such deviations or misstatements may be intentional, and may indicate the possibility of fraud.

Therefore, the auditor shall investigate the nature and causes of any deviations or misstatements identified, and evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit.

In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population. The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.

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

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

28. As per SA 505, "External Confirmation", If management refuses to allow the auditor to send a confirmation request, the auditor shall:

(i) Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;

(ii) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and

(iii) Perform alternative audit procedures designed to obtain relevant & reliable audit evidence. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260 "Communication with Those Charged with Governance". The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705 "Modifications to the Opinion in the Independent Auditor's Report".

29. Follow up for items that are obsolete, damaged, slow moving and ascertain the possible realizable value of such items. Carefully examine the valuation of obsolete and damaged inventory. For the purpose, request the client to provide inventory ageing split and follow up for any inventories which at time of observance of physical counting were noted as being damaged or obsolete.

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

30. If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures

required by other SAs, seek direct communication with the entity's external legal counsel. The auditor shall do so through a letter of inquiry requesting the entity's external legal counsel to communicate directly with the auditor.

If law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures.

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

- (i) A list of litigation and claims;
- (ii) Where available, management's assessment of the outcome of each of the identified litigation & claims & 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.

31. Matters the auditor may consider in determining the extent of test of controls include the following:

- The frequency of the performance of the control by the entity during the period.
- The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
- The expected rate of deviation from a control.
- The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
- The extent to which audit evidence is obtained from tests of other controls related to the assertion.

32. (i) In the given case, risk of material misstatement has been assessed as high in respect of assertions relating to revenue and various direct expenses due to increase in gross profit ratio of company from 14% in year 2022-23 to 24% in year 2023-24.

Few possible reasons which could have led to abnormal jump in gross profit ratio include: -

- Overvaluation of inventories
- Overstatement of revenues
- Understatement of direct expenses

(ii) SA 200, "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing" defines detection risk as the risk that the procedures performed by the auditor to reduce audit risk to an acceptably low level will not detect a misstatement that exists and that could be material, either individually or when aggregated with other misstatements.

Tisha is of a view that detection risk in this engagement should be kept at high level whereas in the given situation, risk of material misstatement has been assessed as high for assertions relating to revenue and direct expenses. Therefore, detection risk has to be kept at low level so that a material misstatement in these assertions does not remain undetected.

Therefore, view of Ms. Tisha is not proper.

33. As per SA 500, "Audit Evidence", if the entity has employed or engaged experts, the auditor may rely on the works of experts, provided he is satisfied that sufficient and appropriate audit evidence is obtained with reasonable assurance to form an opinion on the financial statements. When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:-

- (a) Evaluate the competence, capabilities and objectivity of that expert
- (b) Obtain an understanding of the work of that expert and
- (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

Before using the work of PQR Associates, management's expert, auditor should ensure that the criteria mentioned above are fulfilled.

34. Audit procedures to be followed by the statutory auditor of Zed Limited to ensure that only the inventories held by entity have been recorded in the financial statements

and do not include any inventories that belong to third parties but does include inventories owned by the entity and lying with a third party are as under: -

- Perform analytical procedures (comparison tests with industry averages, budgets, prior years, trend analysis, etc.).
  - Compute inventory turnover ratio (COGS/ average inventory)
  - Perform vertical analysis (inventory/ total assets)
  - Compare budgetary expectations vis-à-vis actuals
- Examine non-financial information related to inventory, such as weights and other measurements.
- Perform purchase and sales cut-off tests. Trace shipping documents (bills of lading and receiving reports, warehouse records, and inventory records) to accounting records immediately before and after year-end.
- With respect to tagged inventory, perform tests for omitted transactions and tests for invalid transactions.
- Verify the clerical and arithmetical accuracy of inventory listings.
- Reconcile physical inventory amounts with perpetual records.
- Reconcile physical counts with ledger control totals.
- Reconcile inventories which belong to client but are held with third parties like transporters, warehouses, port authorities etc.
- Goods received on a consignment basis have been properly segregated from other items of inventory.

35. In accordance with SA 505, "External Confirmations", 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:

- (i) 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.
- (ii) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions.
- (iii) A very low exception rate is expected and

(iv) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests. The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request. Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request. Therefore, view of CA X is not correct.

36. During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. Examples of the records or the documents that may provide information about related party relationships and transactions are:

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and those charged with governance.
5. Records of the entity's investments and those of its pension plans.
6. Contracts & agreements with key management or those charged with governance.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Specific invoices and correspondence from the entity's professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.
11. Internal auditor's reports.
12. Documents associated with the entity's filings with a securities regulator (e.g. prospectuses).

37. In the given case, method of sampling being used in software is known as interval sampling or systematic sampling. It is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval. Sampling interval = Sampling units in population / Sample size i.e 1000/100

Sampling interval = 10

Records selected = 100

Software would pick every 10th record from 1 to 1000 records.

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

Further, partner of CA Z suggested him to select the first 200 sales invoices from the sales book for the last month. He is suggesting him block sampling for sales, this method involves selection of a block(s) of contiguous items from within the population.

38.

(i) Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable. A predictable relationship is one that may reasonably be expected to exist and continue over time.

In the given case CA M, auditor of a company, has planned to use substantive analytical procedures for testing relationship between sales and cost of sales. Hence, auditor's approach is appropriate in this case.

(ii) Using substantive analytical procedures is also affected by nature of assertion.

Substantive analytical procedures may be more effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations).

In the given case, CA M has planned to use substantive analytical procedures for testing rights over certain assets forming part of account balances. Such procedures are likely to be less effective in this case.

39. Audit evidence comprises both information that supports & corroborates management's assertions, & any information that contradicts such assertions. Purchase bill of ₹ 5.00 lacs pertaining to TIM Industries has been entered in books of TIM Private Limited. Therefore, it is contradicting management's assertion relating to occurrence of such purchases. Hence, it constitutes audit evidence.

Further, the absence of information (for example, management's refusal to provide a

requested representation) is used by auditor, and therefore, also constitutes audit evidence. In the given case, management has refused to provide a written representation relating to physical verification of inventories during the year. Therefore, absence of information is used by auditor and it also constitutes audit evidence.

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

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

41. In accordance with SA 610, the external auditor shall not use internal auditors to provide direct assistance to perform procedures that relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited. In the given situation, valuation of trade receivables is assigned as an area of higher risk by statutory auditor. Judgment required in checking of accuracy of aging of trade receivables is limited. Therefore, external auditor can assign the checking of the accuracy of the aging to Chief Internal Auditor providing direct assistance as it involves limited judgment.

42. Audit Sampling refers to the application of audit procedures to less than 100% of items within a population relevant under the audit such that all sampling units (i.e. all the items in the population) have an equal chance of selection. In the given situation, senior team member is not selecting items for testing by means of audit sampling. He is only selecting specific items from a population. In accordance with SA 500, one of the means available to auditor for selecting items for testing is "by selecting specific items."

Specific items selected may include:-

- **High value or key items:** The auditor may decide to select specific items within a population because they are of high value, or exhibit some other characteristic, for example, items that are suspicious, unusual, particularly risk-prone or that have a history of error.
- **All items over a certain amount:** The auditor may decide to examine items whose recorded values exceed a certain amount so as to verify a large proportion of the total amount of a class of transactions or account balance.
- **Items to obtain information:** The auditor may examine items to obtain information about matters such as the nature of the entity or the nature of transactions. Therefore, Sanjeev's understanding is not proper. The above approach for selecting items for testing is subject to non-sampling risk. Non-sampling risk is the risk that auditor may reach an erroneous conclusion for any reason not related to sampling risk. Like, erroneous conclusion may be reached due to some inappropriate audit procedure.

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

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

44. Audit procedures to verify existence and valuation assertions for work-in-progress are as under:-

- Attend inventory count in accordance with SA 501 and understand how work in progress is arrived at.
- Evaluate work of management expert, if any, in this regard.
- Ascertain how the various stages of production/ value additions are measured and in case estimates are made, understand the basis for such estimates.

- Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity.
- Ensure that material costs exclude any abnormal wastage factors.

## 5. AUDIT OF ITEMS OF FINANCIAL STATEMENTS

Q.1. 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 ₹ 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 ₹ 1.00 crore. Pen Private Limited, following Indian GAAP, has presented the aforesaid details in the Balance Sheet as on 31<sup>st</sup> March, 2024 as follows:

Property, Plant, and Equipment	₹
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.

[JAN 25] (05)

Q.2. 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 unauthorized 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 recognized at the lower of cost and net realizable value in accordance with AS 2 - Inventories.

[JAN 25] (05)

Q.3. 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.

[SEPT 24] (04)

Particulars	Amount (₹)
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?

Q.4. 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.

[SEPT 24] (03)

Q.5. JB Limited has invested huge sums of money on establishment of new Property, Plant and Equipment during the year under audit. They have incurred and amount of ₹ 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?

[SEPT 24] (04)

Q.6. 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 ₹ 25,25,000/- and the net realizable value of the inventory on the same date is ₹ 25,24,000/-. The cost of inventory includes the following:

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

[MAY 24] (04)

Q.7. 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: [MAY 24] (03)

Borrowers	Maximum Loan granted during the year 2023-2021 (₹ in Lakh)	Outstanding Loan as at 31/03/2024 (₹ in Lakh)
X (Promoter)	20	15
Y (Director)	30	25
Z (KMP)	10	05
A (Related Party)	20	10
Others	80	65
<b>Total</b>	<b>160</b>	<b>120</b>

Q.8. PQ & Co. want to diversify its business and for that purpose they want to raise money by issuing shares to the general public. The face value of the shares is ₹ 100 but the directors of the company propose to issue the shares at a discounted rate of ₹ 95/- so as to receive more response. The statutory auditor, however, objects to the same as it is not allowed as per the Companies Act, 2013. State the provisions of Section 53 of the Companies Act, 2013 with reference to shares issued at a discount and the consequences where the company fails to comply with the provisions of this section. [MAY 24] (04)

Q.9. HR & Associates are the auditors of a large manufacturing company. The company has recently invested huge amount in Property, Plant and Equipment (PPF) 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.

[MAY 24] (04)

Q.10. CA Tripti is in midst of conducting audit of a company engaged in manufacturing of range of bicycles in an industrial township located in a North Indian state. As part of its activities, the company procures bicycle components from various small and medium sized enterprises. Besides, company imports few bicycle components from China on

credit terms. The auditor notices that company has huge trade payables reflected in its financial statements. He wants to be sure that all trade payables reflected in financial statements have been valued appropriately. Suggest few audit procedures to be performed in this respect.

[RTP MAY 25]

Q-11. During the audit of Rapid Industries Private Limited, CA Akshat notices that inventories of raw materials & consumables and work-in- progress amounting ₹ 2.50 crores and ₹ 0.25 crores appear in the financial statements of the company as on March 31<sup>st</sup>, 2024. He wants to verify that the above-mentioned inventories have been valued appropriately and as per generally accepted accounting policies and practices. How should he proceed to verify the above?

[RTP JAN 25]

Q-12. The financial statements of XYZ Limited show long-term borrowings from the banks, financial institutions, leasing, and hire purchase companies. Additionally, the company has issued debentures to its 1000 members to raise funds in accordance with the provisions of the Companies Act, 2013. The money raised by issuing debentures is also reflected in long-term borrowings. As the statutory auditor of XYZ Limited, CA X wants to verify that all borrowings on the balance sheet represent valid claims by banks or other third parties. Suggest a few audit procedures in this regard. [RTP SEPT 24]

Q-13. Proceedings have been initiated against False Limited for holding benami property under law relating to prohibition of benami transactions and the rules made thereunder but such property is not recorded in books of accounts. As a consultant to the company, what will you advise the company as far as disclosure requirements are concerned in financial statements in relation to said proceedings?

[RTP MAY 24]

Q-14. Droma Shoes Private Limited was established in year 2022-23 for manufacturing of footwear. As funds were needed to carry on its business activities - including for purchase of different raw materials, incurring of regular expenses like power and fuel and payment of wages etc., it had got sanctioned a credit facility amounting to ₹ 2 crores repayable on demand from a bank against primary security of its current assets and collateral security of residential house of one of its directors. Duly signed guarantee documents

by directors in favour of bank also form part of bank's loan documentation. Account statement of above facility downloaded from bank's website shows debit balance of ₹ 1.85 crores as on 31<sup>st</sup> March, 2023. The operations in above credit facility are satisfactory. In this regard:-

- (i) Identify nomenclature of such credit facility given by banks. How would above amount of ₹ 1.85 crores be reflected and classified in financial statements of company as on 31.3.23?
- (ii) Also state specific disclosure requirements of Schedule III of Companies Act, 2013 in relation to above.

[RTP MAY 24]

Q.15. Following is extract of notes to accounts of financial statements of STU Private Limited listing some ratios. Discuss, whether disclosure, given in following manner meets requirements of Schedule III of the Companies Act, 2013. Ignore other ratios which are not listed in extract given below:

[RTP MAY 24]

Name of ratio	31.3.2023	31.3.2022
Current ratio	2.50	2.30
Inventory turnover ratio	3.00	6.00
Trade receivables turnover ratio	1.75	5.00
Net profit ratio (in %)	13%	10%

Q.16. 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?

[MTP - I MAY 25] (05)

Q.17. 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.

[MTP - I MAY 25] (04)

Q.18. 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? [MTP - II MAY 25] (05)

Q.19. CA Karan wants to test the “completeness” assertion relating to intangible assets reflected in the financial statements of Data Solutions Private Limited. State audit procedures to be performed by CA Karan in this regard. [MTP - I JAN 25] (05)

Q.20. 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? [MTP - I JAN 25] (04)

Q.21. As the statutory auditor of Ginni Ltd., you need to verify if the company has valid legal ownership rights over the inventories recorded in the balance sheet as on March 31, 2024. What audit procedures should you perform to verify the company's ownership of the inventories, including items stored at third-party locations? [MTP - I JAN 25] (04)

Q.22. M/s AR & Associates have been appointed as statutory auditors of Future Limited, a company engaged in the business of manufacturing of hardware products. They are analyzing the monthly trends for other expenses like rent, power and fuel, repairs, etc. and are also verifying attributes of such types of expenses. List down the attributes for verifying such expenses. [MTP - II JAN 25] (05)

Q.23. While verifying cash and cash equivalents of a company, CA D engagement partner, is very particular that Bank reconciliation statement (BRS) prepared by the management in respect of bank account maintained by the company is proper to rule out misstatements in cash and cash equivalents reflected in the financial statements of

the company. The company does not use net banking and prefers to issue cheques to its creditors and receives substantial payments locally through account payee cheques. Which aspects need to be taken care of and verified by CA D in respect of BRS?

[MTP - I SEPT 24] (04)

Q.24. BOTS is a manufacturing entity having material Property, Plant and Equipment (PPE) items in its financial statements. The auditor of the entity wants to verify that PPE items have been valued appropriately as per generally accepted accounting policies and practices. Comment on significance of such verification. Suggest a few audit procedures in this regard.

[MTP - I SEPT 24] (04)

Q.25. CA J is appointed as statutory auditor of Sigma and Beta Limited for the year 2023-24. During the audit he observed trade receivables amounting to ₹ 50 crores are reflected in the financial statements of the company. He wants to obtain sufficient appropriate evidence to conclude that trade receivables have been valued appropriately. Suggest few audit procedures in this regard.

[MTP - II SEPT 24] (05)

Q.26. M/s Veer and Associates is appointed as auditor of KMP limited. During the audit, auditor wants to verify that trade payables and liability balances that were supposed to be recorded have been recognized in the financial statements. Which assertion auditor wants to ensure and what audit procedures should be followed by him in this regard?

[MTP - II SEPT 24] (05)

Q.27. Mr. Vaayu is appointed as the auditor of PRISM Limited for the year 2023-24. He wants to ensure that the PPE has been valued appropriately and as per generally accepted accounting policies and practices and also that PRISM Limited has valid legal ownership rights over the PPE claimed to be held by the company and recorded in the financial statements. Explain how the auditor will verify the same.

[MTP - II SEPT 24] (05)

Q.28. Prudent Enterprises Private Limited has incurred and fully spent for the first time Corporate Social Responsibility (CSR) expenditure amounting to ₹ 14.50 lacs in

pursuance to provisions of section 135 of Companies Act, 2013. The expenditure was spent for women empowerment programmes through an implementing agency (not a related party). As per law provisions, it was required to spend ₹ 14.00 lacs during the year. Discuss how such information is required to be disclosed in accordance with requirements of Schedule III to the Companies Act, 2013 in financial statements of the company.

[MTP - 1 MAY 24] (03)

Q.29. You are part of engagement team conducting audit of an entity engaged in manufacturing business. State few audit procedures you would undertake to perform to verify that recorded sales in financial statements represent goods actually sold during the period and recorded sales are not overstated.

[MTP - 1 MAY 24] (04)

Q.30. WTE Private Limited is engaged in business of manufacturing a product liable to GST @ 5%. The input raw materials for manufacturing this product are liable to GST @ 12% and 18%. As a result, at the end of financial year, ITC on inputs amounting to ₹ 60 lacs is accumulated in Electronic Credit ledger and refundable to company under provisions of GST law. How would above amount of ₹ 60 lacs be reflected and classified in balance sheet of company? State few audit procedures to be performed by you for verification of abovesaid balance.

[MTP - 1 MAY 24] (04)

Q.31. Tisa Industries Private Limited has prepared its financial statements for year 2023-24. The financial statements and notes to accounts show following information and disclosure in respect of trade receivables of the company: -

S. No.	Particulars	Amount (in ₹ lacs)
1.	Trade Receivables	240.00

Trade receivables ageing schedule:

Outstandings for following periods from due date of payment

(in ₹ lacs)

Particulars	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
MSME	150.00	30.00	10.00	XXX	190.00
Others	40.00	XXX	XXX	XXX	40.00
Disputed dues- MSME	XXX	XXX	XXX	XXX	XXX
Disputed dues- others	10.00	XXX	XXX	XXX	10.00

You are part of engagement team conducting audit of the company. Point out discrepancies including omissions in above disclosure. (Do not prepare another table).

[MTP - II MAY 24] (04)

Q.32. 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 ₹ 2 cores 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. [MAY 25] (05)

Q.33. 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. [MAY 25] (04)

## ANSWERS

1. 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 ₹ 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 ₹ 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

2. (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.

3. **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.

4. 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.

5. 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 ₹ 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. 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.

6. **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 ₹ 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 ₹ 25,25,000 - ₹ 2,000 = 25,23,000 rupees and Net realizable value of inventory is ₹ 25,24,000.

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

7. 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 (₹ in Lakhs)	Percentage to the total Loans and Advances in the nature of loans (₹ 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	$8.333\% = 10/120 \times 100$

8. **Shares issued at a discount:** According to Section 53 of the Companies Act, 2013,

- (1) a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under Section 54 of the Companies Act, 2013.

- (2) any share issued by a company at a discounted price shall be void.

Notwithstanding anything contained in above sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

- (3) Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

9. 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.

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

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

11. To verify that inventories of raw material & consumables and work-in- progress have been valued appropriately and as per generally accepted accounting policies and practices, the following procedures should be performed by CA Akshat:

For Raw materials and consumables:

- Ascertain what elements of cost are included e.g. carriage inward, non-refundable duties etc.
- If standard costs are used, enquire into basis of standards; how these are compared with actual costs and how variances are analysed and accounted for/ treated in accounting records.
- Test check cost prices used with purchase invoices received in the month(s) prior to counting.

- Follow up valuation of all damaged or obsolete inventories noted during observance of physical counting with a view to establishing a realistic net realizable value.

**For Work in Progress:**

- Ascertain how the various stages of production/ value additions are measured and in case estimates are made, understand the basis for such estimates.
- Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity.
- Ensure that material costs exclude any abnormal wastage factors.

12. The audit procedures required to be undertaken by CA X while auditing borrowings is as follows:

- Review board minutes for approval of new lending agreements. During review, ensure that new loan agreements or bond issuances were authorized. Ensure that significant debt commitments are approved by the board of directors.
- Check the details of loans recorded (interest rate, nature and repayment terms) to the loan agreement. Verify that borrowing limits, if any, imposed by the agreements are not exceeded.
- Roll out and obtain independent balance confirmations (SA 505) in respect of all the borrowings from the lender (banks/ financial institutions etc.).
- Verify the details of leases and hire purchase creditors recorded to underlying contracts/agreements.
  - In case of Debentures, examine trust deed for terms and dates of redemption, borrowing restrictions and compliance with covenants.
  - When debt is retired, ensure that a discharge is received on assets securing the debt.
  - Obtain Written Representation that all the liabilities which have been recorded represent a valid claim by the lenders.

13. **Disclosure in case of Benami Properties held by the Company:** Where any proceedings have been initiated or pending against the company for holding any benami property under the relevant law relating to prohibition of such transactions, the company shall disclose the following: -

- (a) Details of such property, including year of acquisition
- (b) Amount there of
- (c) Details of Beneficiaries
- (d) If property is not in the books, then the fact shall be stated with reasons
- (e) Where there are proceedings against the company under this law as an abetter of the transaction or as the transferor, then the details shall be provided
- (f) Nature of proceedings, status of same and company's view on same.

14. (i) The type of credit facilities referred to in above situation given by banks to meet working capital requirements of business which are repayable on demand are known as "cash credit facilities/overdraft" facilities. The amount of ₹ 1.85 crores outstanding as on 31<sup>st</sup> March, 2023 reflects borrowings of the company and it would be classified as "short-term borrowings" as loans repayable on demand from banks under current liabilities in balance sheet of the company. Borrowings shall further be sub-classified as secured.

(ii) Specific disclosure requirements of short-term borrowings under Schedule III to Companies Act, 2013 in given situation are as under: -

- Nature of security i.e. primary security of current assets and collateral security of residential house belonging to a director shall be specified.
- As loans have been guaranteed by directors, the aggregate amount of such loans shall be disclosed.

To be disclosed as Additional Regulatory Information

Since the Company has borrowings from bank on the basis of security of current assets, it shall also disclose the following:-

- (a) whether quarterly returns or statements of current assets filed by the Company with banks or financial institutions are in agreement with the books of accounts.
- (b) if not, summary of reconciliation and reasons of material discrepancies, if any to be adequately disclosed.

15. The disclosure given in the question does not meet requirements of Schedule III to Companies Act, 2013.

Schedule III requires that the company shall explain the items included in numerator

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

In the given table, the company has not explained the items included in numerator and denominator for computing ratios. Further, variations in ratios as compared to preceding year are as under: -

Name of ratio	31.3.23	31.3.22	Variation
Current ratio	2.50	2.30	8.69%
Inventory turnover ratio	3.00	6.00	50%
Trade receivables turnover ratio	1.75	5.00	65%
Net Profit ratio (in %)	13%	10%	30%

As calculated above, there is change in inventory turnover ratio, trade receivables turnover ratio and net profit ratio by more than 25% as compared to preceding year.

Therefore, explanations for such changes have also to be provided where there are changes by more than 25% as compared to preceding year.

16. **Application of Securities Premium Account:** The securities premium account may be applied by the Company:

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

The auditor needs to verify whether the premium received on shares, if any, has been transferred to a "securities premium account" and whether the application of any amount out of the said "securities premium account" is only for the purposes mentioned above.

17. In the given situation, the auditor is verifying Completeness assertion by ensuring that all goods dispatched 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.

18. 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.

19. The audit procedures to be performed by CA Karan to test completeness assertion relating to intangible assets are as under: -

- Verify the movement in the intangible assets schedule compiled by the management i.e.  $\text{Opening balances} + \text{Additions} - \text{Deletions} = \text{Closing balances}$ . Tally the closing balances to the entity's books of account.
- Check the arithmetical accuracy of the movement in intangible assets schedule.
- For additions during the period under audit, obtain a listing of all additions from the management and undertake the following procedures:-
  - 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.

- In relation to deletions of intangible assets, understand from the management the reason and rationale for deletion and the manner of disposal. Obtain the management approval and disposal note authoring disposal of the asset from its active use. Verify the process followed for sale of discarded asset, for example inviting competitive quotes, tenders and the basis of calculation of sales proceeds. Verify that the management has accurately recorded the deletion of intangible asset (original cost and accumulated amortization up to the date of disposal) and the resultant gain/ loss on disposal in the entity's books of account.

20. To verify the rights and obligations assertion regarding Property, Plant, and Equipment (PPE), the auditor must ensure the entity has valid legal ownership and identify any charges against it. The audit procedures should include the following:

- In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity.
- For all additions to land and building in particular, the auditor should check the conveyance deed/ sale deed to verify whether the entity is the legal and valid owner or not.
- The auditor should insist and verify title deeds for immoveable property acquired.
- In case, the entity has given such immoveable property as security for any borrowings and the original title deeds are not likely to be available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security.
- The auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

21. The statutory auditor of Ginni Ltd. should perform the following audit procedures to verify if the company has valid legal ownership rights over the inventories recorded in the balance sheet as on March 31<sup>st</sup>, 2024.

- Vouch recorded purchases to underlying documentation (purchase requisition, purchase order, receiving report, vendor invoice and cancelled cheque or payment file).
- Evaluate the consigned goods.
- Examine client correspondence, sales and receivables records, purchase documents.
- Determine existence of collateral agreements.
- Review consignment agreements.
- Review material purchase commitment agreements.
- Examine invoices for evidence of ownership i.e. the invoices shall be in the name of the client.
- Obtain confirmation for significant items of inventory.
- For instances of inventory held by third party, the auditor should insist on obtaining declaration from the third party on its business letterhead and signed by an authorized personnel of that third party confirming that the items of inventory belong to the entity and are being held by such third party on behalf of and for the benefit of the entity under audit.

22. **Attributes for verifying other expenses like Power and Fuel, Repair etc.:** An entity in addition to making purchases and incurring employee benefit expenses, also incurs other expenditures like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to running of business operations.

While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes.

- Whether the expenditure pertained to current period under audit;
- Whether the expenditure qualified as a revenue and not capital expenditure;
- Whether the expenditure had a valid supporting document like travel tickets, insurance policy, third party invoice etc.;
- Whether the expenditure has been classified under the correct expense head;
- Whether the expenditure was authorised as per the delegation of authority matrix;
- Whether the expenditure was in relation to the entity's business and not a personal expenditure.

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

Verification of BRS shall entail the following:

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

24. It is a common understanding that the value of fixed assets/ PPE depreciates due to efflux of time, use and obsolescence. The diminution of the value represents an item of cost to the entity for earning revenue during a given period. Unless this cost in the form of depreciation is charged to the accounts, the profit or loss would not be correctly ascertained, and the values of PPE would be shown at higher amounts. Therefore, such verification is significant.

Audit procedures that the auditor should follow to verify that the PPE items have been valued appropriately as per generally accepted accounting policies and practices are:-

- Verify that the entity has charged depreciation on all items of PPE unless any item of PPE is non- depreciable like freehold land
- Assess that the depreciation method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. It could be Straight line method, diminishing value method, unit of production method, as applicable.
- The auditor should also verify whether the management has done an impairment assessment to determine whether an item of property, plant and equipment is impaired as per the requirements of AS 28 Impairment of Assets.

25. Few audit procedures to obtain sufficient appropriate audit evidence to conclude that trade receivables have been valued appropriately are as under:-

- Review the process followed by the Company to derive an allowance for doubtful accounts. This will include a consistency comparison with the method used in the last year, and a determination of whether the method is appropriate for the underlying business environment.
- Obtain the ageing report receivable (both Dr/Cr balance).
- Also, obtain the list of debtors under litigation and compare with previous year.
- Scrutinize the analysis and identify those debtors which appear doubtful; discuss with management about reasons as to why these debtors are not included in the provision for bad debts. Perform further testing where any disputes exist.
- He should check if provisions are made at appropriate rates considering recoverability of amounts due.
- Prepare schedule of movements of bad debts – Provision accounts and debts written off and compare the proportion of bad debt expense to sales for the current year in comparison to prior years to see if the current expense appears reasonable.
- Check that write-offs of the receivable balances have been authority appropriate approved by an appropriate authority i.e. the Board of Directors in case of a company.

26. Auditor wants to ensure Completeness and the audit procedures to be followed by him to verify that trade payables and liability balances that were supposed to be recorded have been recognized in the financial statements are as follows:

- The auditor needs to perform the following cut off procedures:

- For the last 5 invoices received/ recorded at the end of the reporting date (cut off date) and which have been included in the trade payables; the goods should have been received/ risk and rewards of ownership in goods should have been transferred in favour of the entity;
- All goods received prior to the period/ year- end should have been booked in the form of purchases and included in trade creditors.
- Test purchases/ expenses on a sample basis selecting the same from the accounts payable ledgers and checking their supporting documents to ensure that the purchases were recorded at the correct amounts and correct dates.
- Match purchase invoice dates to the gate entry (inward) dates to check whether the purchases are being recorded in the correct accounting period. This can include an examination of purchase/ expense invoices received subsequent to the period being audited, to see if they should have been included in the period under audit.
- Review subsequent expense vouchers. Review all material expense vouchers recorded post the balance sheet date to see if they relate to transactions from within the audit period.
- For advance received from customers/ revenue received in advance, obtain the customer wise listing along with its ageing and the nature. Enquire from the entity's management if there has been any dispute with the customer and if there is any additional liability to be recorded. For all such advances, the auditor should verify the underlying documentation based on which the entity had received the advance.
- In relation to statutory dues liability like withholding tax (TDS) payable, GST payable, luxury tax payable, professional tax payable, PF and ESI payable etc., prepare a reasonability with respect to sales/ purchases/ employee benefit expenses. Example- GST liability for last month may be calculated by applying the applicable rate to the sales made and in case of any variance with the GST liability recorded by the entity, reasons for variance should be requested from client and in case found satisfactory, the same should be maintained as part of audit documentation.

Similarly, Provident Fund liability for last month may be calculated by applying the applicable rate to the employee benefit expense and in case of any variance with the liability recorded by the entity, reasons for variance should be requested from client and in case found satisfactory, the same should be maintained as part of audit documentation.

Further, the auditor should obtain and verify the challans for deposits made subsequent to the period-end for all statutory liabilities as at the balance sheet date and also analyse the reasons, if any, in consultation with the management for any variance between the amounts deposited subsequently vis-à-vis the liability recorded in books of account.

- He shall prepare a complete list of all statutory dues and consider his reporting requirements under CARO, 2020.

27. PPE have been valued appropriately and as per generally accepted accounting policies and practices:

It is a common understanding that the value of fixed assets/ PPE depreciates due to efflux of time, use and obsolescence. The diminution of the value represents an item of cost to the entity for earning revenue during a given period. Unless this cost in the form of depreciation is charged to the accounts, the profit or loss would not be correctly ascertained, and the values of PPE would be shown at higher amounts. Mr. Vaayu, the auditor should:

- Verify that the entity has charged depreciation on all items of PPE unless any item of PPE is non- depreciable like freehold land;
- Assess that the depreciation method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. It could be Straight line method, diminishing value method, unit of production method, as applicable.
- The auditor should also verify whether the management has done an impairment assessment to determine whether an item of property, plant and equipment is impaired as per the requirements of AS 28 - Impairment of Assets.

The entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements (Rights and Obligation)

- In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity.
- For all additions to land & building in particular, the auditor should check the conveyance deed/ sale deed to verify whether the entity is the legal and valid owner or not.

- The auditor should insist and verify the original title deeds for all immovable properties held as at the balance sheet date.
- In case the entity has given such immovable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immovable property as security.
- In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

28. In the given situation, following information is required to be disclosed in accordance with requirements to Schedule III to the Companies Act, 2013:

(a) amount required to be spent by the company during the year	₹ 14.00 lacs
(b) amount of expenditure incurred	₹ 14.50 lacs
(c) shortfall at the end of the year	NIL
(d) total of previous years shortfall	NA
(e) reason for shortfall	NA
(f) nature of CSR activities - Women empowerment activities through implementing agency	
(g) 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	NIL
(h) 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	NIL

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

- Check whether a single sales invoice is recorded twice or a cancelled sales invoice has been recorded.
- Test check few invoices with their relevant entries in sales journal.
- Obtain confirmation from few customers to ensure genuineness of sales transaction
- Check whether any fictitious customers and sales have been recorded.

- Verify whether any shipments were done without the consent and agreement of the customer, especially at the year end to inflate the sales figure
- Whether unearned revenue recorded as earned.
- Whether any substantial uncertainty exists about collectability
- Whether customer obligations are contingent on other (financing, resale, etc.).
- Review sequence of sales invoices
- Review journal entries for unusual transactions
- Calculate the ratio of sales return to sales and compare it with previous year and enquire for the reasons for unusual variation.

30. In the given situation, ₹ 60 lacs is accumulated in Electronic credit ledger of WTE Private Limited as finished product is liable to lower GST rate whereas input raw materials for manufacturing carry higher GST rate. It is refundable to company by virtue of provisions of GST law. The above balance would be reflected and classified under current assets. Within current assets, it would be classified into "Other current assets".

Few audit procedures to be performed for verification of above balance are:

- In relation to balances with statutory authorities like GST input credit, prepare a reasonability analysis with respect to purchases by applying the applicable rate to the purchases and in case of any variance with the asset recorded by the entity, reasons for variance should be requested from the entity.
- Obtain copies of statutory GST returns filed on GST portal.
- In case refundable amount as on balance sheet date is still outstanding, verify whether the amount recorded as per books of account tallies with the claim made with the authorities subsequently by going to GST portal.
- In case refundable amount as on balance sheet date is received subsequently, verify it from Bank statement.

31. The above disclosure is not in accordance with requirements of Division I of Schedule III of Companies Act, 2013. The discrepancies are as under:-

(1) The Company has wrongly disclosed information for trade receivables in a manner which is applicable for trade payables.

(2) No distinction between MSME and other trade receivables is required.

(3) Trade receivables are to be categorised into undisputed and disputed trade receivables as under: -

- Undisputed trade receivables considered good
- Undisputed trade receivables considered doubtful
- Disputed trade receivables considered good
- Disputed trade receivables considered doubtful

(4) Aging is to be reflected for each of above categories in respect of outstanding for the following periods from due date of payment

- for less than 6 months
- 6 months- 1 year
- 1- 2 years
- 2-3 years
- more than 3 years

(5) Following information is also required to be disclosed: -

Trade receivables shall be sub-classified as:

- (a) Secured, considered good
- (b) Unsecured, considered good
- (c) Doubtful

(6) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.

(7) Debts due by

- directors or other officers of the company or any of them either severally or jointly with any other person or
- firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.

## 6. AUDIT DOCUMENTATION

Q.1. 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? [SEPT 24] (04)

Q.2. CA Piku has prepared audit documentation of an entity describing nature, timing and extent of audit procedures performed during the course of audit. In documenting nature, time and extent of audit procedures performed, which matters shall be recorded? He is also of the view that such documentation alone as described above meets requirements of Standards on Auditing. Comment upon validity of his views.

[RTP MAY 25]

Q.3. CA Ripun completed the audit of a listed company, and the audit report was issued on July 17<sup>th</sup>, 2024. However, he had not properly organized the audit working papers, including records of discussions with management, audit procedures performed, and conclusions reached. More than six months after issuing the report, he received a letter from the regulator in connection with audit of the company requesting him to share copy of audit file. In a hurry, CA Ripun quickly assembled the audit file, adding some papers he thought were necessary, but he used the current date on these newly added documents. He then sent the audit file to the regulator. Discuss the issues involved related to "audit documentation" and assembling of the final audit file in this case.

[RTP JAN 25]

Q.4. An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results. Explain stating clearly the examples of significant matters.

[RTP SEPT 24]

Q.5. Rajni, a CA student, has understood that SA 230 requires auditor to prepare audit documentation on a timely basis. While reading about SQC 1, she notices that time limit for completion of final audit file is ordinarily not more than 60 days after the date of auditor's report. She finds it to be puzzling. Unable to comprehend, she seeks your guidance. Guide her.

[RTP MAY 24]

Q.6. Discussing meaning of completion memorandum, elaborate upon its importance.

[RTP MAY 24]

Q.7. 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?

[MTP - I MAY 24] (04)

Q.8. M/s KSJS & Associates are the statutory auditors of Moon Ltd. for the financial year 2023-24. During an audit briefing, CA Sanket, the engagement partner, explained that the auditor must assemble the audit documentation in an audit file and complete the administrative process of finalising the audit file on a timely basis after the date of the auditor's report. He also highlighted the requirements of SQC 1 regarding establishment of policies and procedures for the retention of engagement documentation in a firm. Explain the requirements related to the timely assembly and retention of audit files in accordance with relevant Engagement and Quality Control Standards.

[MTP - I MAY 24] (05)

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

[MTP - II JAN 25] (04)

Q.11. CA N, statutory auditor of Rock Limited, is in the process of final assembly of audit file. Under what circumstances, a statutory auditor can make changes to audit documentation during final assembly process of audit file? Give a few examples of such changes. [MTP - II SEPT 24] (04)

Q.12. What is meant by audit documentation? What are objectives of an independent auditor in accordance with SA 230? [MTP - I MAY 24] (03)

Q.13. One of the factors affecting the form, content and extent of audit documentation relates to size and complexity of the entity. State six other factors in this respect. [MTP - II MAY 24] (03)

Q.14. 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.

- Explain the meaning and significance of a Completion Memorandum. (02)
- Team Member Y completed the assembly of the final audit file in March 2025 & handed it over to CA P. Was team member Y correct in his approach? [MAY 25] (02)

## ANSWERS

- 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.

2. In documenting the nature, timing and extent of audit procedures performed, the auditor shall record:

- (a) The identifying characteristics of the specific items or matters tested.
- (b) Who performed the audit work and the date such work was completed; and
- (c) Who reviewed the audit work performed and the date and extent of such review.

The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

- (a) The nature, timing and extent of the audit procedures performed.
- (b) The results of the audit procedures performed, & the audit evidence obtained; and
- (c) Significant matters arising during the audit and the conclusions reached thereon and significant professional judgements made in reaching those conclusions.

Thus, all above matters shall be recorded to meet requirements of SA 230. Documenting nature, time and extent of audit procedures performed alone does not meet the requirements of SA 230. Therefore, CA Piku's views are not valid.

3. 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.

- SQC 1, "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files.
- An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.

The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.

- Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature.

Further, preparing sufficient & appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

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

4. As per SA 230, "Audit documentation" judging the significance of a matter requires an objective analysis of the facts and circumstances.

Examples of significant matters include:

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

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

Documentation of the professional judgements made, where significant, explains the auditor's conclusions and reinforces the quality of the judgement.

Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits, when reviewing matters of continuing significance (for example, when performing a retrospective review of accounting estimates)

5. SA 230 requires that the auditor shall prepare audit documentation on a timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained & conclusions reached before the auditor's report is finalized. SQC 1, however, requires auditor to complete assembly of final audit file in ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is only an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Therefore, auditor shall prepare documentation on a timely basis. However, for completion of assembly of final audit file which is an administrative process, time period of 60 days after the date of auditor's report has been required in SQC 1.

6. Completion memorandum is a summary 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.

7. During the audit of MNT Ltd., CA Shubh identifies an issue with stock valuation. To ensure the accuracy & reliability of his observations, it is crucial for him to document the audit procedures performed, the evidence obtained, & 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.

8. 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.

- ❖ SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files.
- ❖ An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.
- ❖ Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature. Examples of such changes include:
  - Deleting or discarding superseded documentation.
  - Sorting, collating and cross-referencing working papers.
  - Signing off on completion checklists relating to the file assembly process.
  - Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.
- ❖ After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.
- ❖ SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

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

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

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

11. Changes may be made to the audit documentation during the final assembly process, if they are administrative in nature.

Examples of such changes include: -

- Deleting or discarding superseded documentation.
- Sorting, collating and cross-referencing working papers.
- Signing off on completion checklists relating to the file assembly process.
- Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.

12. Audit documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. The objective of the auditor in accordance with SA 230 is to prepare documentation that provides:-

(i) A sufficient and appropriate record of the basis for the auditor's report and

(ii) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

13. One of the factors affecting the form, content and extent of audit documentation relates to size and complexity of audit. Other factors are:

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

## 7. COMPLETION AND REVIEW

Q.1. 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? (03)

(ii) State any two audit procedures in relation to the cash flow forecast likely to be performed by CA Z. [JAN 25] (02)

Q.2. 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. [JAN 25] (04)

Q.3. 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? [JAN 25] (05)

Q-4. 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 ₹ 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. [SEPT 24] (04)

Q-5. 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. [SEPT 24] (04)

Q-6. The management of PQ Ltd. changed during the period under audit. Mr. G an auditor, at the time of receiving written representation on the management responsibilities from the management, was in a dilemma related to the date of and period(s) covered

by the written representation. Further, new management was of the view that they can give written representation from the date they over and not for the prior period when old management were managing affairs of the company. Guide the auditor & the management in this respect. [MAY 24] [MTP - II JAN 25] (04)

Q-7. 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. [MAY 24] (03)

Q-8. On reviewing internal control over inventories as part of statutory audit of a company, auditor finds that physical verification is not being conducted at regular intervals as stipulated by the management. The auditor finds it to be significant deficiency in internal control over inventories.

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

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

Is above communication by auditor proper? Ignore statutory reporting requirements, if any in this regard. [RTP MAY 25]

Q-9. During the audit of a company, CA Kartik has noticed that company's turnover has fallen drastically as compared to last three years due to loss of its major markets and key customers. The company is in need of funds for new product development, but bankers are not willing to lend financial support. Which additional audit procedures need to be performed by CA Kartik in accordance with SA 570 when such events or conditions are identified? [RTP JAN 25]

Q-10. CA Manoj is the statutory auditor of a company. He has completed the audit and issued the audit report dated June 30, 2024. Before signing the audit report, written representations dated June 29, 2024, were obtained from the management of the company. Discuss the significance of the date of written representations. Also state

whether the written representations obtained on June 29, 2024 is appropriate or not. [RTP SEPT 24]

Q-11. While conducting audit of BYN Limited, CA Y notices that company has lost one of its key markets along with important customers. Additionally, several highly successful competitors have emerged, impacting business of the company. Despite the existence of material uncertainty, CA Y finds the use of going concern basis of accounting appropriate for preparation of financial statements. The company has also disclosed material uncertainty in notes to accounts adequately. How should he deal with the matter in auditor's report? [RTP SEPT 24]

Q-12. CA K is statutory auditor of DEMA Private Limited for the year 2022-23. The company has three plants in India. He is nearing completion of audit procedures relating to financial statements for the year under audit and has yet to sign audit report. Meanwhile, a huge fire had broken out in one of plants of the company located near Nashik on 25<sup>th</sup> June, 2023 damaging substantial part of machinery and work-in-process resulting in loss of about ₹ 5 crores. Unaware of the incident, he is in process of finalizing his report in first fortnight of July 2023. State few audit procedures to be performed by him to obtain sufficient appropriate evidence for identifying such events. Also explain auditor's responsibilities in this situation. [RTP MAY 24]

Q-13. Kundan, a CA student, is part of an engagement team conducting audit of an entity. The audit procedures are nearing completion. He notices that engagement partner has asked for a cash flow forecast from management for next twelve months from date of financial statements. Keeping in view above, answer the following: -

- Discuss likely purpose of engagement partner in the above situation. Elaborate upon significance of such testing being performed by engagement partner.
- State any two audit procedures in relation to cash flow forecast likely to be performed by engagement partner. [RTP MAY 24]

Q-14. 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. [MTP - I MAY 25] (05)

Q.15. CA Yash is conducting audit of a company for year 2023-24. The company is engaged in export of ethnic rugs to buyers in Europe. The audit is nearing completion in month of July 2024. However, it becomes known to the auditor that one of overseas buyers has made a legal claim against the company on 1st June 2024 for injury caused to a customer of one European buyer due to sub-standard dyes used in rugs of one lot of order shipped in August, 2023. The management of company has decided to agree to an out of court settlement of ₹ 5 crore to protect its reputation. The financial statements of the company are silent on this issue. Discuss, how, CA Yash should proceed to deal with above issue. [MTP - I MAY 25] (04)

Q.16. 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. [MTP - I MAY 25] (05)

Q.17. 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. [MTP - II MAY 25] (05)

Q.18. During the audit of Jimjam Ltd., CA Arjun, the auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report, that requires adjustment of, or disclosure in, the financial statements have been identified. With reference to Standards on Auditing, what specific audit procedures should CA Arjun include in his risk assessment to address subsequent events effectively?

[MTP - 11 MAY 25] (04)

Q.19. During the audit of a company, CA Jack obtained written representations from management regarding all known instances of non-compliance with laws and regulations that should be considered in the preparation of the financial statements. However, during the audit, he observed that the information provided in this regard was incomplete, and the audit evidence indicating such non-compliance contradicted the written representations, casting doubt on their reliability.

How should CA Jack proceed in this situation?

[MTP - 1 JAN 25] (05)

Q.20. During the audit of a company, CA Atul noticed that company is facing significant skilled labour shortages resulting in hampering operations of the company. The company's manufacturing is dependent upon skilled labour coming from villages in certain districts of Eastern UP. However, due to job opportunities available near villages now, many are not interested in leaving their native villages.

The company failed to keep its commitments due to such situation, consequently lost orders and faced decrease in its revenues. The fixed costs of the company remain at a high level. As a result, the company is facing a liquidity crunch and is not able to pay its creditors on time. The bankers of the company are also not willing to help the company to tide over liquidity crisis. The auditor has doubts over going concern status of the company. How should management of the company try to address auditor's concerns? What audit procedures may be performed by auditors in such a situation?

[MTP - 1 JAN 25] (04)

Q.21. ABC Pvt. Ltd., a manufacturing company, is facing significant financial difficulties due to downfall in market and increase in cost of production. CA Ram, the auditor of

ABC Pvt. Ltd. has identified the following conditions:

- The company has defaulted on a major loan repayment.
- Current liabilities exceed current assets by 50%.
- Sales revenue has declined by 30% compared to the previous year.

Management has not yet performed an assessment of the company's ability to continue as a going concern, but they provided assurance for implementing corrective measures, including cost-cutting initiatives and discussions with creditors for restructuring the loan. Which additional audit procedures need to be performed by CA Ram in accordance with SA 570 when such events or conditions are identified? [MTP - II JAN 25] (05)

Q.22. Stay fit Private Limited is a start-up that has been in business for about two years. It runs an application which provides valuable information pertaining to nutrition and helps its clients to access customized healthy food. The company's revenues are expected to grow in the coming period. Although company has reflected net losses in its financial statements for the last two years, it has managed to meet its financial commitments. The financial statements for last two years were prepared on going concern basis of accounting. The management of company wants to follow the same basis of accounting for the current year. Is the view of management appropriate? How does the "going concern" affect the preparation of financial statements? [MTP - I SEPT 24] (05)

Q.23. CA Sumit has been appointed as statutory auditor of Core Limited. List out some matters that he may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a "significant deficiency".

[MTP - I SEPT 24] (05)

Q.24. As per SA 560, 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, it may have caused the auditor to amend the auditor's report. In this context, what is meant by "Date the financial statements are issued"? Can it be later than the date of providing auditor's report to the entity? [MTP - II SEPT 24] (04)

Q.25. Up and High Private Limited has started its export business during the year 2023-24. The company was catering to domestic market only in past years. CA H, statutory auditor of the company, is of the view that the company has understated its revenue by ₹ 50.00 lacs in the year 2023-24 by not complying with requirements of AS 9 relating to revenue recognition.

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

(ii) If management refuses to correct misstatement as communicated by the statutory auditor, how should he proceed? [MTP - 1 MAY 24] (04)

Q.26. Mention any four financial events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as going concern.

[MTP - 1 MAY 24] (04)

Q.27. CA J is working as internal auditor in JKL Limited, a non-listed company. The responsibilities of internal auditor include reviewing financial information and performing detailed tests on transactions and balances. He is also responsible for compliance with laws, regulations and external requirements.

During the year 2022-23, services of an employee of company were terminated. The said employee had filed a suit against the company in respect of certain compensation dues amounting to ₹ 10 lakhs which were not paid to him. Based upon advice of legal counsel, the company had made a provision of ₹ 10 lacs in financial statements for year 2022-23. However, somewhere in June 2023, there is an out of court settlement between company and employee for ₹ 6 lakhs. The statutory audit of company is under progress and audit report has not yet been finalized. How internal auditor should have proceeded in situation? [MTP - II MAY 24] (03)

Q.28. Written representation about management's responsibilities involves confirmation of fulfilment of management's responsibilities in the preparation of the financial statements providing the relevant information and also informing about completeness of transactions. Explain. [MTP - II MAY 24] (04)

Q.29. On reviewing internal control over accounting for sales as part of statutory audit of A Ltd, auditor finds certain deficiencies in segregation of duties, authorization of sales orders, preparation of invoices, preparation and authorization of debit/credit notes etc. and non-following of standard procedures as stipulated by the management. The auditor finds these lapses to be significant deficiencies in internal control over sales. He points it out to the management in a one-liner as under:-  
"Instructions on internal control related to sales are not properly followed by the staff." Is above communication by the auditor proper? [MTP - II MAY 24] (04)

Q.30. 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. [MAY 25] (05)

Q.31. 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. [MAY 25] (05)

## ANSWERS

1. (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.

2. 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.

3. 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 & 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.

4. **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 ₹ 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.

5. (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.

6. As per SA 580, "Written Representations", the date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements. The written representations shall be for all financial statements and period(s) referred to in the auditor's report.

Furthermore, because the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate.

Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such person's responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies. In view of above, management is required to provide the written representation for all the periods even when current management were not present during all periods referred to in the auditor's report.

7. 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 & 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.

8. As per SA 265, "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management", while pointing out significant deficiencies in internal control, auditor has not only to communicate significant deficiencies giving their description but also explain the potential effects and sufficient information to those charged with governance and management to understand context of communication. In the given situation, auditor noticed significant deficiency in internal control over inventories and he pointed out the same to management i.e. "Physical verification of inventories is not being conducted at regular intervals as stipulated by management." Therefore, the above communication is not proper. Not only significant deficiency has to be communicated, it should also be explained to management the potential effects of not carrying out physical verification of inventories at regular intervals as stipulated by management. It should explain that such a significant deficiency can lead to misstatement of inventories impacting profits of the company. Highlighting the importance of such a control, it should be stated that responsibility be fixed for concerned person(s) for adhering to such an important control.

9. Loss of major markets, key customers and inability to obtain financing for new product development are examples of events or conditions that may cast a significant doubt on the entity's ability to continue as going concern. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not 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 through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:

(a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.

- (b) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
- (c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions: -
  - (i) Evaluating the reliability of the underlying data generated to prepare the forecast; and
  - (ii) Determining whether there is adequate support for the assumptions underlying the forecast.
- (d) Considering whether any additional facts or information have become available since the date on which management made its assessment.
- (e) Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

10. As per SA 580, "Written Representations" the date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements.

Since written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated before the date of the written representations. Furthermore, because the auditor must consider events occurring up to the date of the auditor's report that might require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

In the given situation, CA Manoj obtained written representations dated June 29, 2024, from the management of the company before signing the audit report on June 30, 2024.

From the above it can be concluded that written representations have been obtained appropriately.

11. As per SA 570, "Going concern", if adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified

opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to: -

- (a) Draw attention to the note in the financial statements that discloses such matters.
- (b) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

12. In the given situation, a huge fire had broken out in one of plants of company on 25<sup>th</sup> June, 2023 destroying substantial part of machinery and work-in-process resulting in loss of ₹ 5 crores. The auditor has yet to sign audit report.

Before signing audit report, he should perform following audit procedures to obtain sufficient appropriate audit evidence that all such events have been identified and are appropriately reflected in financial statements: -

- Inquiry of management whether any subsequent events have occurred
- Reading minutes of the meetings of owners, management that have been held after date of financial statements and inquiring about matters discussed at such meetings for which minutes are not available
- Reading entity's latest subsequent interim financial statements
- Obtaining written representations from management in accordance with SA 580

The situation is an example of subsequent event occurring between date of financial statements and date of audit report requiring disclosure in financial statements. The auditor has a responsibility to obtain sufficient appropriate audit evidence whether such an event requiring disclosure in financial statements is appropriately reflected in financial statements.

13. In the given situation, the engagement partner has asked for a cash flow forecast from management for next twelve months from date of financial statements. The audit procedures are also nearing completion.

Therefore, purpose of engagement partner in requiring a cash flow forecast is to obtain sufficient appropriate audit evidence regarding and to conclude on appropriateness of management's use of going concern basis of accounting in preparation of its financial statements. Further, his purpose is also to conclude on basis of audit evidence obtained,

whether a material uncertainty exists related to events or conditions that may cast a significant doubt on ability of entity to continue as a going concern, and to report in accordance with SA 570.

The significance of testing going concern assumption is due to its effect on preparation of financial statements. When the use of going concern is considered as appropriate, assets and liabilities are recorded on the basis that entity will be able to realize its assets and discharge liabilities in normal course of business. In case it is not so viewed, financial statements are prepared on liquidation basis. Hence, testing such an assumption provides evidence to auditor whether use of such assumption is appropriate or not.

Two audit procedures in relation to cash flow forecast likely to be performed

- Evaluate reliability of underlying data generated to prepare the forecast
- Determine whether there is adequate support for assumptions underlying the forecast

14. CA T should undertake the following audit procedure to establish Rights and Obligations of the entity over PPE:

- During the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity.
- For all additions to land and building in particular, the auditor should check the conveyance deed/ sale deed to verify whether the entity is the legal and valid owner or not.
- The auditor should insist and verify the original title deeds for all immoveable properties held as at the balance sheet date.
- In case the entity has given such immoveable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security.
- In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

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

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

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

16. 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.

17. 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.

18.	<p>The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.</p> <p>The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.</p> <p>The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto.</p> <p>The auditor shall take into account the auditor's risk assessment which shall include the following:</p> <ul style="list-style-type: none"> <li>(i) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.</li> <li>(ii) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.</li> <li>(iii) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.</li> <li>(iv) Reading the entity's latest subsequent interim financial statements, if any.</li> </ul> <p>19. In the given situation, company's management has not provided complete information regarding instances of non-compliance with laws &amp; regulations. If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations and audit evidence in general.</p> <p>The above situation highlights that auditor has obtained audit evidence relating to non-compliance with laws which is inconsistent with written representations in this respect casting a doubt about reliability of written representations.</p>
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As per SA 580, "Written Representation", if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the reliability of representations and audit evidence in general. If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report" having regard to the requirement of disclaimer of opinion.

20. Significant shortage of skilled labour, inability to pay creditors on time and overall liquidity crisis faced by the company are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. In such a situation, management should try to address auditor's concerns by preparing its future plan of action including preparation of cash flow forecast showing inflow and outflow of cash. Such a cash flow forecast should address auditor's concerns regarding liquidity crisis being faced by the company. The auditor should perform audit procedures to evaluate the reliability of the underlying data to prepare the forecast and determining whether there is adequate support for the assumptions underlying the forecast. The auditor should also consider whether any additional facts or information have become available since the date on which management made its assessment.

21. SA 570, "Going Concern", deals with the auditor's responsibilities in the audit of financial statements relating to going concern & the implications for the auditor's report. If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not 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 through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:

- (i) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.
- (ii) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
- (iii) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions:
  - (I) Evaluating the reliability of the underlying data generated to prepare the forecast; and
  - (II) Determining whether there is adequate support for the assumptions underlying the forecast.
- (iv) Considering whether any additional facts or information have become available since the date on which management made its assessment.
- (v) Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.

22. As per SA 570, "Going Concern", going concern is one of the fundamental accounting assumptions. The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor the necessity of liquidation or of curtailing materially the scale of the operations.

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so.

In the given situation, company has reflected net losses in financial statements of last two years but is able to meet its financial commitments signifying its ability to carry on business/trade. The revenue of company is also expected to grow in the coming period. It shows that management has neither the intention nor the necessity of

liquidation or of curtailing materially the scale of operations. Therefore, view of the management for following going concern basis of accounting in current year is appropriate.

Further, the significance of going concern is due to its effect on the preparation of financial statements. Ability or otherwise of an enterprise to be viewed as going concern affects its preparation of financial statements. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business. When an enterprise is not viewed as a going concern, the financial statements are prepared on liquidation basis. For example, inventories may need to be written down as these may be sold for a lower price. Assets may have to be recorded at the likely prices they will fetch.

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

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process, for example:
  - General monitoring controls (such as oversight of management).
  - Controls over the prevention and detection of fraud.
  - Controls over the selection and application of significant accounting policies.
  - Controls over significant transactions with related parties.
  - Controls over significant transactions outside the entity's normal course of business.
  - Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).

- The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.
- The interaction of the deficiency with other deficiencies in internal control.

24. "Date the financial statements are issued" reflects the date on which the auditor's report and audited financial statements are made available to the third parties. The date the financial statements are issued generally depends on the regulatory environment of the entity.

In some circumstances, the date the financial statements are issued may be the date that they are filed with a regulatory authority. Since audited financial statements cannot be issued without an auditor's report, the date that the audited financial statements are issued must not only be at or later than the date of the auditor's report but must also be at or later than the date the auditor's report is provided to the entity. Therefore, "date the financial statements are issued" can be later than date of providing auditor's report to the entity.

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

26.	<p><i>Financial events or conditions that may cast significant doubt on the entity's ability to continue as going concern:</i></p> <ul style="list-style-type: none"> <li>(i) Net liability or net current liability position.</li> <li>(ii) Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short term borrowings to finance long term assets.</li> <li>(iii) Indications of withdrawal of financial support by trade payables.</li> <li>(iv) Negative operating cash flows indicated by historical or prospective financial statements.</li> <li>(v) Adverse key financial ratios.</li> <li>(vi) Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.</li> <li>(vii) Arrears or discontinuance of dividends.</li> <li>(viii) Inability to pay trade payables on due dates.</li> <li>(ix) Inability to comply with terms of loan agreements.</li> <li>(x) Change from credit to cash-on-delivery transactions with suppliers.</li> <li>(xi) Inability to obtain financing for essential new product development or other essential investments.</li> </ul>
27.	<p><i>Subsequent events are events occurring between the date of financial statements and the date of the auditor's report and facts that become known to the auditor after the date of the auditor's report.</i></p> <p><i>In the given case, the company had already made provision of ₹ 10 lakhs in financial statements for year 2022-23. However, there is an out of court settlement between the company and employee for ₹ 6 lakhs.</i></p> <p><i>It is an example of event which provides evidence of conditions that existed at the date of financial statements i.e. 31st March, 2023. It provides evidence on adjustment in provision amount already made in financial statements.</i></p> <p><i>Therefore, internal auditor should ask management to revise provision downwards to ₹ 6 lakhs so that financial statements are in accordance with applicable accounting standards.</i></p>
28.	<p><i>Written representation about management's responsibilities involves confirmation of fulfilment of management's responsibilities in following areas:-</i></p>

(I) **Preparation of the financial statements**

The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation, as set out in the terms of the audit engagement. Due to its responsibility for the preparation and presentation of the financial statements and its responsibilities for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing and presenting the financial statements and the assertions therein on which to base the written representations.

(II) **Information provided and completeness of transactions**

- (i) It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement and
- (ii) All transactions have been recorded and are reflected in the financial statements.

29. While pointing out significant deficiencies in internal control, auditor has not only to communicate significant deficiencies giving their description but also explain the potential effects and sufficient information to those charged with governance and management to understand context of communication.

Therefore, the above communication is not proper. Not only significant deficiency has to be communicated, it should also be explained to management the potential effects of not following the standard instructions/ procedures specified in relation to various aspects of sales as stipulated by the management. It should explain that such a significant deficiency can lead to misstatement of revenue and trade receivables impacting profits of the company. Highlighting importance of such a control, it should be stated that responsibility be fixed for concerned persons for adhering to such an important control.

## 8. AUDIT REPORT

Q-1. 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. [JAN 25] (04)

Q-2. 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? [JAN 25] (05)

Q-3. M/s. PQ Limited has a turnover of 807 crores during the financial year 2023-24. It has outstanding dues towards Goods and Services Tax (GST) of 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]. [SEPT 24]

Q-4. 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? [SEPT 24] (03)

Q.5. 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.

[MAY 24] (04)

Q.6. You have been appointed as the statutory auditor of a limited company. The company is registered as a Nidhi Company. What are the reporting requirements of a Nidhi company under the Companies Auditor's Report Order, 2020? [MAY 24] (03)

Q.7. As per SA 701, the objectives of the auditor are to determine key audit matters and having formed an opinion on the financial statements, communicate those matters by describing them in the auditor's report. Which factors are taken into account by auditor while determining Key Audit Matters? How Key Audit Matters are communicated in audit report? [RTP MAY 25]

Q.8. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements.

Explain clearly the differences between the approaches stating the essential audit reporting. Also define comparative information and audit procedures regarding comparative information. [RTP JAN 25]

Q.9. Kiran, a CA student, was reviewing an audit report of the company when she noticed an 18-digit alphanumeric code below the auditor's signature and membership number. She wants to understand the purpose and importance of this randomly generated number as unique code. Is this code required for audit reports only? [RTP JAN 25]

Q.10.	Discuss the reporting requirements as per CARO, 2020, regarding:
(i)	Statutory Dues and
(ii)	Transactions with Related Parties
	[RTP SEPT 24]
Q.11.	Mention some examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph.
	[RTP MAY 24]
Q.12.	CA S, while conducting audit of an entity is facing the following issues: -
(i)	He has not been provided with necessary support for attending inventory count process of entity as at year end.
(ii)	Accounts Manager is not providing him present addresses of customers as well as suppliers for sending external confirmations. Even mail ids have not been provided on the pretext of business confidentiality.
(iii)	He was not able to verify revenues of entity due to lack of complete details.
(iv)	He has been asking for bills on a sample basis for the purpose of verifying expenses, but staff has been making lame excuses.
	The matter was brought to knowledge of higher management, but of no avail. The auditor, CA S has come to the conclusion that the possible effects on the financial statements of undetected misstatements would be material and affecting many aspects of financial statements and in such a case, a qualification of the opinion would be inadequate to communicate the gravity of the situation.
	How should the auditor proceed in such a situation?
	[RTP MAY 24]
Q.13.	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.
	[MTP - 1 MAY 25] (05)
Q.14.	SKN Ltd. a biopharma company and global manufacturers of select critical care medical products has been sanctioned working capital limits of ` 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? [MTP - 1 MAY 25] (04)

Q.15. 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?

[MTP - II MAY 25] (04)

Q.16. "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.

[MTP - 1 JAN 25] (05)

Q.17. During the audit of a limited company as a statutory auditor you discovered that a fraud amounting to ₹ 5 lakh has been committed by the company. What are the reporting requirements regarding fraud under the Companies Auditor's Report Order, 2020? [MTP - 1 JAN 25] (04)

Q.18. CARO, 2020 shall apply to every company including foreign company. However, it specifically exempts certain class of companies. State which class of companies are specifically exempt from the applicability of CARO, 2020? [MTP - II JAN 25] (05)

Q.19. ASD Limited's business has grown from one state of India to various countries of the world. Since the business has increased manifold, the management decided to appoint joint auditors for conducting the statutory audit of the company. They appointed

three CA firms for it. For which audit work the joint auditors will be jointly & severally responsible?

[MTP - II JAN 25] (05)

Q.20. PQR & Associates and MNO & Co., both firms of Chartered Accountants, have been appointed as joint auditors of Gama and Beta Limited. Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should identify division of audit areas and common audit areas. Explain stating the other relevant considerations in this regard with reference to the Standards on Auditing.

[MTP - I SEPT 24] (05)

Q.21. Mr. Chetan is appointed as an auditor of Spot Limited, a small company. Mr. Chetan is aware that CARO 2020 is not applicable to small company. List out the classes of companies that are specifically exempt from the applicability of CARO 2020.

[MTP - I SEPT 24] (05)

Q.22. Pure Services Limited is into the litigation relating to some legal action initiated by the industry regulator. The matter has reached jurisdictional High Court. Keeping in view uncertainty related to future outcome of matter, statutory auditor of the company has decided to include Emphasis of Matter (EOM) Paragraph in auditor's report.

- (i) Briefly discuss the considerations to be taken care of by the statutory auditor when EOM paragraph is included in auditor's report.
- (ii) State any two examples of circumstances where the auditor may consider it necessary to include an EOM paragraph.

[MTP - II SEPT 24] (05)

Q.23. Section 143(1) of Companies Act, 2013 states that every auditor of a company shall have access to books of accounts and vouchers of company and shall be entitled to require from officers of company such information and explanation as considered necessary and shall inquire into certain matters. State those matters to be inquired.

[MTP - II SEPT 24] (05)

Q.24. DOX Limited, a service provider company engaged in providing courier services pan-India as well as internationally, has appointed an internal auditor, Mr. G, in accordance with requirements of the Companies Act, 2013 during financial year 2023-24. The company's annual turnover during year 2022-23 and 2023-24 has been about ₹ 300 crores during each of above years. Business of the company has been profitable. Mr. G heads internal audit department of the company assessing governance activities, assisting in improving risk management activities and reviewing controls. Discuss reporting responsibility of statutory auditor of the company under the Companies Act, 2013 specifically in relation to internal audit and related matters for the year 2023-24. [MTP - I MAY 24] (04)

Q.25. CA B is statutory auditor of Boom Payments Bank for year 2023-24. During the year, banking regulator has imposed restrictions on Bank from accepting new deposits due to non-compliance in conducting KYC in large number of accounts and violation of rules aimed at preventing money laundering. There is material uncertainty regarding probable outcome of such restrictions on ability of Bank to continue as going concern. However, for year 2023-24, auditor has concluded that use of going concern basis of accounting is appropriate. The financial statements of Bank do not make adequate disclosure of material uncertainty due to above events in financial statements. What are implications for auditor's report for year 2023-24 in view of above? [MTP - I MAY 24] (04)

Q.26. M/s S R & Associates are the Statutory Auditors of Vanee Textile and Garments Ltd., a company engaged in the business of manufacturing of various textile products. The auditor has completed the audit and is in the process of forming an opinion on the financial statements for the F.Y. 2023-2024. CA S, the engagement partner, wants to conclude whether the financial statements as a whole are free from material misstatements, whether due to fraud or error. Guide him about the factors he should consider to reach that conclusion. [MTP - II MAY 24] (04)

Q.27. Discuss the objective of the auditor as per Standard on Auditing (SA) 705 "Modifications to The Opinion in The Independent Auditor's Report". [MTP - II MAY 24] (03)

Q.28. CA. Ravi Patnaik is conducting audit of a company for which reporting requirements under CARO, 2020 are applicable. He finds that cash credit facilities amounting to ₹ 4 crores were released to the company by branch of a bank for meeting its working capital requirements. He finds that out of above funds, ₹ 1 crore have been used by company for installing effluent treatment plant to meet State pollution control Board requirements.

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

[MTP - II MAY 24] (03)

Q.29. 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. [MAY 25] (05)

Q.30. 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. [MAY 25] (04)

Q.31. 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? [MAY 25] (05)

## ANSWERS

1. 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.

2. 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,

3. **Reporting responsibility of the auditor under paragraph 3 of CARO, 2020:** The auditor is required to report as per clause (vii) (a) of Paragraph 3 of CARO, 2020 that whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated; Further, the auditor is also required to report as per Clause (vii) (b) of Paragraph 3 of CARO, 2020, where statutory dues referred to in sub-clause have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute).

4. **Appropriate and Inappropriate 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.

5. 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.

6. **Reporting requirements of a Nidhi Company under the CARO 2020:** The auditor is required to report under clause (xii) of Paragraph 3 of CARO 2020:

- (a) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability;
- (b) whether the Nidhi Company is maintaining ten per cent. unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;
- (c) whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof.

7. 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 judgements relating to areas in the financial statements that involved significant management judgement, 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.

The auditor shall determine which of the matters determined, as stated above, were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

The auditor shall describe each key audit matter, using an appropriate subheading, in a separate section of the auditor's report under the heading "Key Audit Matters".

The introductory language in this section of the auditor's report shall state that:

(a) 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]; and

(b) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

8. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in terms of engagement.

The essential audit reporting differences between the approaches are:

(a) For corresponding figures, the auditor's opinion on the financial statements refers to the current period only; whereas

(b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

**Definition of Comparative Information** – The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

**Audit Procedures regarding comparative information**

The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

- (a) The comparative information agrees with the amounts and other disclosures presented in the prior period; and
- (b) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

9. The 18-digit alpha numeric number noticed by her at the end of the audit report is Unique Document Identification number (UDIN). It is a system generated unique number. It was noticed that financial documents/ certificates attested by third persons misrepresenting themselves as CA Members were misleading the Authorities and Stakeholders. ICAI also received number of complaints of signatures of CAs being forged by non CAs. To curb the malpractices, ICAI implemented the concept of UDIN i.e. Unique Document Identification Number. Chartered Accountants having full-time Certificate of Practice can register on UDIN Portal and generate UDIN by registering the certificates attested/certified by them. An auditor is required to mention the UDIN with respect to each audit report being signed by him, along with his membership number while signing an audit report and Certificates.

It is required to be stated in case of audit reports and certificates.

10. (i) Reporting under CARO, 2020 regarding statutory Dues [Para 3(vii)]

- (a) whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other

statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute);

(ii) Reporting under CARO, 2020 regarding transactions with related parties [Para 3(xiii)]

Whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act where applicable and the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards.

11. Examples of circumstances to include Emphasis of Matter Paragraph:

As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report", the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:-

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

12. In the given case, auditor has not been able to obtain sufficient appropriate audit evidence relating to inventories, debtors, creditors, revenues and expenses. The matter was brought to the knowledge of management but no result has been achieved. In such circumstances, auditor should proceed as given here under:-

If the auditor concludes that the possible effects on the financial statements of

undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:

- (i) Withdraw from the audit, where practicable and possible under applicable law or regulation; or
- (ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.  
If auditor withdraws from such an engagement, before withdrawing, auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

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

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

- (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

	<p>(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.</p>
14.	<p>In the given situation, the auditor is verifying Completeness assertion by ensuring that all goods dispatched prior to the year-end have been invoiced. Audit procedures to be adopted by the auditor to verify the Completeness assertion are as under:</p> <ul style="list-style-type: none"> <li>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.</li> </ul>
	<ul style="list-style-type: none"> <li>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.</li> <li>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.</li> <li>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.</li> <li>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.</li> </ul> <p>Review the process of giving discounts/ incentives and check whether the same were given as per the Company's policy/ general industry trends.</p>
15.	<p>As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating</p>

key audit matters in the auditor's report is not:

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

16. "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.

17. **Reporting requirements of a fraud under the CARO 2020:** The auditor is required to report the fraud under clause (xi) of Paragraph 3 of CARO 2020:

- (a) whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated;
- (b) whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;
- (c) whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;

18. CARO, 2020 shall apply to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013, except:

- (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949 (10 of 1949);
- (ii) an insurance company as defined under the Insurance Act, 1938 (4 of 1938);
- (iii) a company licensed to operate under section 8 of the Companies Act;
- (iv) a One Person Company as defined in clause (62) of section 2 of the Companies Act and a small company as defined in clause (85) of section 2 of the Companies Act; and
- (v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than one crore rupees as on the balance sheet date and which does not have total borrowings exceeding one crore rupees from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Schedule III to the Companies Act (including revenue from discontinuing operations) exceeding ten crore rupees during the financial year as per the financial statements.

19. **Joint Audit of Financial Statements:** As per SA 299, "Joint Audit of Financial Statements", all the joint auditors shall be jointly and severally responsible for:

- (i) the audit work which is not divided among the joint auditors and is carried out by all joint auditors;

- (ii) decisions taken by all the joint auditors under audit planning in respect of common audit areas;
- (iii) matters which are brought to the notice of the joint auditors by any one of them and there is an agreement among the joint auditors on such matters;
- (iv) examining that the financial statements of the entity comply with the requirements of the relevant statutes;
- (v) presentation and disclosure of the financial statements as required by the applicable financial reporting framework;
- (vi) ensuring that the audit report complies with the requirements of the relevant statutes, applicable Standards on Auditing and other relevant pronouncements issued by ICAI.

20. In accordance with SA 299, "Joint Audit of financial statements", before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, PQR & Associates and MNO & Co., the joint auditors should:

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

21. CARO 2020 shall apply to every company including a foreign company as defined in clause (42) of section 2 of the Companies Act, 2013, except-

- (i) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
- (ii) an insurance company as defined under the Insurance Act, 1938;
- (iii) a company licensed to operate under section 8 of the Companies Act;
- (iv) a One Person Company as defined in clause (62) of section 2 of the Companies Act and a small company as defined in clause (85) of section 2 of the Companies Act; and

(v) a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than one crore rupees as on the balance sheet date and which does not have total borrowings exceeding one crore rupees from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Schedule III to the Companies Act (including revenue from discontinuing operations) exceeding ten crore rupees during the financial year as per the financial statements.

22. (i) When the auditor includes an Emphasis of Matter (EOM) paragraph in the auditor's report, the auditor shall:-

- (a) include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter"
- (b) 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
- (c) indicate that the auditor's opinion is not modified in respect of the matter emphasized.

(ii) Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter (EOM) paragraph are:

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

23. Under section 143(1) of the Companies Act, 2013 auditor shall inquire into following matters given as under: -

- (a) whether loans and advances made by the company on the basis of security have been

properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members

- (b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company
- (c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company
- (d) whether loans and advances made by the company have been shown as deposits
- (e) whether personal expenses have been charged to revenue account
- (f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

24. DOX Limited is in business of providing courier services. As name of the company and given facts suggest: -

- It is not a small company under section 2(85) of Companies Act, 2013.
- It is not a private company.
- It is not a one person company.
- It is not a banking or insurance company.
- It is not a Section 8 company as it does not have charitable objects etc.

Therefore, it does not qualify for any exemption from applicability of CARO, 2020. Hence, reporting requirements under CARO, 2020 are applicable. While reporting under CARO, 2020, statutory auditor is required to report under clause (xiv) of paragraph 3 as under:

- (a) whether the company has an internal audit system commensurate with the size and nature of its business
- (b) whether the reports of the internal auditors for the period under audit were considered by the statutory auditor

25. As described in the situation given in the question, banking regulator has imposed restrictions due to non-compliance with regulatory requirements and there is material uncertainty of such events or conditions which may cast a significant doubt on ability of Bank to continue as going concern. However, the financial statements of Bank do not make adequate disclosure of material uncertainty due to above events in financial statements.

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:

- (i) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705.
- (ii) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

26. Factors to be considered to form an opinion:

The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:

- (1) whether sufficient appropriate audit evidence has been obtained
- (2) whether uncorrected misstatements are material, individually or in aggregate.
- (3) The evaluations required
  - (i) The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.
  - (ii) This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

27. As per Standard on Auditing (SA) 705 "Modifications to the Opinion In The Independent Auditor's Report", the objective of the auditor is to express clearly an

*appropriately modified opinion on the financial statements that is necessary when:*

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

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

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

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

## 9. SPECIAL FEATURES OF AUDIT OF DIFFERENT TYPES OF ENTITIES

Q.1. 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? [JAN 25] (04)

Q.2. 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? [JAN 25] (05)

Q.3. 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. [SEPT 24] (03)

Q.4. 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? [SEPT 24]

Q.5. Sanskar Foundation is a Non-Governmental Organisation (NGO) for orphan children. They have received voluntary contribution of ₹50 lacs from the promoters, specifying that ₹20 lacs are towards the Corpus contribution and ₹30 lacs are towards

Revolving fund. Explain the terms "Corpus contribution" and "Revolving fund".

[MAY 24] (04)

Q.6. JK Ltd. has opened a new manufacturing unit and for that they want plant & machinery. Since the capital outflow will be huge, they are considering of taking it on lease. They have approached several parties and have shortlisted one of them who is ready to give the plant on lease for 11 years, which is approximately the estimated economic life of the asset. As per the agreement, JK Ltd. will bear the insurance and maintenance expenses of the asset. Which kind of lease agreement have JK Ltd. entered into and what is the ownership status, the accounting treatment and the tax benefits of the same?

[MAY 24] (03)

Q.7. A government department has been allocated a budget for infrastructure development. During the audit, the auditor observes the following:

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

Identify the different types of audits applicable to each of these observations.

[RTP MAY 25]

Q.8. An NGO based in Kolkata collected significant donations for flood victims in Bihar. The funds were distributed to various NGOs operating in Bihar to support relief efforts. You have been appointed as the auditor for this NGO's accounts for the year in which it collected and disbursed these donations. Draft an audit program to audit the receipts of donations and the remittance of the collected funds to different NGOs.

[RTP JAN 25]

Q.9. Section 77 of Multi-State Cooperative Societies Act, 2002 states that the Central Government may at any time by order direct that a special audit of the Multi-State

Co-Operative Society's accounts for such period or periods as may be specified in the order, shall be conducted. Further, it may by the same or a different order appoint either a Chartered Accountant or the Multi-State Co-Operative Society's auditor himself to conduct special audit. Under which circumstances such power can be exercised by the Central Government?

[RTP SEPT 24]

Q.10. Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. Explain.

[RTP MAY 24]

Q.11. From a lessee's perspective, highlight main differences between an operating lease & finance lease only in relation to accounting treatment and tax benefits.

[RTP MAY 24]

Q.12. 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.

[MTP - I MAY 25] (05)

Q.13. 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.

[MTP - I MAY 25] (05)

Q.14. 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.

[MTP - II MAY 25] (05)

Q.15. 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.

[MTP - II MAY 25] (05)

Q.16. 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.

[MTP - II MAY 25] (05)

Q.17. 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?

[MTP - I JAN 25] (05)

Q.18. Aman Cooperative Society appointed FAB & Associates as an auditor for the financial year 2023-2024. During the audit, the auditors noted the following details:

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

(I) Mr. Dhairyा, 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.

[MTP - II JAN 25] (05)

Q.19. Section 72(1) of the Multi-State Co-operative Societies Act, 2002 states that only a person who is a Chartered Accountant within the meaning of the Chartered

Accountants Act, 1949 can be appointed as an auditor of a multi-state co-operative society. Who, according to Section 72(2), is disqualified from being appointed as auditors of a multi-state co-operative society? [MTP - 1 SEPT 24] (04)

Q.20. While auditing the financial statements of Bro Traders LLP, CA L is carefully going through LLP agreement. Briefly discuss the key points CA L should pay attention in the LLP agreement and the reporting responsibilities of CA L concerning the financial statements of Bro Traders LLP? [MTP - 11 SEPT 24] (05)

Q.21. Goods and Services Tax Network (GSTN) is a not for profit, limited by shares, company. Its 50% shareholding is with Union Government and 50% with different State Governments. The company provides IT infrastructure and services to various stakeholders including governments and tax payers. The company is in operation since past few years and subsequent auditor needs to be appointed during financial year 2023-24. Who appoints statutory auditor of such a company described above in accordance with provisions of Companies Act, 2013? Can any directions be issued to statutory auditors of above Company? [MTP - 1 MAY 24] (03)

Q.22. You have been appointed as an auditor of ABC Hotel, a three star hotel, for Financial Year 2022-23. As an auditor what are the special points that need to be considered in verifying the Inventories in the nature of food and beverages? [MTP - 1 MAY 24] (03)

Q.23. The audit of Government expenditure is one of the major components of Government audit. Briefly explain the basic standards set in relation to audit of Government expenditure. [MTP - 1 MAY 24] (04)

Q.24. Cinescreen Multiplex Ltd. is operating cinemas in different locations in Mumbai and has appointed you as an internal auditor. What are the areas that need to be verified in relation to receipts from sale of Tickets? [MTP - 1 MAY 24] (04)

Q.25. You are auditor of a college running different courses operating in your city. During audit of a year, it is noticed that fees concessions to students have been provided in substantial number of cases. Discuss, how, you as an auditor, would proceed to verify the same and also explain two other points to verify fees from students.

[MTP - II MAY 24] (03)

Q.26. Audit against propriety seeks to ensure that expenditure conforms to certain principles which have for long been recognised as standards of financial propriety. Explain those principles.

[MTP - II MAY 24]

Q.27. 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 - 25. 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?

[MAY 25] (05)

## ANSWERS

1. 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

2. Steps involved in the verification of fees collected from students:

- (i) Check names entered in the Students Fee Register for each month or term, with the respective Class Registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- (ii) Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
- (iii) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- (iv) Check admission fees with admission slips signed by the head of the institution and confirm that the amount has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
- (v) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the Rules prepared by the Managing Committee.
- (vi) Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority. (vii) Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded.

3. **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.

4. 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.

5. 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 & then recover the loan so as to give temporary loans again & 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 & Expenditure Account depending on restrictions laid down by the authority providing the contribution (for the revolving fund) or by the rules & regulations laid down by the concerned NGO in this regard.

6. In the given situation, JK Ltd. has opened a new manufacturing unit and for that they want plant & machinery. They have taken the plant on lease for 11 years, which is approximately the estimated economic life of the asset. As per the agreement, JK Ltd. will bear the insurance and maintenance expenses of the asset.

Same will be considered as Finance Lease as per AS - 19 since the lease term is for a major part of the economic life of the asset even if title is not transferred.

**Status of Ownership:** Ownership transfer option at the end of the lease period is with the lessee. Title may or may not be eventually transferred.

**Accounting treatment:** Finance lease is treated like loan arrangement. Hence, the asset ownership is considered of that of the lessee and thus appears on the balance sheet of the lessee.

**Tax benefit:** Lessee can claim both interest and depreciation expense as financial lease is treated like a loan.

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

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

the scope of a Propriety Audit. It ensures that the expenditure is incurred with due regard to broad and general principles of financial propriety.

8. Receipt of Donations:

- (i) Internal Control System: Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.
- (ii) Custody of Receipt Books: Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.
- (iii) Receipt of Cheques: Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.
- (iv) Bank Reconciliation: Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.
- (v) Cash Receipts: Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.
- (vi) Foreign Contributions, if any, to receive special attention to compliance with applicable laws and regulations.

**Remittance of Donations to Different NGOs:**

- (i) Mode of Sending Remittance: All remittances are through account payee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.
- (ii) Confirming Receipt of Remittance: All remittances are supported by receipts and acknowledgements.
- (iii) Identity: Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.
- (iv) Direct Confirmation Procedure: Send confirmation letters to entities to whom donations have been paid.
- (v) Donation Utilisation: Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.

(vi) *System of NGOs' Selection: System for selecting NGO to whom donations have been sent.*

9. The Central government has power to order special audit of Multi-State Cooperative Society's Accounts where it is of the opinion: -

- (a) that the affairs of any multi-state co-operative society are not being managed in accordance with self-help and mutual deed and co-operative principles or prudent commercial practices or with sound business principles or
- (b) that any multi-state co-operative society is being managed in a manner likely to cause serious injury or damage to the interests of the trade industry or business to which it pertains or
- (c) that the financial position of any multi-state co-operative society is such as to endanger its solvency.

10. Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. It is the responsibility of management to introduce controls which will minimize the leakage as far as possible. Evidence of their success is provided by the preparation of regular perhaps weekly, trading accounts for each sales point and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being investigated. The auditor should obtain these regular trading accounts for the period under review, examine them and obtain explanations for any apparent deviations.

The auditor should verify a few restaurant bills by reference to K.O.T.s (Kitchen Order Tickets) or basic record. 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 occupants on food and occupation have been paid over to the proper authorities. If the internal control in a hotel is weak or perhaps breaks down, then a very serious problem exists for the auditor. As a result of the transient nature of many of his clients' records, the auditor must rely to a very large extent on the gross margin shown by the accounts. As a result, the scope of his audit tests will necessarily be increased and, in the event of a material margin discrepancy being unexplained, he will have to consider qualifying his audit report.

## 71. Accounting treatment

Operating lease is generally treated like a renting arrangement. Lease payments are treated as operating expenses and asset does not appear as asset in lessee's balance sheet. Finance lease is treated like a loan arrangement hence, asset ownership is considered of that of lessee and thus appears on the balance sheet of the lessee.

### Tax benefits

Operating lease payment is considered like an expense just as in case of renting. However, no depreciation can be claimed by lessee. In case of finance lease, lessee can claim both interest and depreciation as it is treated like a loan.

## 72. Inspection of Multi-State Co-operative societies under Section 79

**When:** The Central Registrar may, on a request from

- federal co-operative to which a Multi-State Co-operative society is affiliated or a creditor or
- not less than one-third of the members of the board or
- not less than one-fifth of the total number of members of a Multi-State co-operative society

**How:** By general or special order in writing in this behalf inspect or direct any person authorized by him by order in writing in this behalf to make an inspection into the constitution, working and financial condition of a Multi-State co-operative society.

**Opportunity of Being heard:** No inspection shall be made unless a notice of not less than fifteen days has been given to the multi-state co-operative society.

**Powers available:** The Central Registrar or the person authorized by him shall have the following powers:

- (i) He shall at all times have access to all books, accounts, papers, vouchers, securities, stock and other property of that society & may, in the event of serious irregularities discovered during inspection, take them into custody and shall have power to verify the cash balance of the society and subject to the general or special order of the central registrar to call a meeting of the society where such general meeting is, in his opinion necessary.
- (ii) Every officer or member of a Multi-State Co-operative society shall furnish such information with regard to the working of the society as the central registrar or the person making such inspection may require.

**Inspection Report:** A copy of the report of inspection under this section shall be communicated to the Multi-State Co-operative society within a period of three months from the date of completion of such inspection.

13. **Audit against Rules & Orders** - Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority. Audit of expenditure against regularity is of a quasi-judicial type of work performed by the audit authorities. It involves interpretation of the Constitution, statutes, rules, regulations and orders. The final power of interpretation of these, however, does not vest with the C&AG.

These rules, regulations and orders against which regularity audit is conducted mainly fall under the following categories:

- (i) Rules & orders regulating the powers to incur & sanction expenditure from the Consolidated Fund of India or of a State (& the Contingency Fund of India or of a State);
- (ii) Rules and orders dealing with the mode of presentation of claims against government, withdrawing moneys from the Consolidated Fund, Contingency Fund and Public Accounts of the Government of the India and of the States, and in general the financial rules prescribing the detailed procedure to be followed by government servants in dealing with government transactions; and
- (iii) Rules and orders regulating the conditions of service, pay and allowances, and pensions of government servants.

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

But, it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that:

- (a) they are not inconsistent with any provisions of the Constitution or any laws made thereunder;

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

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

- (i) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operates.
- (ii) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions viz. 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.

15. 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 & that collections are reconciled with receipts.
- The auditor should see that costs of repairs and minor renovation and redecoration are treated as revenue expenditure, whereas costs of major alterations and additions to the hotel building and facilities capitalised.

16. 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. 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.

17. 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.

18. **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. Dhairyा, 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. Dhairyा 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.

19. As per section 72 of the Multi-State Co-operative Society Act, 2002 following persons are not qualified for appointment as auditors of a multi- state co-operative society:-

- (a) A body corporate
- (b) An officer or employee of the multi-state co-operative society
- (c) A person who is a member or who is in employment, of an officer or employee of the multi-state co-operative society.
- (d) A person who is indebted to the multi-state co-operative society or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the multi- state co-operative society for an amount exceeding one thousand rupees.

20. The auditor, CA L should read the LLP agreement & note the following provisions:-

- (a) Nature of the business of the LLP.
- (b) Amount of capital contributed by each partner.
- (c) Interest - in respect of additional capital contributed.
- (d) Duration of partnership.
- (e) Drawings allowed to the partners.
- (f) Salaries, commission etc. payable to partners.
- (g) Borrowing powers of the LLP.
- (h) Rights & duties of partners.
- (i) Method of settlement of accounts between partners at the time of admission, retirement, admission etc.
- (j) Any loans advanced by the partners.
- (k) Profit sharing ratio

Reporting Responsibilities of CA L/ concerning the financial statements of Bro Traders LLP is as follows:

The auditor should mention

- (a) Whether the records of the firm appear to be correct & reliable.
- (b) Whether he was able to obtain all information & explanation necessary for his work.
- (c) Whether any restriction was imposed upon him.

21. The above company is a government company. Section 143(5) of the Companies Act, 2013 states that, in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) of section 139 i.e. appointment of subsequent auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statements of the company.

22. **Verification of inventories in the nature of food and beverages:** The inventories in any hotel are both readily portable and saleable particularly the food and beverage inventories. It is therefore extremely important that all movements and transfers of such inventories should be properly documented to enable control to be exercised over each individual stores' areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed. Therefore, following may be noted in this regard:

- (a) All movement and transfer of inventories must be properly documented.
- (b) Areas where inventories are kept must be kept locked and the key retained by the departmental manager.
- (c) The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.
- (d) Many hotels use specialized professional valuers to count and value the inventories on a continuous basis throughout the year.
- (e) The auditor should ensure that all inventories are valued at the year end and that he should himself be present at the year-end physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories.

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

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

24. The special steps involved in the audit of receipts from sale of tickets are stated below—

- (i) Verify that entrance to the cinema-hall during show is only through printed tickets;
- (ii) Verify that they are serially numbered and bound into books. In case bookings are made online, verify the system for online booking;
- (iii) Verify that the number of tickets issued for each show and class, are different though the numbers of the same class for the show on the same day, each week, run serially;
- (iv) Verify that for advance booking a separate series of tickets is issued;
- (v) Verify that the inventory of tickets is kept in the custody of a responsible official.
- (vi) Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it.
- (vii) Verify that a record is kept of the 'free passes' and that these are issued under proper authority.

(viii) Reconcile the amount of Tax collected with the total number of tickets issued for each class.

(ix) Vouch the entries in the Cash Book in respect of cash collected on sale of tickets for different shows on a reference to Daily Statements which have been test checked as aforementioned with record of tickets issued for the different shows held.

**25. Fee from Students:**

The fees concessions have to be under proper authority of college management. The auditor would verify internal controls in this regard. Besides, detailed checking of few cases needs to be undertaken to ensure genuineness of fees concessions and proper management approvals.

Other points to verify fee from students are:

1. Check names entered in the Students Fee Register for each month or term, with the respective Class Registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal control which ensures that demands against the students are properly raised.
2. Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
3. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
4. Check admission fees with admission slips signed by the head of the institution and confirm that the amount has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
5. Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority.
6. Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded.

26. Some general principles have been laid down in the Audit Code, which have for long been recognised as standards of financial propriety. Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows:

- (a) The expenditure should not be *prima facie* more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.
- (b) No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.
- (c) Public moneys should not be utilised for the benefit of a particular person or section of the community unless:
  - (i) the amount of expenditure involved is insignificant; or
  - (ii) a claim for the amount could be enforced in a Court of law; or
  - (iii) the expenditure is in pursuance of a recognised policy or custom; and
  - (iv) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

## 10. AUDIT OF BANK

Q.1. K Ltd. is availing cash credit limit of ₹ 25 crores from LMN Bank Ltd. The drawing power of the company ranged between ₹ 22 crores and ₹ 25 crores during the year 2023-24. The limit availed by the company remained less than ₹ 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. [SEPT 24] (03)

Q.2. You are the auditor of Plus Bank Limited. The bank has made following provisions for the year ended on 31-03-2024:

Particulars	Amount (₹ 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? [SEPT 24] (04)

Q.3. MNB bank advanced certain loans guaranteed by government. State the prudential norms for asset classification and income recognition of such loans. [MAY 24] (04)

Q.4. While conducting the statutory audit of a large branch of KNB Bank for the year 2023-24, CA Hema observed that Profit and Loss account of branch reflects interest income of ₹ 80 crores and other income of ₹ 5 crores. She also noticed that few borrower accounts at branch have slipped into NPA category in past periods as well as in current year. Which audit procedures should be performed by her to verify reversal of income in the books of branch? [RTP MAY 25]

Q.5. CBC Bank Ltd. has multiple loan accounts classified as Non-Performing Assets (NPAs). During the financial year, some borrowers made partial payments towards their

outstanding dues. However, there was no explicit agreement between the bank and the borrowers regarding the appropriation of these recoveries i.e., whether they should be adjusted against principal or interest.

The bank's finance team decided to recognise the recovered amount as interest income in its financial statements. However, during the statutory audit, the auditors raised concerns about the treatment of these recoveries. Discuss the appropriate accounting treatment of partial recoveries in NPAs. Also, explain the principles that banks should follow in recognising interest income from NPAs.

[RTP MAY 25]

Q.6. Agrim, a CA student, is part of an engagement team conducting audit of Madurai branch of ARB Bank. CA Bhuvan, engagement partner, has asked him to verify provision made by branch as on March 31st, 2024 in respect of the following non-performing assets:-

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

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

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

[RTP SEPT 24]

Q.7. Compute the Drawing Power for Cash Credit A/c of Kirpa Limited for the month of March 2024 with following information:

(Amount in ₹)

Stock 60,000

Debtors 55,000

(Including Debtor of ₹ 15,000 for an invoice dated 20.10.2023) Sundry

creditors 10,000

Sanctioned Limit 48,000

Margin on stock is 30% and on debtors is 40%.

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

[RTP SEPT 24]

Q.8. While conducting statutory audit of branch of a nationalized bank, it is noticed by CA Z that credit facilities granted to a borrower consisting solely of term loan have been classified as "Sub-standard Asset" during the year 2022-23 due to failure of borrower to pay EMIs on time. Such EMIs were outstanding for more than 90 days and account was, therefore, classified as "Sub-Standard Asset". CA Z has also agreed to above asset classification made by branch management.

What are CA Z's responsibilities regarding verification of compliance with income recognition norms by branch in respect of above credit facilities? [RTP MAY 24]

Q.9. While verifying provisions of advances of a branch of MCO Bank as part of statutory branch audit, CA Z notices that credit facilities consisting of term loan to KRT Enterprises have been classified under doubtful asset (D1) category. The outstanding balance in above term loan account as on 31.3.2023 is ₹ 50 lakhs. Value of security held in account is ₹ 40 lakhs. The branch has made provision of ₹ 7.50 lakhs. Is provision made by branch proper? Discuss. [RTP MAY 24]

Q.10. 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. [MTP - 1 MAY 25] (05)

Q.71. Mahavir and Associates is appointed as the statutory auditor of KBC Bank for the financial year 2023-2024. During the audit, Ms. Chandana, an article trainee, noticed that Sidharth Industries had an outstanding loan of ₹ 50,00,000 as on March 31, 2024. On March 29, 2024, the company made a payment of ₹ 10,00,000, reducing the outstanding loan balance to ₹ 40,00,000. However, on April 4, 2024, Sidharth Industries initiated a reversal transaction of ₹ 8,00,000, increasing the outstanding loan balance back to ₹ 48,00,000. The payment and subsequent reversal occurred within a short period, with the final outstanding balance remaining ₹ 48,00,000 after the reversal.

Considering this scenario, what should be the response of Mahavir and Associates to this matter, particularly regarding the classification of the borrower's account and the potential risk of it slipping into the NPA category? [MTP - I JAN 25] (05)

Q.72. During the audit of Smile Bank, CA Sweety focused on understanding the risk management process of the bank. She reviewed how management developed controls and used performance indicators to monitor key business and financial risks. CA Sweety also assessed whether the risk management system effectively identified and mitigated risks in required areas. How should CA Sweety evaluate the adequacy of the bank's risk management controls? [MTP - II JAN 25] (05)

Q.73. National Bank has advanced cash credit facility of ₹ 25 Lakh to Sun Industries. Following is the extract of account of Sun Industries reflecting in CBS of Bank from December 1, 2023 to March 31, 2024: -

Date	Particulars	Dr.	Cr.	Balance (Dr.)
01/12/2023	To Transfer	45,000		24,75,000
31/12/2023	By Clearing		1,00,000	23,75,000
31/12/2023	To Interest	25,000		24,00,000
31/01/2024	To Interest	24,700		24,24,700
29/02/2024	To Interest	24,800		24,49,500
31/03/2024	To Inspection charges	1,000		24,50,500
31/03/2024	To Interest	24,900		24,75,400

Drawing power during the above period was consistent at ₹ 25 Lakh. The account was classified as "Standard asset" as on 31-12-2023 in books of Bank. The security charged with the bank remains intact throughout this period.

Comment on "asset classification" of above account as on 31<sup>st</sup> March 2024 in books of Bank in accordance with RBI norms. [MTP - I SEPT 24] (05)

Q.14. During the course of statutory branch audit of a nationalized bank, CA Amrish is performing audit procedures in relation to the advances. He has verified the selected sample of borrower accounts representing advances and found nothing unusual. In a banking environment, there exist documentary evidence containing observations/comments on advances which can be useful to the statutory branch auditor in performing an effective audit. List out few such documentary evidence which can be made use of by CA Amrish. [MTP - II SEPT 24] (05)

Q.15. Following is the extract from Schedule no. 10 of Advances as appearing in financial statements of branch of a nationalized bank for year ending 31<sup>st</sup> March, 2024.

Schedule 10 - Advances

S. No.	Particulars	Amount (In ₹ Crores) rounded off
1.	Bills Purchased and Discounted	50.00
2.	Cash credits, overdrafts and loans repayable on demand	150.00
3.	Term Loans	75.00
	<b>Total</b>	<b>275.00</b>

In carrying out audit of above advances as part of statutory audit of branch, a statutory auditor would obtain evidence about certain matters. State those matters.

[MTP - II MAY 24] (04)

Q.16. Column A describes description of certain terms used in banking industry. Complete Column B by suggesting term appropriate to description given.

[MTP - II MAY 24] (04)

Column A	Column B
Audit of borrower client of bank carried out at bank's request to verify borrower's current assets	?
Limit up to which an entity can withdraw from sanctioned working capital limit	?
Statutory right of a creditor to adjust debit balance in debtor's account against any credit balance lying in another account of debtor	?
Creation of security in a bank branch by mere delivery of title deeds by a prospective borrower of funds	?

Q.17. 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: [MAY 25] (04)

Particulars	Amount in (₹)
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.

### ANSWERS

1. An account should be treated as 'out of order' if: -

- the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
- In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet; or
- credits are there but are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

In the given case, K Ltd. is availing cash credit limit of ₹ 25 crores from LMN Bank Ltd and the drawing power of the company range between ₹ 22 crores and ₹ 25 crores during the year 2023-24. The limit availed by K Ltd. remained less than ₹ 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 (₹ 20 crore) is less than the sanctioned limit/drawing power (₹ 22 cores and ₹ 25 crores), but there are no credits continuously for 90 days as on the date of Balance Sheet.

2. For audit of provisions and contingencies the auditor should:

- ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled.
- obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets. The auditor may verify the loan classification on a sample basis.
- obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger.
- obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation.
- examine the other provisions for expenses vis-a-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

3. Government Guaranteed Advances (In case of accounts overdue for more than 90 days): Central Government Guaranteed Advances, where the guarantee is not invoked/repudiated would be classified as Standard Assets, but regarded as NPA for Income Recognition purpose.

The situation would be different if the advance is guaranteed by State Government, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

4. The following audit procedures should be performed to verify reversal of income in books of branch:

- If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.
- In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.
- Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognised as income in the previous year(s).
- Furthermore, the auditor should enquire if there are any large debits in the Interest Income account that have not been explained. It should be enquired whether there are any communications from borrowers pointing out differences in interest charge and whether appropriate action has been taken in this regard.

5. Appropriate accounting treatment of partial recoveries in NPAs:

In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e., towards principal or interest due), banks are required to adopt an accounting policy and exercise the right of appropriation of recoveries in a uniform and consistent manner.

The appropriate policy to be followed is to recognise income as per AS 9, "Revenue Recognition", when certainty attaches to realisation and accordingly amount reversed/derecognised or not recognised in the past should be accounted.

Interest partly/fully realised in NPAs can be taken to income. However, it should be ensured that the credits towards interest in the relevant accounts are not out of fresh/additional credit facilities sanctioned to the borrowers concerned.

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

Categories of Non-Performing Assets:	Provision required
<input type="checkbox"/> <b>Substandard Assets:</b>  Would be one, which has remained NPA for a period less than or equal to 12 months.	15%
<input type="checkbox"/> <b>Doubtful Assets:</b>  Would be one which has remained in the substandard category for a period of 12 months.	(Secured + Unsecured) 25%
<b>Sub-categories:</b>  Doubtful up to 1 Year (D1) Doubtful 1 to 3 Years (D2) Doubtful more than 3 Years (D3)	+ 100% 40% + 100%
<input type="checkbox"/> <b>Loss Assets</b>	100% + 100% 100%

From the above provision, it can be concluded that in case of:

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

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

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

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

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

7. Computation of Drawing Power (DP) for CC A/c of Kirpa Ltd.

Particulars of current assets		Amt. (₹)	DP Amt. (₹)
<b>(A) Stocks:</b>			
Stocks at realizable value		60,000	
Less: Unpaid stocks:			
- Sundry creditors	10,000	<u>10,000</u>	
Paid for stocks		50,000	
Margin @ 30%		<u>15,000</u>	35,000
<b>(B) Debtors:</b>			
Total Debtors		55,000	
Less: Ineligible debtors		<u>15,000</u>	
Eligible debtors		40,000	
Margin @ 40%		<u>16,000</u>	<u>16,000</u>
<b>Total Drawing Power</b>			51,000

The sanctioned limit given in the question is ₹ 48,000 whereas drawing power as per the above working is ₹ 51,000. So, drawing power would be restricted to sanctioned limit i.e., ₹ 48,000/-.

8. RBI norms stipulate that if any advance account becomes NPA as at close of any year, the entire interest accrued or credited to income account in past periods should be reversed or provided for, if the same is not realized.

Further, in respect of NPAs, fees, commission and other similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected.

In the given case, account has turned Sub-standard asset which is a type of NPA. Therefore, auditor should make compliance of above norms relating to income recognition.

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

Outstanding balance as on 31.3.23	50 lakhs
Less: Value of security	40 lakhs
Unsecured portion	10 lakhs

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

#### Provision calculation

25% of secured part i.e., 25% of ₹ 40 lakhs	₹ 10 lakhs
100% of unsecured part i.e., 100% of ₹ 10 lakhs	₹ 10 lakhs
Required provision	₹ 20 lakhs

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

10. 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.

**In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:**

- (i) Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
- (ii) Advances represent amount due to the bank.
- (iii) Amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of advances.
- (iv) There are no unrecorded advances.
- (v) The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.
- (vi) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
- (vii) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

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

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

In the given case of Sidharth Industries, a payment of ₹ 10,00,000 was made on March 29, 2024 reducing the outstanding loan balance to ₹ 40,00,000 and subsequently reversed by ₹ 8,00,000 on April 4, 2024.

Thus, Mahavir and Associates should carefully assess the classification of Sidharth Industries' Account, and determine if the payment and reversal transactions indicate an attempt to prevent the account from slipping into the NPA category. If yes, the account should be classified as an NPA in compliance with regulatory guidelines.

12. **Understanding the Risk Management Process:** Management develops controls and uses performance indicators to aid in managing key business and financial risks. An effective risk management system in a bank generally requires the following:

- (i) **Oversight and involvement in the control process by those charged with governance:** Those charged with governance (Board of Directors/Managing Director) should approve written risk management policies. The policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable.
- (ii) **Identification, measurement and monitoring of risks:** Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria.
- (iii) **Control activities:** A bank should have appropriate controls to mitigate its risks including effective segregation of duties (particularly between front and back offices), accurate

measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting up limits, reporting and approval of exceptions, physical security and contingency planning.

(iv) Monitoring activities: Risk management models, methodologies and assumptions used to measure and mitigate risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit.

(v) Reliable information systems: Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

13. In accordance with RBI norms on asset classification, a non-performing asset is a loan or advance where the account remains "out of order" in respect of an Overdraft/Cash Credit. An account should be treated as 'out of order' if:

- the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
- In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet; or
- credits are there but are not enough to cover the interest debited during the same period.

In the given case, although outstanding balance in account is less than sanctioned limit/drawing power of ₹ 25 lacs, there are no credits continuously for 90 days as on the date of Balance sheet. Therefore, it has become out of order and is required to be classified as NPA.

Under non-performing assets, it would be classified as "Sub-Standard Asset" as it has remained NPA for a period of less than or equal to 12 months.

14. In a banking environment, there exist documentary evidence containing observations/comments on advances which can be useful to the statutory branch auditor in performing an effective audit. CA Amrit, the auditor should take into account the adverse comments, if any, on advances appearing in the following:-

- Previous year's audit reports.
- Latest internal inspection reports of bank officials.
- Reserve Bank's latest inspection report.
- Concurrent / Internal audit report.
- Report on verification of security.
- Any other internal reports specially related to particular accounts.
- Manager's charge-handing-over report when incumbent is changed.

15. In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:-

- Amounts are included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
- Advances represent amount due to the bank branch.
- Amounts due to the bank branch are appropriately supported by loan documents and other documents as applicable to the nature of advances.
- There are no unrecorded advances.
- The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.
- The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
- Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

16. Audit of borrower client of bank carried out at bank's request to verify borrower's current assets- **Stock audit**  
 Limit up to which an entity can withdraw from sanctioned working capital limit-  
**Drawing power**  
 Statutory right of a creditor to adjust debit balance in debtor's account against any credit balance lying in another account of debtor- **Set-off**  
 Creation of security in a bank branch by mere delivery of title deeds by a prospective borrower of funds- **Equitable Mortgage**

## 11. ETHICS & TERMS OF AUDIT ENGAGEMENT

Q-1. 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?

[JAN 25] (05)

Q-2. 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. (02)
- (ii) A professional accountant shall not knowingly be associated with reports where he believes that the information contains a materially false or misleading statement.

[JAN 25] (02)

Q-3. 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?

[SEPT 24] (03)

Q.4. 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, CA P 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.

[SEPT 24] (04)

Q.5. 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.

[MAY 24] (03)

Q.6. 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.

[MAY 24] (03)

Q.7. 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.

[MAY 24] (04)

Q.8. CA Puneet is appointed as an auditor of Kamla Limited for the F.Y. 2023-24. The management of Kamla Limited has requested the auditor to change the terms of original engagement as the company has diversified its business and a few new products have been introduced by the company. Whether CA Puneet can agree to the request made by the management? Under which circumstances can the client make a request to the auditor for a change in the terms of engagement?

[RTP MAY 25]

Q.9. CA Sudhakar has been appointed as the auditor of AMRO Ltd. Before accepting the appointment, he learns that his cousin, who held shares in the company and recently passed away without children, named him as the nominee for these shares, which have substantial value. Although holding such shares through a distant relative does not violate legal provisions or affect his independence, this unexpected inheritance places him in a dilemma. Advise CA Sudhakar on how he should deal with this situation and safeguard his independence.

[RTP JAN 25]

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

[RTP SEPT 24]

Q.11. CA X has been offered audit of financial statements of TDK Industries, a partnership firm. Prior to accepting proposed offer, he insists upon obtaining an agreement of management regarding acknowledgment of its responsibility of having a proper process in place to ensure that financial statements prepared are free from material misstatements. However, management is of the view that it is auditor's duty to

detect material misstatements in financial statements and such an insistence by auditor is totally uncalled for. Whose view is proper? Also discuss reasons for arriving at your conclusion. What should be likely proper course of action for CA X in above situation?

[RTP MAY 24]

Q.12. "SA 220 is premised on the basis that the firm is subject to SQC 1". What do you understand by given statement in context of audit quality? [RTP MAY 24]

Q.13. 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? [MTP - I MAY 25] (05)

Q.14. 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. [MTP - II MAY 25] (05)

Q.15. CA Paras has accepted audit of financial statements of an entity. According to the Standards on Auditing, the auditor is required to send an audit engagement letter to the entity. What are the key areas that should be included in the audit engagement letter? Under what circumstances is the auditor not required to record the terms of engagement in such a written agreement? [MTP - I JAN 25] (05)

Q.16. Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. Explain. [MTP - II JAN 25] (04)

Q.17. SQC 1 requires assumption of leadership responsibilities for quality within firm. Are

such leadership responsibilities required for audit engagements only? Who assumes such leadership responsibilities within firm? How it is important for audit quality?

[MTP - I SEPT 24] (05)

Q.18. CA H has been offered audit of financial statements of a society engaged in promoting social causes, such as setting up of drug de-addiction centres for misguided youth and rehabilitating such young people by helping them find avenues of gainful employment. However, CA H failed to send audit engagement letter to the society's governing body and proceeded to conduct the audit. In the absence of this letter, the governing body is of the view that purpose of such an audit is to provide absolute assurance against probable errors and frauds in the financial statements. Does it constitute violation of fundamental principles governing professional ethics? State reasons for the same.

[MTP - I SEPT 24] (05)

Q.19. CA N, statutory auditor of QST Limited, appointed for a term of 5 years has completed audit for the first financial year ending on 31st March 2024. In compliance with requirements of professional standards, an audit file has been assembled. After about a period of six months from date of issue of audit report, he gets a call from CFO of the company to share complete audit file so that financial reporting of company can be improved upon in coming periods. Is it mandatory for statutory auditors to share audit files with client? What are the requirements for making audit documentation available to clients?

[MTP - II SEPT 24] (04)

Q.20. 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?

[MTP - I MAY 24] (03)

Q.21. SQC 1 dwells upon engagement quality control review (EQCR) as part of system of quality control in a firm. Why is such a review required? For which type of engagements EQCR is mandatory?

What should be approach of firm for engagements for which EQCR is not mandatory?

[MTP - 1 MAY 24] (03)

Q.22. 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. [MTP - 1 MAY 24] (03)

Q.23. An engagement partner takes overall responsibility for maintaining audit quality in an audit engagement in accordance with SA 220. What are his objectives in taking and emphasizing such responsibility? [MTP - 1 MAY 24] (03)

Q.24. The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement. Who gives engagement letter to whom and what is included in such a letter? [MTP - II MAY 24] (03)

Q.25. 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? [MAY 25] (04)

Q.26. 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?

[MAY 25] (05)

## ANSWERS

### 1. 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.

2. **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.*

3. **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.

4. 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.

5. **Assembly of the Final Audit File:** Audit documentation may be recorded on paper or on electronic or other media. Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement. Hence the views of CA B that audit documentation should be maintained mandatorily in paper form is not correct. The auditor shall prepare audit documentation on timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed. Completing the audit Documentation by CA B not on timely basis is not proper.

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 situation, CA. B, after completion of audit season, is completing the audit file as well as assembling of final audit files of his client after three months of the date of audit report which is not valid as per SQC 1.

SQC "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and Related Services", requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report. He retains audit file of the client for 4 years from the date of audit report is also non-compliance of SQC 1.

## 6. 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.

7. **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.

8. The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, a significant change in nature or size of the entity's business is one of the factors which may make it appropriate to revise the terms of the audit engagement.

In the given situation, Kamla Limited has diversified its business, and few new products have also been introduced by the company which is indicative of significant change in nature or size of the entity's business. In view of the above, CA. Puneet can agree to the request made by the management to change the terms of the audit engagement. Therefore, the request of Management to change the terms of audit engagement is appropriate.

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

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

9. In the given situation, holding shares by CA Sudhakar involves financial interest in the company and is in nature of self-interest threat. Though he has come to hold shares due to nomination made by his distant relative before accepting the appointment. Chartered Accountants have a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to address the threats.

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

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

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

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

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

- The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- The nature of the client's operations, including its business practices.

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

11. SA 210 deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management and, where appropriate, those charged with governance. This includes establishing that certain preconditions for an audit, responsibility for which rests with management and, where appropriate, those with governance, are present. The objective of the auditor is to accept or continue an audit engagement only when the basis upon which it is to be performed has been agreed, through:

(A) Establishing whether the preconditions for an audit are present and

(B) Confirming that there is a common understanding between the auditor and management and, where appropriate, those charged with governance of the terms of the audit engagement.

One of the preconditions for an audit is to obtain the agreement of management that it acknowledges and understands its responsibility for preparation of financial statements and for such internal control as is necessary to enable preparation of financial statements that are free from material misstatements.

In the given situation, CA X is insisting only upon obtaining agreement of management regarding acknowledgment of its responsibility for internal control to enable preparation of financial statements that are free from material misstatements in accordance with SA 210. Design, implementation and maintenance of internal control to ensure preparation of reliable financial statements that are free from material misstatements is management's responsibility. He is insisting on obtaining agreement of management regarding acknowledgment of its responsibility. Therefore, CA X's view is proper.

In case management does not provide such agreement acknowledging its responsibility, the auditor shall not accept proposed audit engagement unless required by law or regulation.

12. Audit quality is essential to maintain confidence in the independent assurance provided by the auditors. It is responsibility of auditor to maintain high audit quality. *SQC 1* and *SA 220* both deal with quality control. *SQC 1* applies to entire firm. However, *SA 220* applies to a particular audit engagement.

Based upon quality control system of firm established in accordance with requirements of *SQC 1*, quality control policies pertaining to audit engagements are decided by engagement teams. Engagement partner of a team is responsible for quality control procedures of a particular audit engagement in accordance with *SA 220*.

Therefore, *SA 220* is premised on the basis that the firm is subject to *SQC 1*. Within the context of the firm's system of quality control, engagement teams have a responsibility to implement quality control procedures that are applicable to the audit engagement.

13. 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.

74. 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.

75. Key areas that should be included in Audit engagement letter are:

- The objective and scope of the audit of the financial statements;
- The responsibilities of the auditor;
- The responsibilities of management;
- Identification of the applicable financial reporting framework for the preparation of the financial statements and
- 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.

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

- close relative of the audit team working in a senior position in the client company;

- (ii) former partner of the audit firm being a director or senior employee of the client;
- (iii) long association between specific auditors and their specific client counterparts; and
- (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees.

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

17. SQC 1 requires firms to establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Therefore, such leadership responsibilities are required for all engagements and not for audit engagements only.

Such policies and procedures should require the firm's chief executive officer or the firm's managing partners to assume ultimate responsibility for the firm's system of quality control. The example set by firm's leadership encourages an inner culture that recognizes high quality audit work. Further, persons assigned operational responsibilities for the firm's quality control system by the firm's chief executive officer or managing partners should have sufficient and appropriate experience, ability and the necessary authority to assume that responsibility.

18. As per SA 210, "Agreeing the Terms of Audit Engagements", the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement. Such a letter includes, *inter alia*, objective and scope of audit of financial statements. The absence of such a letter leads to misunderstanding between auditor and management. As auditor has failed to send engagement letter, the governing body has formed an improper view of objective and scope of audit of financial statements.

By not following requirements of SA 210, CA H is not acting ethically. He has violated principle of professional competence and due care governing professional ethics. This principle requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives

competent professional service, based on current technical and professional standards and relevant legislation and act diligently and in accordance with applicable technical and professional standards. Maintaining professional competence requires awareness of current technical and professional standards. Non sending of engagement letter shows lack of such awareness on part of CA H. Therefore, he has violated said fundamental principle governing professional ethics.

19. Standard on Quality Control 1 (SQC 1), "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. Therefore, it is not mandatory for CA N to share audit file with client. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

20. 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.

21. Significant judgments made in an engagement should be reviewed by an engagement quality control reviewer for taking an objective view before the report is issued. Engagement quality control review is mandatory for all audits of financial statements of listed entities. In respect of other engagements, firm should devise criteria to determine cases requiring performance of engagement quality control review.

22. 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 smacks of lack of courtesy and professional responsibility. In the given case, Chartered accountant has not followed principle of Professional Behaviour.

23. Leadership responsibility of an engagement partner is to take responsibility for the overall quality on each audit engagement. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise-

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

24. 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. Such a letter includes:

- (a) The objective and scope of the audit of the financial statements
- (b) The responsibilities of the auditor
- (c) The responsibilities of management
- (d) Identification of the applicable financial reporting framework for the preparation of the financial statements and

(e) 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.