

NEW AND UPDATED

APPLICABLE FOR
JANUARY' 26
AND
MAY' 26

**AUDITING
AND ETHICS
REVIEWER**

**Chapter-wise compilation
RTP, MTP and PYP questions**

5



LDR QUESTIONS SOLVED BY

CA CPA NIVEDHA SHANKAR

Table of Contents

Sr.	Particulars	Page No. of Reviewer	IMP	LDR Questions
1	Nature, Objective and Scope of Audit	1.7, 1.10, 1.13,1.14	C	Q 17, Q 26, Q 33, Q 35
2	Audit Strategy, Audit Planning and Audit Programme	2.6, 2.8,2.11, 2.14, 2.15	B	Q 15, Q 18, Q 29, Q 36, Q 37
3	Risk Assessment and Internal Control	3.9, 3.10, 3.13, 3.20, 3.22, 3.31	B	Q 18, Q 21, Q 29, Q 49, Q 51, Q 76
4	Audit Evidence		A	
4.1	SA 500- Audit Evidence	4.1-8, 4.1-9, 4.1-10		Q 21, Q 23, Q 24
4.2	SA 610- Using the Work of Internal Auditors	4.2-1		Q 2
4.3	SA 530 Audit Sampling	4.3-6, 4.3-10		Q 19, Q 26
4.4	SA 501- Audit Evidence-Specific Considerations for Selected Items	4.4-3		Q 7
4.5	SA 505- External Confirmations	4.5-3		Q 8
4.6	SA 510- Initial Audit Engagements – Opening Balances	4.6-2		Q 3
4.7	SA 550- Related Parties	4.7-2		Q 2
4.8	SA 520 Analytical Procedures	4.8-8, 4.8-9		Q 19, Q 21
5	Audit of Items of Financial Statements	5.4, 5.10, 5.14,5.19, 5.26, 5.31	A	Q 3, Q 15, Q 25, Q 36, Q 51, Q 62
6	Audit Documentation	6.7, 6.8	C	Q 20, Q 21
7	Completion and Review		B	
7.1	SA 560- Subsequent Events	7.1-3		Q 4
7.2	SA 570- Going Concern	7.2-3		Q 6
7.3	SA 450- Evaluation of Misstatements Identified during Audit	-		-
7.4	SA 580- Written Representations	7.4-4		Q 11
7.5	SA 260- Communication with Those Charged with Governance	-		-
7.6	SA 265- Communicating Deficiencies in Internal Control to Those Charged with Governance and Management	7.6-2		Q 3
8	Audit Report		B	
8.1	SA 700- Forming an Opinion and Reporting on Financial Statements	8.1-5		Q 9
8.2	SA 705- Modifications to the Opinion in the Independent Auditor's Report	8.2-2		Q 4
8.3	SA 706- Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	8.3-2		Q 6

8.4	SA 701- Communicating Key Audit Matters in the Independent Auditor's Report	8.4-2		Q 3
8.5	SA 710- Comparative Information—Corresponding Figures and Comparative Financial Statements	8.5-1		Q 2
8.6	Audit of Branch Office Accounts 128(1)	-		-
8.7	Joint Audit	8.7-2		Q 3
8.8	Reporting Requirements under Companies Act	8.8-4		Q 8
8.9	CARO	8.9-5, 8.9-6		Q 9, Q 11
9	Special Features of Audit of Different Type of Entities	9.7, 9.10, 9.18, 9.21, 9.23, 9.29	B	Q 11, Q 17, Q 36, Q 42, Q 45, Q 58
10	Audit of Banks	10.14, 10.15, 10.16, 10.18	C	Q 30, Q 32, Q 35, Q 38
11	Ethics and Terms of Audit Engagements		B	
11.1	Ethics	11.1-5, 11.1-7		Q 11, Q 14
11.2	SA 210- Agreeing the Terms of Audit Engagements	11.2-3		Q 7
11.3	SQC 1- Quality Control for Firms which Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Service Engagements	-		-
11.4	SA 220- Quality Control for an Audit of Financial Statements	-		-
12	Case Scenarios	12.24, 12.30, 12.36, 12.37, 12.45, 12.57, 12.60	A	Q 19, Q 23, Q 28, Q 29, Q 34, Q 43, Q 45

ABC Analysis

A Very Important,
Read on priority

B Moderately
Important

C Less critical but still
essential

Ensure you thoroughly read all chapters without skipping any. The ABC analysis is designed to help you prioritize based on past trends, but it should not replace comprehensive preparation.

CHAPTER 1: NATURE, SCOPE & OBJECTIVES OF AUDITING

CONCEPTS OF THIS CHAPTER

- Meaning, nature, and scope of Audit
- Audit objectives, Limitations & Benefits
- Different Types of Engagements
- Purpose of Engagement and Quality Control Standards
- Engagement Standards



LDR
Questions
Q 17
Q 26
Q 33
Q 35

Meaning, Nature, Scope & Objectives of Auditing

Questions & Answers

Question 17

 LDR

Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. He said, “an auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true” Explain stating clearly the qualities of an auditor. (MTP 4 Marks March '21, RTP May'19)

OR

Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. Explain stating the qualities an auditor should possess. (MTP 4 Marks Oct '21)

Answer 17

It is not enough to realise what an auditor should be. He is concerned with the reporting on financial matters of business and other institutions. Financial matters inherently are to be set with the problems of human fallibility; errors and frauds are frequent. The qualities required, according to Dicksee, are **tact, caution, firmness, good temper, integrity, discretion, industry, judgement, patience, clear headedness and reliability**. In short, all those personal qualities that go to make a **good businessman** contribute to the making of a good auditor. In addition, he must have the **shine of culture** for attaining a great height. He must have the highest degree of **integrity** backed by adequate **independence**. In fact, **Code of ethics** mentions **integrity, objectivity and independence** as one of the fundamental principles of professional ethics.

He must have a thorough **knowledge** of the general **principles of law** which govern matters with which he is likely to be in intimate contact. The **Companies Act** need special mention but **mercantile law**, specially the law relating to contracts, is no less important. Needless to say, where undertakings are governed by a special statute, its knowledge will be imperative; in addition, a sound knowledge of the **law** and practice of **taxation** is unavoidable.

He must pursue an intensive programme of **theoretical education** in subjects like **financial and management accounting, general management, business and corporate laws, computers and information systems, taxation, economics, etc.** Both **practical training** and **theoretical education** are **equally necessary** for the development of professional competence of an auditor for undertaking any kind of audit assignment.

The auditor should be equipped not only with a sufficient knowledge of the way in which business generally is conducted but also with an understanding of the **special features** peculiar to a particular business whose accounts are under audit. The auditor, who holds a position of **trust**, must have the **basic human qualities**



apart from the technical requirement of professional training and education.

He is called upon constantly to critically review financial statements and it is obviously useless for him to attempt that task unless his own **knowledge is that of an expert**. An exhaustive knowledge of accounting in all its branches is the **sine qua non of the practice of auditing**. He must know thoroughly all accounting principles and techniques.

Lord Justice Lindley in the course of the judgment in the famous London & General Bank case had succinctly summed up the overall view of what an auditor should be as regards the personal qualities. He said, “an auditor must be honest that is, he must not certify what he does not believe to be true and must take reasonable care and skill before he believes that what he certifies is true”.



VIVITSU
STRIVING TOWARDS KNOWLEDGE



Questions & Answers

Question 26

LDR

There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain giving examples. Also explain the difference between audit and investigation. (RTP Nov 22, Nov'23, RTP Nov '21, May'20, SM, MTP 3 Marks Oct '20)

OR

An audit does not provide absolute assurance. Discuss how nature of audit procedures itself is one of the reasons due to which audit cannot provide absolute assurance. (MTP 3 Marks Oct'23)

Answer 26

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

1. There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.
2. Fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

We have to clearly understand that 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 as we have already discussed, 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.

Therefore, audit is never started with a pre-conceived notion about state of affairs; about wrong-doing; about some wrong having been committed. The auditor seeks to report what he finds in normal course of examination of accounts. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. It may happen that auditor has given some findings of serious concern. Such findings may prompt for calling an investigation.



Question 33



“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 5 Marks Aug'24)

Answer 33

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**.

STRIVING TOWARDS KNOWLEDGE



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 ’22, RTP May’24)

Answer 35

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

CHAPTER 2: AUDIT STRATEGY, AUDIT PLANNING & AUDIT PROGRAMME

CONCEPTS OF THIS CHAPTER

- Audit planning and its benefits
- Planning process and elements
- Establishing strategy and detailed audit plan
- Audit program basics
- Quality control in delegation and supervision
- Practicality via examples and case studies



LDR Questions

- Q 15 Q 18
Q 29 Q 36
Q 37

Audit Planning

Questions & Answers

Question 15



The audit plan includes the nature, timing and extent of audit procedures to be performed by engagement team members. Explain. (RTP Nov '23, SM)

OR

Engagement Partner CA Viv Tsu of Tsu and Associates wanted to develop an audit plan of Wavelength Ltd. Discuss the matters to be described in such an audit plan. (RTP May'22)

OR

Auditor shall develop an audit plan that includes description of audit procedures. Specify requirements in this regard. (MTP 3 Marks Mar'24)

Answer 15

The auditor shall develop an audit plan that shall include a description of

- The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
- The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 "The Auditor's Responses to Assessed Risks".
- Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

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. **Example-** Planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.



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. (PYP 3 Marks Sep'24, MTP 5 Marks Dec'24)

Answer 18**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.



VIVITSU
STRIVING TOWARDS KNOWLEDGE

**Questions & Answers****Question 29****LDR**

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 5 Marks July'24)

Answer 29

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.



Questions & Answers

Question 36

LDR

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

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 Vivi Ltd.?

(PYP 4 Marks May '24 MTP 4 Marks Oct'22 RTP May '18 & Nov '22, PYP 3 Marks, May '19 PYP 4 Marks Nov,19)

Answer 36

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 Vivi Ltd.

Exam Insights: Examinees have written general answers on meaning and advantages of Audit programme instead of focusing on aspects to be looked into for construction of an Audit programme.



M/s. PP & Co, a firm of Chartered Accountants, has been auditing the books of accounts of KALI Ltd. for the past 3 years. The company has recently made some major changes in its business policies. While planning to start the audit for the 4th year i.e. for financial year 2024-25, the audit manager of the firm, as per the routine practice, handed over the previous years' audit programme as it is to the audit team with the instructions to adhere unfailingly to the said audit programme. Evaluate the decision of the audit manager with reference to the use of audit programme. (PYP 4 Marks Sep'24)

Answer 37

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.

STRIVING TOWARDS KNOWLEDGE

CHAPTER 3: RISK ASSESSMENT & INTERNAL CONTROL

CONCEPTS OF THIS CHAPTER

- Audit Risk and influencing Variables
- Risk Assessment Procedures
- Materiality in Audit Planning and Execution
- Understanding the Entity and its Environment
- Internal Control: Meaning, Objectives, Benefits, Limitations, Components
- Relevance of controls to Audits
- Understanding and Evaluating relevant Controls
- Risks needing Special Audit Focus
- Internal Control Evaluation: Benefits and Methods
- Testing Internal Controls
- Key features of Automated Environments
- IT System Risks
- Control types in Automated Settings
- Role of Data Analytics in Audit
- Internal Financial Controls as per laws
- Auditor's Response to Assessed Risks



LDR Questions

- Q 18
- Q 21
- Q 29
- Q 49
- Q 51
- Q 76

Audit Risk & Risk Assessment Procedures

Questions & Answers

Question 18



The risk assessment procedures shall include the **Inquiries of management and of others within the entity** who in the auditor's judgment may have information that is likely to assist in identifying risks of material misstatement due to fraud or error. Explain giving at least three examples.

(MTP 3 Marks Sep'22)

OR

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 and 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

Information systems personnel (PYP 4 Marks May '24)

Answer 18

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.

Examples

- ◆ **Inquiries** directed towards **those charged with governance** may help the auditor understand the environment in which the financial statements are prepared.
- ◆ **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 terms.
- ◆ **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.



VIVITSU
STRIVING TOWARDS KNOWLEDGE



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 5 Marks July'24)

Answer 21

(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.

STRIVING TOWARDS KNOWLEDGE



Questions & Answers

Question 29

LDR

An auditor has to exercise professional judgement in determining materiality. Explain the factors that may affect the identification of an appropriate benchmark in determining materiality for the financial statements as whole. (PYP 3 Marks May '23)

OR

You are being appointed as the auditor of Track Ltd. for the first time. You want to determine the materiality level and for that you have applied percentage to choose benchmark as a starting point in determining materiality for the financial statements as a whole. What are the factors that may affect the identification of an appropriate benchmark? (RTP May '22)

Answer 29

SA 320 "Materiality in Planning and Performing an Audit" prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole.

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:

- i. The **elements of the financial statements** (for example, assets, liabilities, equity, revenue, expenses);
- ii. 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);
- iii. 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.
- iv. 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); and
- v. The **relative volatility** of the bench.

VIVITSU
STRIVING TOWARDS KNOWLEDGE

Questions & Answers

Question 49



The auditor shall obtain an understanding of major activities that the entity uses to monitor internal control over financial reporting. Discuss "Monitoring of control" as a component of Internal control.

(PYP 4 Marks, Nov'20)

OR

Define Monitoring of Controls and in respect of monitoring of controls, answer the following questions:

(i) How monitoring of controls would be helpful in assessing the effectiveness of controls?

(ii) How can management accomplish monitoring of controls?

(iii) What is included in the Management's monitoring activities? (RTP Nov'22)

Answer 49**Monitoring of Controls: Component of Internal Control**

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

Monitoring of controls Defined: Monitoring of controls is a process to assess the effectiveness of internal control performance over time.

- (i) **Helps in assessing the effectiveness of controls on a timely basis:** It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.
- (ii) **Management accomplishes through ongoing activities, separate evaluations etc.:** Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.
- (iii) **Management's monitoring activities include:** Management's monitoring activities may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.
- (iv) **In case of Small Entities:** Management's monitoring of control is often accomplished by management's or the owner-manager's close involvement in operations. This involvement often will identify significant variances from expectations and inaccuracies in financial data leading to remedial action to the control.





Question 51

LDR

While obtaining audit evidence about the effective operation of internal controls, the auditor considers how they were applied, the consistency with which they were applied during the period and by whom they were applied. The concept of effective operation recognizes that some deviations may have occurred. Analyse and explain. (RTP Nov '18, MTP 3 Marks Oct'23)

OR

Based on the results of the tests of control, the auditor should evaluate whether the internal controls are designed and operating as contemplated in the preliminary assessment of control risk. Analyse and explain. (RTP Nov '19)

Answer 51

While obtaining audit evidence about the effective operation of internal controls, the auditor considers how they were applied, the consistency with which they were applied during the period and by whom they were applied. The concept of effective operation recognises that some deviations may have occurred. Deviations from prescribed controls may be caused by such factors as changes in key personnel, significant seasonal fluctuations in volume of transactions and human error. When deviations are detected the auditor makes specific inquiries regarding these matters, particularly, the timing of staff changes in key internal control functions. The auditor then ensures that the tests of control appropriately cover such a period of change or fluctuation.

Based on the results of the tests of control, the auditor should evaluate whether the internal controls are designed and operating as contemplated in the preliminary assessment of control risk. The evaluation of deviations may result in the auditor concluding that the assessed level of control risk needs to be revised. In such cases, the auditor would modify the nature, timing and extent of planned substantive procedures.

Before the conclusion of the audit, based on the results of substantive procedures and other audit evidence obtained by the auditor, the auditor should consider whether the assessment of control risk is confirmed. In case of deviations from the prescribed accounting and internal control systems, the auditor would make specific inquiries to consider their implications. Where, on the basis of such inquiries, the auditor concludes that the deviations are such that the preliminary assessment of control risk is not supported, he would amend the same unless the audit evidence obtained from other tests of control supports that assessment. Where the auditor concludes that the assessed level of control risk needs to be revised, he would modify the nature, timing and extent of his planned substantive procedures.

It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Procedural tests simply mean testing of the compliance with the procedures laid down by the management in respect of initiation, authorization, recording and documentation of transaction at each stage through which it flows.

**Questions & Answers****Question 76**

LDR

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. Explain stating uses of Data analytics. (MTP 4 Marks April 19)

OR

Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialized audit tools viz., IDEA and ACL to perform Fraud investigation. Explain the other relevant points in the above context i.e. Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialized audit tools viz., IDEA and ACL to perform.

(MTP 4 Marks Oct 20)

OR

While auditing in an automated environment, how data analytics can be used in testing electronic records and data residing in IT systems using spread sheets and specialised audit tools? (PYP 3 Marks May '23)

OR

While it is true that companies can benefit immensely from the use of data analysis in terms of increased profitability, better customer service, etc., analyse various functions that can be performed even by the auditor also using Data Analytics tools and techniques in the audit process to obtain good results. (MTP 3 Marks Sep '23, RTP Nov '18, May '21 & May 20, PYP 4 Marks Nov '20)

OR

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

OR

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 Sep'24)

Answer 76

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. A famous businessman recently said, "Data is the new Oil".

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 as required by SA 240
- fraud investigation
- evaluating impact of control deficiencies

EXAM INSIGHTS: Use of Data analytics: Few examinees answered the question correctly. Most of the examinees were not aware of the concept of Data Analytics.

CHAPTER 4: AUDIT EVIDENCE



Chapters	Page Number	LDR Questions
Chapter 4.1: SA 500- Audit Evidence	4.1-1 – 4.1-14	Q21, Q23, Q24
Chapter 4.2: SA 610- Using the Work of Internal Auditors	4.2-1 – 4.2- 4	Q2
Chapter 4.3: SA 530- Audit Sampling	4.3-1 – 4.3-13	Q19, Q26
Chapter 4.4: SA 501- Audit Evidence-Specific Considerations for Selected Items	4.4-1 – 4.4-7	Q7
Chapter 4.5: SA 505- External Confirmations	4.5 -1 – 4.5-5	Q8
Chapter 4.6: SA 510- Initial Audit Engagements – Opening Balances	4.6-1 – 4.6-2	Q3
Chapter 4.7: SA 550- Related Parties	4.7-1 – 4.7-3	Q2
Chapter 4.8: SA 520: Analytical Procedures	4.8-1 – 4.8-10	Q19, Q21

Chapter 4.1: SA 500- Audit Evidence

Questions & Answers

STRIVING TOWARDS KNOWLEDGE

Question 21



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 4 Marks July'24)

OR

CA Amar is the statutory auditor of XYZ Ltd. for the FY 2021-22. During the course of audit, CA Amar found that a litigation is going against the company for which the company has hired an external legal team (management expert). CA Amar wanted to use the information as audit evidence which is prepared using the work of the management expert. What should CA Amar consider before using the work of such management expert? (MTP 3 Marks Oct'22)

OR

When information to be used as audit evidence has been prepared using the work of a management's expert and having regard to the significance of expert's work for the auditor's purposes, explain the considerations auditor would consider for the purposes of his audit. (RTP May '21)

OR

T Ltd has used the services of an expert for the purpose of physical verification of its inventory which is appearing in the financial statements of the company at ` 75 Crores. Discuss the broad parameters auditor would take into consideration while deciding about using the work performed by the Management's Expert in physical verification of company's inventory. (RTP Nov '23)

Answer 21

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.



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STRIVING TOWARDS KNOWLEDGE



What is meant by sufficiency of Audit Evidence? Explain the factors affecting the auditor's judgement as to the sufficiency of audit evidence. (MTP 3 Marks April '23, RTP Nov 20 & May 23, SM)

OR

The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. Analyse and Explain stating clearly the factors affecting the auditor's judgement as to sufficiency of audit evidence. (RTP May '18 & May '19)

OR

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

Answer 23

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

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

- (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** described as follows at the assertion level:
 - **Inherent risk**—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls.
 - **Control risk**—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control.

Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand, if assertions have a higher risk of material misstatement, more evidence would be required.

- (iii) **Size of a population:** It refers to the number of items included in the population. **Less evidence** would be required in case of smaller, more **homogeneous population** but on the other hand in case of larger, more **heterogeneous populations**, **more evidence** would be required.



Question 24

LDR

SA 500 – “Audit Evidence”, explains what constitutes audit evidence in an audit of financial statements. A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements. Explain and discuss the meaning of Audit Evidence in detail. (RTP Nov '23)

OR

The auditor of Fresh and Well Limited explained to the audit team members about the relationship between Audit Evidence and Opinion of Auditor. Explain what relationship exists between Audit Evidence and Opinion of Auditor. (SM)

OR

You are the senior member of the engagement team of M/s BB-& Associates. Before starting the audit, you explained to other junior assistants about the meaning of Audit evidence. One of the junior assistants is of the view that audit evidence includes only information contained in the accounting records and no other information. You are of the opinion that a combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements.

In the above context, illustrate with two appropriate examples of each:

- (i) Information contained in the accounting records.**
- (ii) Other information that authenticates the accounting records. (PYP 4 Marks Nov'23)**

Answer 24

SA 500 – “Audit Evidence”, explains what constitutes audit evidence in an audit of financial statements, and deals with the auditor’s responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor’s opinion.

Audit evidence may be defined as the information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Explaining this further, audit evidence includes:

- (1) Information contained in the accounting records:** Accounting records include
 - the records of **initial accounting entries** and supporting records, such as checks and records of electronic fund transfers;
 - **invoices;**
 - **contracts;**
 - the **general and subsidiary ledgers**, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and
 - records such as **work sheets** and **spreadsheets** supporting cost allocations, computations, reconciliations and disclosures.
- (2) Other information** that authenticates the accounting records and also supports the auditor’s rationale behind the true and fair presentation of the financial statements: Other information which the auditor may use as audit evidence includes, for example
 - **minutes** of the meetings,
 - **written confirmations** from **trade receivables** and **trade payables**,
 - **manuals** containing details of **internal control** etc.

A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements.



Chapter 4.2: SA 610- Using the Work of Internal Auditors

Questions & Answers

Question 2



Saburi Textile Ltd is an established player in the textile manufacturing sector. It has developed strong internal controls in almost every area. It has appointed you as an Internal Audit team head. Internal audit has a very strong relation with internal control of the company. Internal Audit analyses the effectiveness with which the internal control of the company is operating and also makes suggestions for improvement in that internal control. Explain stating clearly activities relating to Internal Control. (RTP May '22)

OR

Internal audit not only analyses the effectiveness with which the internal control of a company is operating but also improves the effectiveness of internal control. Elucidate the statement. (PYP 4 Marks May'22)

Answer 2

The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the **activities Relating to Internal Control**:

- (i) **Evaluation of internal control**: The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit.
- (ii) **Examination of financial and operating information**: The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
- (iii) **Review of operating activities**: The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including nonfinancial activities of an entity.
- (vi) **Review of compliance with laws and regulations**: The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

Internal audit has a very strong relation with internal control of a company. Internal Audit analyzes the effectiveness with which the internal control of a company is operating and also makes suggestions for improvement in that internal control.

Exam Insights: Improvement in Effectiveness of internal Control: Very few examinees attempted this question and those who attempted failed to quote relevant points.



Chapter 4.3: SA 530- Audit Sampling

Questions & Answers

Question 19



XYZ Ltd is engaged in trading of electronic goods and having huge accounts receivables. For analysing the whole accounts receivables, auditor wanted to use sampling technique. In considering the characteristics of the population from which the sample will be drawn, the auditor determines that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques. Advise the auditor in accordance with SA 530.

(MTP 4 Marks Oct '19, RTP May '18)

OR

In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is appropriate. Guide the auditor on the use of stratification and value-weighted sampling techniques. (RTP Nov '21)

Answer 19

Stratification and Value-Weighted Selection: In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection technique is appropriate. SA 530 provides guidance to the auditor on the use of stratification and value-weighted sampling techniques.

Stratification: Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic. The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement. Similarly, a population may be stratified according to a particular characteristic that indicates a higher risk of misstatement, for example, when testing the allowance for doubtful accounts in the valuation of accounts receivable, balances may be stratified by age.

The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum. To draw a conclusion on the entire population, the auditor will need to consider the risk of material misstatement in relation to whatever other strata make up the entire population. For example, 20% of the items in a population may make up 90% of the value of an account balance. The auditor may decide to examine a sample of these items. The auditor evaluates the results of this sample and reaches a conclusion on the 90% of value separately from the remaining 10% (on which a further sample or other means of gathering audit evidence will be used, or which may be considered immaterial). If a class of transactions or account balance has been divided into strata, the misstatement is projected for each stratum separately. Projected misstatements for each stratum are then combined when considering the possible effect of misstatements on the total class of transactions or account balance.

Value-Weighted Selection: When performing tests of details it may be efficient to identify the sampling unit as the individual monetary units that make up the population. Having selected specific monetary units from within the population, for example, the accounts receivable balance, the auditor may then examine the particular items, for example, individual balances, that contain those monetary units. One benefit of this approach to defining the sampling unit is that audit effort is directed to the larger value items because they have a greater chance of selection, and can result in smaller sample sizes.

This approach may be used in conjunction with the systematic method of sample selection and is most efficient when selecting items using random selection.

**Question 26**

LDR

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 5 Marks Aug'24)

Answer 26

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.

STRIVING TOWARDS KNOWLEDGE





Chapter 4.4: SA 501- Audit Evidence-Specific Considerations for Selected Items

Inventories

Questions & Answers

Question 7

LDR

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 31st 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 Sep'24)

Answer 7

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.



Chapter 4.5: SA 505- External Confirmations

Questions & Answers

Question 8

LDR

CA P is the auditor of MN Ltd. While scrutinising the accounts of MN Ltd., he observed that the company had large volume of Trade payable outstanding in the Balance sheet as on 31st March, 2023 for which external confirmations are not available, CA P wants to send external confirmation request to selected Trade payables but management of MN Ltd. refused for the same. Discuss how CA P should deal in this regard as per relevant Standard on Auditing.

(PYP 4 Marks May '23, PYP 4 Marks, Nov'20, MTP 5 Marks Dec'24)

Answer 8

If management refuses to allow the auditor to send a confirmation request, CA P should deal in this regard in the manner prescribed in SA 505 explained hereunder:

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

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is **unreasonable** or the auditor is **unable to obtain relevant and reliable audit evidence** from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with **SA 260**. The auditor shall also determine the implications for the audit and the auditor's opinion in accordance with **SA 705**.

Exam Insights: Refusal by management to send external confirmation request: Many examinees answered the question correctly, however, some examinees did not explain the procedure as required by the question rather they straightaway explained about disclaimer of opinion without explaining about inquiry, evaluation and alternative procedures.



Chapter 4.6: SA 510- Initial Audit Engagements – Opening Balances

Questions & Answers

Question 3



M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore he is not required to verify them. Is CA Pankaj correct in his approach? (PYP 3 Marks May'22, MTP 3 Marks April '23, RTP May'24, SM)

Answer 3

Initial audit engagement is an engagement in which either

- (i) The financial statements for the prior period were not audited; or
- (ii) The financial statements for the prior period were audited by a predecessor auditor.

From the above, it is quite clear that CA Pankaj is not correct in his approach and therefore would be required to follow the initial audit engagement and also apply audit procedures regarding opening balances.

Audit Procedures regarding Opening Balances; The auditor shall read the most recent financial statements, if any, and the predecessor auditor's report thereon, if any, for information relevant to opening balances, including disclosures. The auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

- (a) Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;
- (b) Determining whether the opening balances reflect the application of appropriate accounting policies; and
- (c) Performing one or more of the following:
 - (i) Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements.
 - (ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
 - (iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

Exam Insights: (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; The above points were not written by many examinees.





Chapter 4.7: SA 550- Related Parties

Questions & Answers

Question 2

LDR

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.

(RTP Nov '21, MTP 5 Marks Oct'23)

OR

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 5 Marks July'24)*

Answer 2

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)



Chapter 4.8: SA 520- Analytical Procedures

Questions & Answers

Question 19

LDR

While applying the Substantive Analytical Procedures what techniques can be used by the statutory auditor of a company to obtain sufficient and appropriate audit evidence? (MTP 4 Marks March 22, RTP May'23, SM)

Answer 19

While applying the Substantive Analytical Procedures the statutory auditor of a company may use the following techniques to obtain sufficient and appropriate audit evidence

Trend analysis – Trend analysis is a **commonly used** technique. It is the **comparison of current data with the prior period balance** or with a trend in two or **more prior period balances**. We evaluate whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.

Ratio analysis – Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry.

Reasonableness tests – Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts. In other words these tests are made by reviewing the relationship of certain account balances to other balances for reasonableness of amounts.

Examples include:

- Interest expense against interest bearing obligations.
- Raw Material Consumption to Production (quantity)
- Wastage & Scrap % against production & raw material consumption (quantity)
- Work-in-Progress based on issued of materials & Sales (quantity)
- Sales discounts and commissions against sales volume
- Rental revenues based on occupancy of premises.

Structural modelling – A **modelling tool** constructs a **statistical model from financial and/or non- financial data of prior accounting periods to predict current account balances** (e.g., linear regression).

The statutory auditor may use any of the above mentioned techniques while applying substantive analytical procedures depending upon the availability of data and requirements of the case.



The statutory auditor of ABC Ltd., CA Raj identifies certain inconsistencies while applying analytical procedures to the financial and non-financial data of ABC Ltd. With reference to SA 520 on "Analytical Procedures", how CA Raj shall investigate such differences? (PYP 3 Marks, July'21, SM)

Answer 21

If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

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

Conclusion: In the present case CA Raj identifies certain inconsistencies while applying analytical procedure to financial or nonfinancial data of ABC Ltd. CA Raj should inquire the management of ABC Ltd, and obtain sufficient and appropriate audit evidences relevant to the management response. Further CA Raj should also perform other audit procedures, if required in the circumstances of the case to obtain further sufficient and appropriate evidence.

Exam insights: Analytical Procedure: Some examinees elaborated the analytical procedures in detail only i.e. trend analysis, without writing about the inquiry of management and performing other audit procedures as necessary in the circumstances.



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CHAPTER 5: AUDIT OF ITEMS OF FINANCIAL STATEMENTS

CONCEPTS OF THIS CHAPTER

- General considerations in financial statement audits
- Auditing procedures for balance sheet and profit/loss heads
- Procedures for specific financial statement disclosures



LDR Questions

Q 3, Q 15, Q 25,
Q 36, Q 51, Q 62

Share Capital

Questions & Answers

Question 3



While conducting audit of Air Space Ltd, the auditor observes that it has issued shares at discount to its creditors when its debt is converted into shares in pursuance of debt restructuring scheme in accordance with any guidelines specified by the Reserve Bank of India. Discuss explaining clearly the provisions relating to discount on issue of shares and its verification by the auditor. (MTP 3 Marks March 22, RTP May 22)

OR

Any share issued by a company at a discounted price shall be void. Explain stating also the audit procedure in this regard. (MTP 3 Marks March '19)

OR

Validity and consequence of issue of shares at discount, check with respect to the provisions of the Companies Act 2013. (PYP 4 Marks, Nov'19)

OR

Management of D Ltd. has issued shares at a discount to its creditors. Explain the provisions of the Companies Act, 2013 when shares are issued at a discount to creditors?

As an auditor what will be your concern of checking in such a case? (PYP 4 Marks May '23)

OR

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. (PYP 4 Marks MAY24)

Answer 3

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.

(2A) Notwithstanding anything contained in 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.

The auditor needs to check

- (i) the movement in share capital during the year and wherever there is any issue,
- (ii) he should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price.
- (iii) Further, auditor should also verify that in case a company has issued 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.

In the given case of Air Space Ltd, it is clear that it can issue shares to its creditors when its debt is converted into shares in accordance with approved restructuring scheme.

Exam insights: Nov'19: Many examinees were not aware about the penal consequences to the Company. May '23: Issue of shares at discount to creditors: Majority of the examinees did not explain about the issuance of 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.



VIVITSU
STRIVING TOWARDS KNOWLEDGE



Questions & Answers

Question 15

LDR

M/s Veer and Associates is appointed as auditor of Wavelength 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 5 Marks Aug'24)

Answer 15

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**.



Property, Plant & Equipment

Questions & Answers

Question 25

LDR

State assertions that are implied in the extract of financial statement given below:

			(₹)
	Plant and Machinery (at Cost)		4,00,000
Less:	Depreciation:		
	Up to Previous year	1,40,000	
	For the year	26,000	1,66,000
			2,34,000

- (i) Indicate different assertions in respect of account balances at period end.
(ii) State specific assertions relating to the above extract of financial statement.
(MTP 6 Marks Sep '23, MTP 6 Marks April 19, March'21)

Answer 25

(i) Assertions about account balances at the period end:

- Existence** – assets, liabilities, and equity interests exist.
- Rights** and obligations – the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
- Completeness** – all assets, liabilities and equity interests that should have been recorded have been recorded.
- Valuation** and allocation – assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

(ii) The specific assertions are as follows:

- the **firm owns** the plant and machinery;
- the **historical cost of plant and machinery** is ₹ 4 lacs;
- the plant and machinery **physically exists**;
- the asset is **being utilised in the business** of the company productively;
- total charge of depreciation** on this asset is ₹ 1,66,000 to date on which ₹ 26,000 relates to the year in respect of which the accounts are drawn up; and
- the amount of depreciation has been calculated on recognised basis and the **calculation is correct**.



Questions & Answers

Question 36



XYZ Ltd made huge additions to Intangible assets during the period 01-04-2021 to 31-03-2022 i.e period under audit. You have been appointed as an auditor and you want to verify the additions made to intangible assets during the period. Suggest the audit procedure to verify the additions to intangible assets. (MTP 6 Marks March 22, Sep 22, Nov'24)

Answer 36

1. Verify the **movement in the intangible assets schedule** (asset class wise like software, designs/ drawings, goodwill etc.) compiled by the management i.e. **Opening balances + Additions – Deletions = Closing balances**. Tally the closing balances to the entity's books of account.

2. 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:

- (i) For all material additions, verify whether such expenditure meets the criterion for recognition of an intangible asset **as per AS 26**.
- (ii) Ensure that **no cost related to research** (or from the research phase of an internal project) gets recognized as intangible asset.
- (iii) 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.
- (iv) Verify whether the additions (acquisitions) have been **approved by** appropriate entity's personnel.
- (v) 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.
- (vi) 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, 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.



**Questions & Answers****Question 51**

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 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 4 Marks Apr'24)

Answer 51

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 outstandings 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.



Questions & Answers

Question 62



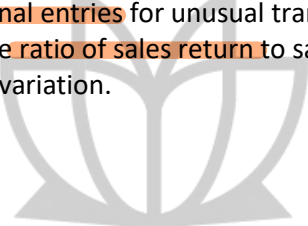
You are part of engagement team conducting audit of an entity engaged in manufacturing business. State few audit procedures you would undertake to perform to verify that recorded sales in financial statements represent goods sold during the period and recorded sales are not overstated.

(MTP 4 Marks Mar'24 PYP 4 Marks, July'21)

Answer 62

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.



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Questions & Answers

Question 81

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 3 Marks Mar'24)

Answer 81

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

STRIVING TOWARDS KNOWLEDGE



Questions & Answers

Question 88

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

- (i) Employee benefit expenses do not include the cost of any unauthorised personnel.
- (ii) All the items of inventory pertaining to the relevant year shall be included regardless of the location.
- (iii) Sales are recorded correctly in the books based on the invoices. Discounts have been properly adjusted or accounted for.
- (iv) The entity owns or controls the inventory recorded in the financial statements. i.e. the purchase invoices have been made in the name of the client.
- (v) Inventory has been recognised at the lower of cost and net realizable value in accordance with AS 2 - Inventories. *(PYP 5 Marks Jan'25)*

Answer 88

- (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.
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.
- (iv) 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

CHAPTER 6: AUDIT DOCUMENTATION

CONCEPTS OF THIS CHAPTER

- Audit documentation: nature, purpose, form, content, extent
- Audit documentation summary
- Audit file and final file assembly
- Ownership of audit documentation



LDR Questions

Q 20

Q 21

Questions & Answers

Question 20



Audit documentation serves a number of purposes. List such purposes. (MTP 3 Marks March '21)

OR

A new team member of GSR & Co., the auditors of Esteem Limited, was of the view that Audit Documentation would not serve any purpose at any stage of Audit. Explain. (RTP May '21)

OR

CAM is the engagement partner of S Ltd. He has instructed his audit team to maintain proper audit documentation. The audit team members are not sure about the purpose for which the documentation should be made. Explain the various purposes of audit documentation with reference to SA 230. (PYP 3 Marks Nov 22)

OR

Discuss any two purposes of audit documentation (SM)

OR

SA 230, "Audit Documentation" deals with the auditor's responsibility to prepare audit documentation for an audit of financial statements. Such audit documentation serves various purposes. Explain. (RTP May '23)

Answer 20

Audit documentation: SA 230 on "Audit Documentation", audit documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. (terms such as "working papers" or "work papers" are also sometimes used.)

Nature of Audit Documentation

Audit documentation provides:

- evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and
- evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Purpose of Audit Documentation

The following are the purpose of Audit documentation:

1. Assisting the engagement team to plan and perform the audit.
2. Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.
3. Enabling the engagement team to be accountable for its work.
4. Retaining a record of matters of continuing significance to future audits.



5. Enabling the conduct of **quality control** reviews and inspections.
6. Enabling the conduct of **external inspections in** accordance with applicable legal, regulatory or other requirements.

From the above, it can be concluded that Audit documentation serves a number of purposes and hence it would be incorrect to say that audit documentation would not serve any purpose at any stage of audit



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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. Explain in detail. (RTP Nov '23, May'23, Nov '18 & May '22) (RTP Jan'25, MTP 4 Marks Aug'24)

Answer 21

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.

STRIVING TOWARDS KNOWLEDGE

CHAPTER 7: COMPLETION & REVIEW



Chapters	Page Number	LDR Questions
Chapter 7.1: SA 560- Subsequent Events	7.1-1 – 7.1-5	Q4
Chapter 7.2: SA 570- Going Concern	7.2-1 – 7.2-6	Q6
Chapter 7.3: SA 450- Evaluation of Misstatements Identified during Audit	7.3-1 – 7.3-2	-
Chapter 7.4: SA 580- Written Representations	7.4 -1 - 7.4-5	Q11
Chapter 7.5: SA 260- Communication with Those Charged with Governance	7.5-1 – 7.5-2	-
Chapter 7.6: SA 265- Communicating Deficiencies in Internal Control to Those Charged with Governance and Management	7.6-1 - 7.6-3	Q3

Chapter 7.1: SA 560- Subsequent Events

Questions & Answers

Question 4



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. Explain.

(RTP May '19, PYP 4 Marks, Jul'21)

Answer 4

Audit Procedure Regarding Events Occurring Between the Date of The Financial Statements and The Date of the Auditor's Report

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.

The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

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. The auditor shall take into account the auditor's risk assessment which shall include the following:

- Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- 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.



(d) Reading the **entity's latest subsequent interim financial statements**, if any.

Exam Insights: Identification of Events occurring after Balance sheet date: Examinees did not possess sufficient knowledge about the topic and general types of answers were given. Many examinees wrote about the adjusting and non- adjusting events. Some examinees did not write about the audit procedures specifically in relation to subsequent events as per SA- 560 but only wrote about general audit procedures.



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Chapter 7.2: SA 570- Going Concern

Questions & Answers

Question 6



While doing audit of ABC Pvt. Ltd, on the basis of sufficient and appropriate evidence, auditor comes to a conclusion that use of the Going Concern Basis of Accounting is appropriate, but a material uncertainty exists.

- (a) Discuss the implications for auditor's report if: Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements
- (b) Adequate Disclosure of a Material Uncertainty is Made is not made in the Financial Statements (RTP Nov '21)

OR

S Ltd., a large textile manufacturing company, due to heavy recession in the market was unable to collect amount of huge receivables in time and also holding large amounts of stock of raw materials and finished goods since last 9 months of the Financial Year 2022-23.

From your primary observations of audit evidence, you feel that there is a material uncertainty existing about going concern.

How will you deal in your audit report?

What will be the effect on your audit opinion in the following situations?

- (i) If adequate disclosure of such material uncertainty is already made in the financial statements.
- (ii) If adequate disclosure of such material uncertainty is not made in the financial statements. (PYP 4 Marks May '23, SM)

Answer 6

Use of the Going Concern Basis of Accounting is Appropriate but a Material Uncertainty Exists

The identification of a material uncertainty is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that a material uncertainty related to going concern exists alerts users to this circumstance.

(a) Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements

If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern."

(b) Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements

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

- (i) Express a **qualified opinion** or **adverse opinion**, as appropriate, in accordance with SA 705 (Revised); and
- (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.

Exam Insights: Effects of going concern on audit opinion: Few examinees could write the reporting requirements in a separate section in the audit report if adequate disclosure about material uncertainty is made in the financial statements. Also, many examinees did not discuss about the Basis for Qualified (Adverse) Opinion section of the auditor's report properly in case adequate disclosure of a material uncertainty is not made in the financial statements. Also, some examinees discussed about expressing disclaimer of opinion which was incorrect.





Chapter 7.4: SA 580- Written Representations

Questions & Answers

Question 11

LDR

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 took over and not for the prior period when old management were managing affairs of the company. Guide the auditor & the management in this respect. (PYP 4 Marks May'24, MTP 4 Marks Dec'24)

Answer 11

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 persons' 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.



Chapter 7.6: SA 265- Communicating Deficiencies in Internal Control to Those Charged with Governance and Management

Questions & Answers

Question 3



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. (PYP 4 Marks Sep'24)

OR

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. (SM & MTP 4 Marks Apr'24) (RTP May'25)

Answer 3

(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.

CHAPTER 8: AUDIT REPORT



Chapters	Page Number	LDR Questions
Chapter 8.1: SA 700- Forming an Opinion and Reporting on Financial Statements	8.1-1 – 8.1-8	Q9
Chapter 8.2: SA 705- Modifications to the Opinion in the Independent Auditor's Report	8.2- 1 – 8.2-5	Q4
Chapter 8.3: SA 706- Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report	8.3-1 – 8.3-4	Q6
Chapter 8.4: SA 701- Communicating Key Audit Matters in the Independent Auditor's Report	8.4-1 – 8.4-3	Q3
Chapter 8.5: SA 710- Comparative Information—Corresponding Figures and Comparative Financial Statements	8.5-1 -8.5-3	Q2
Chapter 8.6: Audit of Branch Office Accounts 128(1)	8.6-1 – 8.6-2	-
Chapter 8.7: SA 299- Joint Audit of Financial Statements	8.7- 1- 8.7- 2	Q3
Chapter 8.8: Reporting Requirements under Companies Act	8.8 -1 – 8.8-5	Q8
Chapter 8.9: Companies Auditors Report Order, 2020 (CARO)	8.9-1 – 8.9-11	Q9, Q11

Questions & Answers

Question 9



M/s ABC & Associates, statutory auditors of Opaque Ltd., are in the process of finalizing the audit report of the company but in view of their inability to obtain sufficient appropriate audit evidence, they would like to disclaim their opinion on the financial statements. Explain reporting responsibilities of M/s ABC & Associates pursuant to SA 700 (Revised). How they will address key audit matters section in accordance with SA 701 when they are expressing disclaimer of an opinion on the financial statements?

(PYP 4 Marks Nov'23)

OR

When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700. Explain (RTP May '22)

OR

CA Guru is in the process of preparing the final audit report of JPA Private Limited and would like to disclaim his opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence. How CA Guru shall amend the description of the auditor's responsibilities as required by SA 700 (Revised)? (PYP 3 Marks, July'21)

Answer 9

SA 700 requires that if the auditor is unable to obtain sufficient appropriate audit evidence to conclude that financial statements as a whole are free from material misstatements, the auditor shall modify opinion in accordance with requirements of SA 705.

SA 705 requires that when the auditor disclaims an opinion on the financial statements due to an inability to





obtain sufficient appropriate audit evidence, the auditor shall:

- (i) State that the auditor does not express an opinion on the accompanying financial statements;
- (ii) State that, because of the significance of the matters described in the Basis for Disclaimer of Opinion section, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- (iii) Amend the statement required by SA 700 (Revised), which indicates that the financial statements have been audited, to state that the auditor was engaged to audit the financial statements.

SA 705 requires that unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.

Alternative Solution

When an auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

- (i) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;
- (ii) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- (iii) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised).

Unless required by law or regulation, when the auditor disclaims an opinion on the financial statements, the auditor's report shall not include a Key Audit Matters section in accordance with SA 701.

Exam Insights: Nov '23 : Disclaimer of opinion (SA 705) and addressing Key Audit Matter (SA 701): Examinees correctly mentioned that Key Audit Matter will not be reported in case Disclaimer of Opinion is given however, they failed to refer provisions of SA 705 and the concept of disclosing the same in the "Basis of opinion" paragraph as per requirement of the question.

July '21 : Amendment in the auditor's responsibilities clause in case of disclaimer audit report: Most of the examinees did not have fair idea about the topic and they generally answered the topic and had not given to the point and specific answer. Many examinees defined the types of opinion (i.e. qualified, adverse and disclaimer), which was not required. Also, some examinees answered as to when the disclaimer of opinion to be given instead of responsibility of auditor.



Chapter 8.2: SA 705- Modifications to the Opinion in the Independent Auditor's Report

Questions & Answers

Question 4



Distinguish between an adverse opinion and a qualified opinion. Also draft an opinion paragraph for both types of opinion. (MTP 4 Marks Oct'23, SM)

Answer 4

An auditor shall express an **adverse opinion**, when the auditor **having obtained sufficient and appropriate audit evidence**, concludes that **misstatements, individually or in aggregate are both material and pervasive**. Whereas, when the auditor, **having obtained sufficient and appropriate audit evidence**, concludes that **misstatements are material but not pervasive, shall express a qualified opinion**.

SA705 – “Modifications to the Opinion in the Independent Auditor's Report” deals with the form and content of both types of report. The following are the draft of the opinion paragraphs of the reports.

(i) Adverse Opinion

We have audited the accompanying consolidated financial statements of ABC Company Limited (hereinafter referred to as the “Holding Company”) and its subsidiaries (the Holding Company and its subsidiaries together referred to as “the Group”), its associates and jointly controlled entities, which comprise the consolidated balance sheet as at March 31, 2023, the consolidated statement of profit and Loss, (consolidated statement of changes in equity) and the consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies (hereinafter referred to as the “consolidated financial statements”). In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the Basis for Adverse Opinion section of our report, the accompanying consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 2023, of its consolidated profit/loss, (consolidated position of changes in equity) and the consolidated cash flows for the year then ended.

(ii) Qualified Opinion

We have audited the standalone financial statements of ABC Company Limited (“the Company”), which comprise the balance sheet as at March 31, 2023, and the statement of Profit and Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company's branches located at (location of branches)) . In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as at March 31st, 2023 and profit/loss, (changes in equity) and its cash flows for the year ended on that date.



Chapter 8.3: SA 706- Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report

Questions & Answers

Question 6



D Ltd. is a company engaged in publishing business magazines. CA P is the statutory auditor of the company. The company takes property in the barter deal from its real estate customers against publication of their advertisements. The properties obtained during the year through such barter deals have been considered in the books of accounts on the basis of possession letter only and have been included in PPE in the financial statements. Considering this matter of such importance that is fundamental to the users understanding, CA P has decided to communicate the same in his report. CA P seeks your guidance in reporting this matter in his audit report. (PYP 4 Marks May'22)

Answer 6

Emphasis of Matter Paragraphs in the Auditor's Report: If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:

- The auditor would not be required to modify the opinion in accordance with SA 705 as a result of the matter; and
- When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

In the given case as the properties obtained during the year through barter deals and included in the PPE in the books of accounts on the basis of possession letter only, hence there is a need to add Emphasis on Matter Paragraph in the Auditor's Report.

The draft of the same is as under:

Emphasis of Matter – Effect of Properties obtained through barter deals by the company We draw attention to Note (Y) of the financial statements, which describes the effects of the properties obtained through barter by the company. Our opinion is not modified in respect of this matter.

Alternative Solution:

In the given case as the properties obtained during the year through barter deals and included in the PPE in the books of accounts on the basis of possession letter only, hence there is a need to report the same under Clause i(c) of Paragraph 3 Companies (Auditor's Report) Order, 2020.

Matters to be included in auditor's report - The auditor's report on the accounts of a company to which this Order applies shall include a statement on the following matter, namely:

- (c) whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company,

if not, provide the details thereof in the format below:

Description of property	Gross carrying value	Held in name of	Whether promoter, director or their relative or employee	Period held— indicate range, where appropriate	Reason for not being held in name of company* *also indicate if in dispute
1	2	3	4	5	6

The auditor should state in the Reason (column 6) for not being held in name of company as follows

"Properties obtained during the year through barter deals and included in the PPE in the books of accounts on the basis of possession letter only"

Exam Insights: Emphasis of Matter Paragraphs in the Auditor's Report/Matters to be included in auditor's report as per CARO, 2020. Most of the examinees were able to mention that there is a need to add Emphasis on Matter Paragraph in the Auditor's Report but they failed to discuss the other part.





Chapter 8.4: SA 701- Communicating Key Audit Matters in the Independent Auditor's Report

Questions & Answers

Question 3

LDR

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? (MTP 3 Marks April 22, RTP Nov '19 & Nov '23, SM)

Answer 3

As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not:

- (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.



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Chapter 8.5: SA 710- Comparative Information—Corresponding Figures and Comparative Financial Statements

Questions & Answers

Question 2

LDR

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in some circumstances. Explain those circumstances.

(MTP 5 Marks Aug '18, Sep 22, PYP 4 Marks Nov '19)

OR

The senior member of the firm Kaur & Associates, Chartered Accountants, informed to its auditing staff that at the time of audit reporting regarding corresponding figures, when corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in specified circumstances. What are those exceptional circumstances? (PYP 4 Marks May'22)

Answer 2

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances.

1. If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or 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:
 - (a) 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
 - (b) 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.
2. If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified.
3. **Prior Period Financial Statements Not Audited**- If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements



Chapter 8.7: SA 299- Joint Audit of Financial Statements

Questions & Answers

Question 3

LDR

The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Explain stating the advantages of the joint audit.

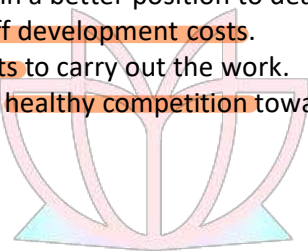
(MTP 4 Marks April '23, RTP Nov '19, SM)

Answer 3

Joint Audit: The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This is by itself a great advantage.

In specific terms the **advantages** that flow may be the following:

- (i) **Sharing of** expertise.
- (ii) Advantage of **mutual consultation**.
- (iii) **Lower workload**.
- (iv) Better **quality** of performance.
- (v) **Improved service** to the client.
- (vi) Displacement of the auditor of the **company taken over** in a takeover often obviated.
- (vii) In respect of **multi-national companies**, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations.
- (viii) **Lower staff development costs**.
- (ix) **Lower costs** to carry out the work.
- (x) A sense of **healthy competition** towards a better performance



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Chapter 8.8: Reporting Requirements under Companies Act

Questions & Answers

Question 8



As per Sec 143(3)(j) of the Companies Act, 2013, the auditor's report shall also include such other matters as may be prescribed by Rule 11 of the Companies (Audit and Auditors) Rule, 2014. Discuss those matters on which views and comments of the auditor are required.

(RTP Nov '23, PYP 3 Marks Dec'21, MTP 4 Marks Mar'22, SM)

Answer 8

Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in auditor's report. The auditor's report shall also include their views and comments on the following matters, namely:

- (i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
- (ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
- (iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.
- (iv) (1) Whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;
(2) Whether the management has represented, that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and
(3) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (1) and (2) contain any material misstatement.
- (v) Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.
- (vi) Whether the company has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention

EXAM INSIGHTS: (b)Others Matters prescribed by Rule 11 to include in Auditor's Report: Very few examinees attempted this question and those who attempted did not have knowledge about the provisions of Rule 11. Also, many examinees wrote about the other reporting requirements in section 143(3).





Chapter 8.9: Companies Auditors Report Order, 2020 (CARO)

Clause (v)-Deposits accepted by the Company

Questions & Answers

Question 9



(Includes concepts of Clause iii- Investments, Guarantee / Security, Loans or Advances)

M Ltd. has given certain loans to related parties and also has accepted certain deposits. As an auditor, how will you include the above items in paragraph 3 of CARO 2020?

(MTP 3 Marks March '21, PYP 4 Marks, Nov '19)

Answer 9

Clause (iii) of paragraph 3 of CARO 2020 states

Whether the company has granted any loans, secured or unsecured to companies, firms, Limited Liability Partnerships or other parties covered in the register maintained under section 189 of the Companies Act, 2013.

If so,

(i) As follows-

- A) **Aggregate amount during the year**, outstanding at the balance sheet date with respect to such loans and advances **to subsidiaries, joint ventures and associates.**
- B) **Aggregate amount during the year**, outstanding at the balance sheet date with respect to such loans and advances to parties **other than subsidiaries, joint ventures and associates.**
- (ii) Whether the terms and conditions of the grant of such loans are **not prejudicial** to the company's interest;
- (iii) Whether the **schedule of repayment of principal** and payment of interest has been stipulated and whether the repayments or receipts are regular;
- (iv) if the amount is overdue, state the total **amount overdue for more than ninety days**, and whether reasonable steps have been taken by the company for recovery of the principal and interest;
- (v) Specify the amount of any **Renew or Extension or Fresh Loan** granted to settle the overdues of existing loans given to same parties.
- (vi) Reporting of any loan granted which are **repayable on demand** or without specifying any terms or period of payment.

Further, Clause (v) of paragraph 3 of CARO 2020 states in case the company has accepted **deposits**,

- (i) whether the directives issued by the Reserve Bank of India and the provisions of **sections 73 to 76 or** any: ether relevant provisions of the Companies Act, 2013 and the rules framed there under, where applicable, have been complied with? If not, the nature of such contraventions be stated;
 - (ii) If an order has been passed by Company Law Board or **National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal**, whether the **same has been complied with or not?**
- In the given situation, M Ltd. has given certain loans to related parties and also has accepted certain deposits. Thus, the auditor is required to report the same as per clause (iii) and (v) of Paragraph 3 of CARO, 2020.



State the matters to be included in auditor's report as per CARO, 2020 regarding "Default in repayment of loan or borrowing to a financial institution, bank etc." (MTP 3 Marks March 22, MTP March'19, 4 Marks, MTP-March'18, 4 Marks, MTP-Nov 21, 3 Marks, MTP 4 Marks April '21, RTP May'18)

OR

ABC Ltd. is a public company, which has availed various loans and cash credit facilities from Banks and other financial institutions. The company has defaulted in repayments of such borrowings during the year under audit. What are the reporting requirements in this regard under the Companies (Auditor's Report) Order, 2020? (PYP 4 Marks May '23)

Answer 11

The auditor is required to report as per clause (ix) of paragraph 3 of CARO 2020

- (a) whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below:-

Nature of borrowing, including debt securities	Name of lender	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any
	lender wise details to be provided in case of defaults to banks, financial institutions and government.				

- (a) whether the company is a declared wilful defaulter by any bank or financial institution or other lender;
- (b) whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported;
- (c) whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated;
- (d) whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case;
- (e) whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised;

EXAM INSIGHTS: Reporting requirements of CARO/Reporting in case of default by the company in bank borrowings: Many examinees were aware of the points to be covered while reporting under CARO, 2020 pertaining to default by the company in repayments of bank borrowings and correctly covered various points. However, instead of mentioning the "amount not paid on due date" examinees wrongly mentioned "amount outstanding." Some examinees were not aware about the table requiring the auditor to state the details.

CHAPTER 9: SPECIAL FEATURES OF AUDIT OF DIFFERENT TYPE OF ENTITIES

CONCEPTS OF THIS CHAPTER

- Government audit and duties of CAG.
- Audit procedures for NGOs and charitable institutions.
- Audit procedures for sole traders, firms, educational institutions, hospitals, clubs, cinemas, hotels.
- Audit of hire purchase and leasing companies.
- Audit of Government, local bodies, co-ops, LLPs, trusts, societies.



LDR Questions

Q11	Q17
Q36	Q42
Q45	Q58

Co-operative Society

Questions & Answers

Question 11



Briefly explain the provisions for qualification and appointment of Auditors under the Multi-State Co-operative Societies Act, 2002. (MTP 4 Marks April '21, PYP 5 Marks, Nov '18)

OR

CA. Z. a Chartered Accountant is the Senior manager of a Multi-State Co-operative Society in Mumbai. He is proposed to be appointed as an auditor of the said Multi-State Cooperative Society. Analyse the provisions of the Multi-State Co-operative Societies Act, 2002 and comment on validity of proposed appointment. (PYP 4 Marks May'23)

OR

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 4 Marks July'24)

Answer 11

Qualification of Auditors -Section 72 of the Multi-State Co-operative Societies Act, 2002 states that a person who is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 can only be appointed as auditor of Multi-State co-operative society.

However, the following persons are not eligible for appointment as auditors of a Multi-State co- operative society-

- A body corporate.
- An officer or employee of the Multi-State co-operative society.
- A person who is a member or who is in the employment, of an officer or employee of the Multi- State co-operative society.
- 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.

If an auditor becomes subject, after his appointment, to any, of the disqualifications specified above, he shall be deemed to have vacated his office as such.

Appointment of Auditors - Section 70 of the Multi-State Co-operative Societies Act, 2002 provides that



the first auditor or auditors of a Multi-State co-operative society shall be appointed by the board within one month of the date of registration of such society and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. If the board fails to exercise its powers under this sub-section, the Multi-State co-operative society in the general meeting may appoint the first auditor or auditors. The subsequent auditor or auditors are appointed by Multi-State co-operative society, at each annual general meeting. The auditor or auditors so appointed shall hold office from the conclusion of that meeting until the conclusion of the next annual general meeting.

EXAM INSIGHTS: (b) Appointment of Auditor of Multi-State Co-operative society: Many examinees correctly mentioned legal provisions relating to the appointment of an auditor by a Multi-State Society. The conclusion drawn by majority of them was correct. However, some examinees wrote the answers by specifically mentioning the provisions of the Companies Act, 2013 which was incorrect.



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Question 17



What are the special steps involved in conducting the audit of an Educational Institution? (Write any 12 points) (MTP 6 Marks April 22, RTP Nov '19 & May '18)

Answer 17

The Special Steps Involved in the Audit of an Educational Institution are the following:

- (i) Examine the **Trust Deed**, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.
- (ii) Read through the **minutes of the meetings** of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, specially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
- (iii) 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.
- (iv) 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.
- (v) **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 the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- (vi) Check **admission fees** with **admission slips** signed by the head of the institution and confirm that the amount had been credited to a Capital Fund, unless the Managing Committee has taken a decision to the contrary.
- (vii) See that **free studentship and concessions** have been granted by a person authorised to do so, having regard to the prescribed Rules.
- (viii) Confirm that **finances for late payment or absence**, etc., have either been **collected or remitted** under proper authority.
- (ix) Confirm that **hostel dues** were recovered before students' accounts were closed and their deposits of caution money refunded.
- (x) Verify **rental income** from landed property with the rent rolls, etc.
- (xi) Vouch **income from endowments and legacies**, as well as interest and dividends from investment; also inspect the securities in respect of investments held.
- (xii) Verify any Government or local authority **grant** with the relevant papers of grant. If any expense has been disallowed for purposes of grant, ascertain the reasons and compliance thereof.
- (xiii) Report any **old heavy arrears on account of fees**, dormitory rents, etc., to the Managing Committee.
- (xiv) Confirm that **caution money** and other deposits paid by students on admission have been shown as liability in the balance sheet and not transferred to revenue.
- (xv) See that the investments representing **endowment funds for prizes are kept separate and any income in excess of the prizes has been accumulated and invested along with the corpus.**
- (xvi) Verify that the **Provident Fund money** of the staff has been invested in appropriate securities.
- (xvii) Vouch **donations**, if any, with the list published with the annual report. If some donations were meant for any specific purpose, see that the money was utilised for the purpose.
- (xviii) Vouch **all capital expenditure** in the usual way and verify the same with the sanction for the Committee as contained in the minute book.
- (xix) Vouch in the usual manner all **establishment expenses** and enquire into any unduly heavy expenditure under any head.
- (xx) See that **increase in the salaries of the staff** have been sanctioned and minuted by the Committee.
- (xxi) Ascertain that the system ordering inspection on receipt and issue of **provisions, foodstuffs, clothing and other equipment** is efficient and all bills are duly authorised and passed before payment.
- (xxii) Verify the **inventories of furniture, stationery, clothing, provision and all equipment**, etc. These should be checked by reference to Inventory Register and values applied to various items should be test checked.





- (xxiii) Confirm that the refund of taxes deducted from the income from investment (interest on securities, etc.) has been claimed and recovered since the institutions are generally exempted from the payment of income-tax.
- (xxiv) Verify the annual statements of accounts and while doing so see that separate statements of account have been prepared as regards Poor Boys Fund, Games Fund, Hostel and Provident Fund of Staff, etc.



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Questions & Answers

Question 36



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 4 Marks Apr'22, RTP Nov '20)

OR

What is the function of audit while examining various rules, regulations and orders with regard Audit against Rules & Orders by C&AG?(MTP 4 Marks Nov '21, PYP 3 Marks Nov'20)

OR

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. These rules, regulations and orders against which regularity audit is conducted fall under various categories. Explain (MTP Sep'22 4 Marks)

Answer 36

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. These rules, regulations and orders against which regularity audit is conducted mainly fall under the following categories:

- (i) Rules and orders regulating the powers to incur and sanction expenditure from the Consolidated Fund of India or of a State (and 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.

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.





Questions & Answers

Question 42

LDR

Advise any five special points in an audit of hospital. (MTP 5 Marks March '18, March '19, Aug'18, Oct'18)
OR

You have been appointed auditor of Dr. Prem Ratan Hospital. Discuss any eight important points that would attract your attention while audit. (MTP 4 Marks Oct '21)

OR

You have been appointed auditor of M/s. BLK Hospital. Discuss important points that would attract your attention while audit. (MTP 6 Marks March 22, PYP 4 Marks Nov '19)

OR

The general transactions of a hospital include patient treatment, collection of receipts, donations, capital expenditures. You are required to mention special points of consideration while auditing such transactions of a hospital? (MTP 4 Marks Oct '19, RTP Nov '18, SM)

OR

A multi-speciality hospital has come up in your city. You are appointed as auditor for first year. Discuss, any four, broad areas to be kept in mind while conducting audit of accounts of such a newly opened multi-speciality hospital. (SM)

Answer 42

Audit of Hospital: The special steps involved in such an audit are stated below-

- (1) **Register of Patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
- (2) **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
- (3) **Income from Investments, Rent etc.:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected.
- (4) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- (5) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- (6) **Authorisation and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
- (7) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
- (8) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
- (9) **Internal Check:** Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorization.
- (10) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
- (11) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
- (12) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.
- (13) **Management Representation and Certificate:** Get proper Management Representation and Certificate



with respect to various aspects covered during the course of audit.



VIVITSU
STRIVING TOWARDS KNOWLEDGE

**Questions & Answers****Question 45**

LDR

Explain and also state the role of auditor with respect to the following in case of a hotel:

- (i) Inventories (MTP 4 Marks March '23 & Sep '22)
- (ii) Travel agents & shops (MTP 3 Marks March '23)

OR

CA Irfan Zaidi is auditor of a prestigious five-star hotel in Jaipur. He notices that there is a gift shop doing brisk business inside the hotel premises. On further enquiries, he comes to know that stocks in gift shop belong to gift shop owner and hotel receives rent for letting out this space. Discuss, how, auditor can verify payment of common amenities used by gift shop owner to the hotel. (SM)

Answer 45**(i) Inventories**

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. Areas where large quantities of inventory are held should be kept locked, the key being retained by the departmental manager. The key should be released only to trusted personnel and unauthorised persons should not be permitted in the stores areas except under constant supervision. In particular, any movement of goods in or out of the stores should be checked. Many hotels use specialised professional valuers to take and value the inventories on a continuous basis throughout the year. Such a valuation is then almost invariably used as the basis of the balance sheet inventory figure at the year end. Although such valuers are independent of the audit client, it is important that the auditor satisfies himself that the amounts included for such inventories are reasonable. In order to satisfy himself of this, the auditor should consider attending the physical inventory taking and carrying out certain pricing and calculation tests. The extent of such tests could well be limited since the figures will have been prepared independently of the hotel.

(ii) Travel agents & shops:

- (i) For ledgers coming through travel agents or other booking agencies the bills are usually made on the travel agents or booking agencies. The auditor should ensure that money are recovered from the travel agents or booking agencies as per the terms of credit allowed.
- (ii) Commission, if any, paid to travel agents or booking agents should be checked by reference to the agreement on that behalf.

Questions & Answers

Question 58



An NGO operating in Delhi had collected large scale donations for Tsunami victims. The donations so collected were sent to different NGOs operating in Tamil Nadu for relief operations. This NGO operating in Delhi has appointed you to audit its accounts for the year in which it collected and remitted donations for Tsunami victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention six points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations. (SM) (RTP Jan'25)

Answer 58**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 accountpayee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.
- (ii) **Confirming Receipt of Remittance:** All remittances are supported by receipts and acknowledgements.
- (iii) **Identity:** Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.
- (iv) **Direct Confirmation Procedure:** Send confirmation letters to entities to whom donations have been paid.
- (v) **Donation Utilisation:** Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.
- (vi) **System of NGOs' Selection:** System for selecting NGO to whom donations have been sent.



CHAPTER 10: AUDIT OF BANKS

CONCEPTS OF THIS CHAPTER

- Legal framework for bank audit.
- Financial statements of banks.
- Audit approach for profit and loss items in banks.
- Key items in bank audit: Advances, NPAs.



LDR Questions

- Q30 Q32
Q35 Q38

Questions & Answers

Question 30



Your firm of Chartered Accountants has been appointed as the Auditor of two branches of OBC which are located in the Industrial area. Considering that the location of the branches of bank in industrial area, these would be “advances oriented branches and audit of advances would require the major attention of the auditors. Advise how would you proceed to obtain evidence in respect of audit of advances.
(MTP 4 Marks Oct 19, RTP May '18)

STRIVING TOWARDS KNOWLEDGE

OR

- a) Advances generally constitute the 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, among other points, the amounts included in balance sheet in respect of advances are outstanding at the date of the balance sheet. Explain. (RTP Nov '23, RTP Nov '19, RTP May 21, RTP Nov '22)
- b) The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of internal controls relating to advances. Explain in the context of Audit of Banks (RTP Nov '19)

Answer 30

Audit of Advances: Advances generally constitute the 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:

- Amounts included in balance sheet in respect of **advances are outstanding at the date of the balance sheet.**
 - Advances represent amount **due to the bank.**
 - Amounts due to the bank 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 that 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.**
- (b) The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of **internal controls** relating to advances, and by:



- examining the validity of the recorded amounts;
- examining loan documentation;
- reviewing the operation of the accounts;
- examining the existence, enforceability and valuation of the security;
- checking compliance with RBI norms including appropriate classification and provisioning; and
- carrying out appropriate analytical procedures.

In carrying out his substantive procedures, the auditor should examine all large advances while other advances may be examined on a sampling basis. The accounts identified to be problem accounts however need to be examined in detail unless the amount involved is insignificant.

Advances which are sanctioned during the year or which are adversely commented by RBI inspection team, concurrent auditors, bank's internal inspection, etc. should generally be included in the auditor's review.



VIVITSU
STRIVING TOWARDS KNOWLEDGE



The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. Explain this statement.

(MTP 4 Marks March 22, SM, MTP 4 Marks April 19, RTP Nov '18 & May '19, PYP 5 Marks Nov '18)

Answer 32

The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. In general, the internal controls over advances should include, inter alia, the following:

- The bank should make an advance only after satisfying itself as to the **credit worthiness** of the borrower and after obtaining sanction from the appropriate authorities of the bank.
- All the necessary **documents** (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
- The compliance with the **terms of sanction** and end **use of funds** should be ensured.
- Sufficient **margin** as specified in the sanction letter should be kept against securities taken so as to cover for any decline in the value thereof. The availability of sufficient margin needs to be ensured at regular intervals.
- If the **securities** taken are in the nature of **shares, debentures, etc.**, the **ownership of the same should be transferred in the name of the bank** and the effective control of such securities be retained as a part of documentation.
- All **securities requiring registration should be registered in the name of the bank** or otherwise accompanied by documents sufficient to give title to the bank.
- In the **case of goods in the possession of the bank**, contents of the packages should be **test checked** at the time of receipt. The godowns should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.
- **Drawing Power Register** should be updated every month to record the value of securities hypothecated. These entries should be checked by an officer.
- The accounts should be kept **within both the drawing power and the sanctioned limit**.
- All the **accounts which exceed the sanctioned limit or drawing power or are otherwise irregular** should be brought to the notice of the **controlling authority** regularly.
- The operation of each advance account should be **reviewed at least once a year** and at more frequent intervals in the case of large advances.

**Question 35****LDR**

TEP Industries Private Limited, a company engaged in obtaining rice from paddy, is enjoying a cash credit facility against hypothecation of paid stocks and book debts (eligible up to 90 days only) from LMV Bank for ₹ 4.00 crore. The letter sanctioning the above credit facility stipulates margin @ 25% on stocks and @ 40% on eligible book debts up to 90 days.

While preparing stock statement as on 30.6.23, accountant of the company calculates value of stocks for ₹ 5 crore (including ₹ 1 crore of rice which was lying in a low lying godown and was completely damaged during recent floods caused by river Yamuna). Debtors outstanding as on 30.6.23 are ₹ 3 crore (including ₹ 50 lacs outstanding for last 6 months). Trade creditors outstanding as on date are ₹ 2 crore. He calculates DP as on 30.6.23 for ₹ 3.30 crore. Is he correct? Justify with your workings. What does drawing power calculated by you signify to the borrower company? (RTP Nov '23, SM)

Answer 35

The calculation of DP is as under:

Value of stocks as on 30.6.23	₹ 5.00 crore
Less: value of damaged stocks	₹ 1.00 crore
Value of stocks considered as on 30.6.23	₹ 4.00 crore
Less: Trade creditors	₹ 2.00 crore
Paid stocks	₹ 2.00 crore
Less: Margin @ 25%	₹ 0.50 crore
Drawing power for stocks [A]	₹ 1.50 crore
Value of Trade debtors	₹ 3.00 crore
Less: Debtors outstanding for more than 90 days	₹ 0.50 crore
	₹ 2.50 crore
Less: Margin @ 40%	₹ 1.00 crore
Drawing power for Book debts [B]	₹ 1.50 crore
Total drawing power [A+ B]	₹ 3.00 crore

Accountant's DP calculation is not correct. The drawing power of ₹ 3.00 crore signifies that company can utilize funds to the tune of ₹3.00 crore only against sanctioned cash credit limit of ₹ 4.00 crore.



Question 38

LDR

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 Jan'25)

Answer 38

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
☐ Substandard Assets:	
Would be one, which has remained NPA for a period less than or equal to 12 months.	15%
☐ Doubtful Assets:	
Would be one which has remained in the substandard category for a period of 12 months.	
Sub-categories:	(Secured + Unsecured)
Doubtful up to 1 Year (D1)	25% + 100%
Doubtful 1 to 3 Years (D2)	40% + 100%
Doubtful more than 3 Years (D3)	100% + 100%
☐ Loss Assets	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 Rs 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.

CHAPTER 11: ETHICS & TERMS OF ENGAGEMENT



Chapters	Page Number	LDR Questions
Chapter 11.1: Ethics	11.1 -1 – 11.1-10	Q 11, Q 14
Chapter 11.2: SA 210- Agreeing the Terms of Audit Engagements	11.2-1 – 11.2-5	Q 7
Chapter 11.3: SQC 1- Quality Control for Firms which Perform Audits and Reviews of Historical Financial Information and Other Assurance and Related Service Engagements	11.3-1 – 11.3-5	-
Chapter 11.4: SA 220- Quality Control for an Audit of Financial Statements	11.4 -1 – 11.4-3	-

Chapter 11.1 - Ethics

Questions & Answers

Question 11



The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism. Explain. (RTP Nov'22)

OR

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

(MTP 4 Marks Sep '23, RTP Nov'20, PYP 4 Marks, Nov' 19, SM)

Answer 11

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

Professional skepticism includes being alert to, for example:

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



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

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



VIVITSU
STRIVING TOWARDS KNOWLEDGE



Question 14

LDR

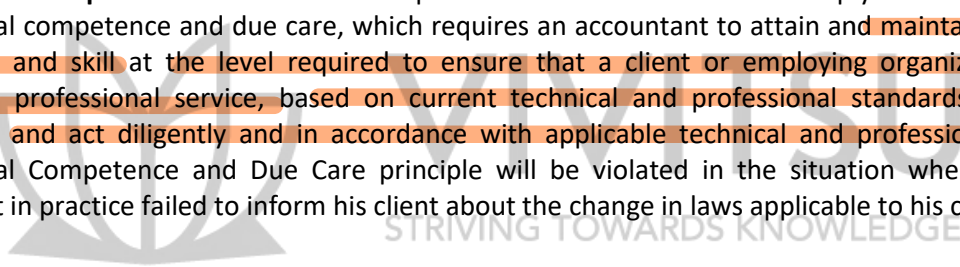
A professional accountant is expected to comply with the fundamental principles of professional ethics at all times. Explain which fundamental principle governing professional ethics is violated in the following situations?

- (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. (PYP 3 Marks May'24)

Answer 14

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.





Chapter 11.2- SA 210- Agreeing the Terms of Audit Engagements

Questions & Answers

Question 7

LDR

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)

Answer 7

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.



CHAPTER 12: CASE SCENARIOS



LDR Questions

Q19 Q23
Q 28 Q29
Q34 Q43
Q 45

CS 19

(MTP 10 Marks April '23)

 LDR

As per SA 210 “Agreeing the Terms of Audit Engagements”, preconditions for an audit may be defined as the use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management and, where appropriate, those charged with governance to the premise on which an audit is conducted.

Mridul & Co, a firm of Chartered Accountants agreed on the Terms of Audit Engagements of a Private Limited Company, Jayshree Private Limited. Jayshree Private Limited has conveyed to Mridul & Co that they want the firm to undertake the statutory audit as well as to examine the life of its plant and machinery at Indore which is in existence for 10 years. While finalizing the scope of the audit, the auditors agreed to cover all the units of the company based at Delhi and Indore. Mridul & Co has asked Jayshree Private Ltd to make all the relevant disclosures in the financial statements. The auditors were vigilant to inquire about any audit evidence that contradicts the other audit evidence.

The auditors decided to cover following aspects under audit:

- (i) An examination of the system of accounting and internal control
- (ii) Reviewing the system and procedures.
- (iii) Checking of the arithmetical accuracy of the books of account.
- (iv) Verification of the authenticity and validity of transactions.
- (v) Classification between capital and revenue expenditure.
- (vi) Comparison of the balance sheet and profit and loss account or other statements with the underlying record.
- (vii) Verification of the title, existence and value of the assets.
- (viii) Verification of the liabilities stated in the balance sheet.
- (ix) Checking the results shown by the profit and loss and to see whether the results shown are true and fair.
- (x) Reporting to the appropriate person/body whether the statements of account examined do reveal a true and fair view of the state of affairs and of the profit and loss of the organisation.
- (xi) Where audit is of a corporate body, confirming that the statutory requirements have been complied with.

While testing the accounts receivables of Jayshree Private Limited, the auditor decided to divide the accounts receivables by age of receivables in the following manner:

- Below 15 days
- 15 days -30 days



- 31-60 days
- 61-90 days
- 91 days and beyond

Based on the above facts, answer the following:

1. According to you, what is the scope of the audit which Mridul & Co should cover in the audit of financial statements of Jayshree Private Limited? (Chapter 1: Nature, Objective and Scope of Audit)
 - I. to examine the life of its plant and machinery at Indore which is in existence for 10 years.
 - II. to cover all the units of the company based at Delhi and Indore.
 - III. to check whether the relevant disclosures are properly made in the financial statements.
 - (a) I,II,III
 - (b) I,II
 - (c) II,III
 - (d) I,III

Ans: (c)

2. What is the name of the method used by the auditor for segregation of accounts receivable? (Chapter 4.3- Audit Sampling)
 - (a) Value weighted selection
 - (b) Stratification
 - (c) Systematic method of Sampling
 - (d) Tests of Control

Ans: (b)

3. The aspects covered by auditor should be: (Chapter 1: Nature, Objective and Scope of Audit)
 - (a) i,ii,iii,x,vi,vii
 - (b) i,ii,iv,v,vi,vii.
 - (c) i,ii,iii,iv,v,vi,vii,viii,ix,x,xi.
 - (d) ii,iii,viii,x,xi

Ans: (c)

4. The auditor's vigilance to question the audit evidence that contradicts the other audit evidence is called as: (Chapter 11.1- Ethics)
 - (a) Professional Skepticism
 - (b) Vigilant Skepticism
 - (c) Professional Judgement
 - (d) Judgement and Skepticism

Ans: (a)

5. With respect to the preconditions for an audit, which one of the following is correct (Chapter 11.2- SA 210- Agreeing the Terms of Audit Engagements)
 - I. The use by Management of an acceptable financial reporting framework in the preparation of financial statements.
 - II. Management's responsibility for the internal control
 - III. Giving auditor access to all information and access to the Entity's premises.
 - (a) I, II
 - (b) I, II, III
 - (c) II, III
 - (d) I, III

Ans: (b)



You are a partner in ABC & Company, a firm of Chartered Accountants based in New Delhi. ABC & Company have been appointed as the statutory auditors of Wave Limited, a public company which manufactures and sells wall and table clocks and has many branches all over India. Wave Limited has been exporting the clocks since past two years. However, the domestic sales have contributed towards major source of revenue for the Company.

One of the team members, CA B noticed that one of the suppliers of Wave Limited, Mr AM had sent some raw material to the Company for storage in their warehouse in March 2023. Due to renovation going on at his warehouse, his stock could be damaged and so he had requested Wave Limited to keep the same in their warehouse. Wave Limited contended that since the raw material was anyway billed to the Company the next month, so the same had been included in the valuation of stock, since physically the stock was present in the warehouse of Wave Limited as on 31.03.2023.

While verifying the debtors, team member C noticed that there were a few trade receivables pertaining to export sales mainly to England. Mr. C verified the same with respect to the invoices issued and other supporting documents. The amount booked as on 31.03.2023 was based on the exchange rate as on the date of the invoice.

Mr. T, another team member verified the PPE of the Company. Wave Limited had purchased few cars for its directors during the year of audit. The same were appearing in the PPE schedule of the Company. Mr T verified the same with respect to the invoices as well as physically verified the assets in the Company's premises. Since the cars were for the official use of the Directors, they were purchased in the name of the Directors of the Company. Mr. T verified the amount with the Invoice and checked the registration and insurance documents. Besides, all items appearing in the PPE schedule were verified and he was satisfied that all PPE items that should have been recorded have, in fact, been recorded.

One of the articled clerks was assigned the work of verification of "Provisions" appearing in the Balance sheet. He wanted to understand from you the circumstances in which a provision is recognised in the books of accounts. You explained him the situations in which an entity recognises Provisions in its books.

Wave Limited has invested in the shares of other companies. One of the Companies has declared dividend on its shares. Wave Limited has not recognised the same in the profit & loss account. Team Member R has asked you to look into the matter since she is unable to understand the reasons for the same.

1. Is the raw material lying in the warehouse of Wave Limited accounted for correctly in its books of account?

- (a) No, since the same belongs to Mr. AM and should appear in his books.
- (b) Yes, since the same is in possession of Wave Limited and was billed to it the following month.
- (c) It should be shown in the books of both Wave Limited and Mr. AM.
- (d) It should not appear in the books of Wave Limited or Mr. AM and the raw material should be disclosed as a note in the final accounts of both the entities.

Ans: (a)

2. Which exchange rate is considered for accounting of foreign debtors at the year end?

- (a) Exchange Rate on the date of the invoice.
- (b) Exchange Rate on the last day of the financial year.
- (c) Exchange Rate on the date of shipment of the products to the customer.
- (d) Exchange Rate on the date of delivery of the products to the customer.

Ans: (b)

3. Which of the following management assertions is not satisfied with respect to Cars included in the PPE items by the company

- (a) Existence
- (b) Valuation
- (c) Completeness
- (d) Rights and Obligations

Ans: (d)



4. Which of the following condition is not required to be met for recognizing a provision?

- (a) When a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.
- (b) When an entity has a present obligation (legal or constructive) as a result of a past event.
- (c) A reliable estimate can be made of the amount of the obligation.
- (d) When it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Ans: (a)

5. Which of the following conditions is not necessary for recognizing dividends in the statement of profit and loss of Wave Ltd.

- (a) the entity's right to receive payment of the dividend is established.
- (b) it is probable that the economic benefits associated with the dividend will flow to the entity.
- (c) the amount of the dividend can be measured reliably.
- (d) payment of income tax on dividends received

Ans: (d)



VIVITSU
STRIVING TOWARDS KNOWLEDGE



Vivi Tsu Limited is a listed Company engaged in the construction business. The Company constructs residential buildings after purchasing vacant land and then sells ready flats to customers. The Company has not been earning good profits and so no dividend was declared in the last financial year for which the statutory audit is to be conducted.

XYZ & Company has been appointed as the statutory auditor of Vivi Tsu Limited. The audit firm has seven partners and is a reputed firm with the partners having expert knowledge in various areas.

While conducting the audit, the engagement partner, CA Z suspects some fraudulent activities undertaken by the officers and employees of the Company. CA Z is aware that for the purpose of SAs, the auditor is concerned with fraud that causes a material misstatement in the financial statements. He understands that misstatements in the financial statements can arise from either fraud or error.

On detailed verification by the audit team, it was observed that accounts were manipulated with a view to presenting a false state of affairs. The fraud was committed to avoid incidence of income-tax and withhold declaration of dividend. There was also an incidence of cash receipts being suppressed which came to the notice of the audit team.

CA Z had enough reasons to believe that the offence of fraud, involved individually an amount of Rs.1 crore, and had been committed against the company by its officers or employees. The audit team discussed the reporting requirements of the fraud committed.

One of the audit team members puts forward his recommendations on reporting which includes disclosure in the Board's Report. He states that sub-section (12) of section 143 of the Companies Act, 2013 prescribes that the companies, whose auditors have reported frauds under this sub-section (12) to the audit committee or the Board, but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

CA Z discusses the reporting under Companies (Auditor's Report) Order, 2020 [CARO, 2020] wherein the auditor is required to report under clause (xi) of paragraph 3 of Companies (Auditor's Report) Order, 2020, about fraud by the company or any fraud on the Company.

Based on the above information, answer the following questions:

1. Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is: (Chapter 3: Risk Assessment and Internal Control)
 - (a) Fraud causes a material misstatement in the financial statements.
 - (b) Fraud is an intentional act.
 - (c) Fraud is easier to detect than error.
 - (d) Fraud can be committed by only the management, those charged with governance, and the employees.

Ans: (b)

2. Which of the following is not a technique of suppressing cash receipts? (Chapter 3: Risk Assessment and Internal Control)
 - (a) Writing down asset values in entirety, selling them subsequently and misappropriating the proceeds.
 - (b) Adjusting unauthorized or fictitious rebates, allowances, discounts, etc. to customer's accounts and misappropriating amount paid by them.
 - (c) Manipulating totals of wage rolls either by including therein names of dummy workers or by inflating them in any other manner.
 - (d) Writing off as debts in respect of such balances against which cash has already been received but has been misappropriated.

Ans: (c)

3. To whom should XYZ & Company report the fraud committed in Vivi Tsu Limited? (Chapter 8.8- Reporting Requirements under Companies Act)
 - (a) Report the matter only to the Audit Committee constituted under section 177 since the amount of fraud has not exceeded 1 crore.
 - (b) Report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days and on receipt of such reply or observations, the auditor shall forward his report and the reply or



observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations.

- (c) Report the matter only to the Board since the amount of fraud is not less than 1 crore.
- (d) Report the matter either to the audit committee constituted under section 177 or the Central Government since the amount of fraud is neither less nor more than 1 crore.

Ans: (b)

4. Sub-rule (4) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that the auditor is required to disclose in the Board's Report details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year. Which of the following details is not required to be disclosed in the Board's Report? (Chapter 8.8- Reporting Requirements under Companies Act)

- (a) Nature of Fraud with description.
- (b) Parties involved, if remedial action taken.
- (c) Approximate Amount involved
- (d) Remedial actions taken.

Ans: (b)

5. For reporting under clause (xi) of paragraph 3 of Companies (Auditor's Report) Order, 2020, which of the following points the auditor may consider? (Chapter 8.9- CARO)

- (a) Fraud by the company or on the company by its officers, employees or third parties to be reported.
- (b) Only suspected frauds shall be included here and not the noticed frauds.
- (c) Principles of materiality outlined in Standards on Auditing.
- (d) The auditor's withdrawal from the engagement and the reasons for the withdrawal.

Ans: (c)



VIVITSU
STRIVING TOWARDS KNOWLEDGE



SAM & Company, a Chartered Accountant firm, is in the process of finalizing the audit of Health is Wealth Limited which is a Company listed on the Bombay Stock Exchange. Since the past decade, Health is Wealth Limited has made its presence felt in over 10 countries, including India, making it a leader in the global fitness industry. It runs a chain of fitness centres that offers energetic group workouts and multiple workout formats to choose from. It also offers the best equipment, knowledgeable staff and personal advice in a welcoming environment.

SAM & Company being a very reputed firm, was appointed for the statutory audit of Health is Wealth Limited. The Engagement Partner CA A and her team of 8 members have conducted the audit in an efficient and effective manner. The senior manager in the team, CA K is of the opinion that they have obtained sufficient appropriate audit evidence, which concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements. One of the article clerks, Mr N, is a fresher and this audit is his first experience as an auditor in a limited company. He is a sharp boy and has grasped all the concepts and techniques very well. However, the term “pervasive” confused him so CA K patiently explained to Mr N the pervasive effects on the financial statements as per the auditor’s judgement. Mr. N understood the term well and thanked CA K for clearing all his doubts.

CA A disagreed with CA K that they have obtained sufficient appropriate audit evidence, which concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements. So, the entire team held various meetings and discussions, and finally reached to a conclusion. They concluded that they have obtained reasonable assurance that the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion took into account:

- (a) Whether sufficient appropriate audit evidence had been obtained;
- (b) Whether uncorrected misstatements were material, individually or in aggregate;
- (c) The evaluations.

The Auditor’s Report was prepared in writing and it was decided that an unmodified opinion would be expressed. The first section of the auditor’s report included the auditor’s opinion, and had the heading “Opinion”. Following the Opinion section, was a section with the heading “Basis for Opinion”. When expressing an unmodified opinion on financial statements, the auditor’s opinion used the following phrase,

“In our opinion, the accompanying financial statements give a true and fair view of [...] in accordance with [the applicable financial reporting framework].”

During the audit, the audit team had observed that there was uncertainty in Health is Wealth Limited relating to the future outcome of a regulatory action. So, a paragraph was included in the auditor’s report that referred to this matter which was appropriately disclosed in the financial statements and that, in the auditor’s judgment, was of such importance that it was fundamental to users’ understanding of the financial statements.

CA A also determined whether the financial statements included the comparative information required by the applicable financial reporting framework and whether such information was appropriately classified. One team member, Mr R was curious to know whether the auditor’s opinion referred to the corresponding figures or not, whenever the corresponding figures are presented. CA A explained the circumstances to Mr R in which, when the corresponding figures are presented, auditor’s opinion referred to the corresponding figures.

Based on the above information, answer the following questions:

1. CA K explained to Mr. N the pervasive effects on the financial statements in the auditor’s judgement. Pervasive effects on the financial statements are those that, in the auditor’s judgement: (Chapter 8.1- SA 700- Forming an Opinion and Reporting on Financial Statements)
 - (i) Are not confined to specific elements, accounts or items of the financial statements;
 - (ii) If so confined, represent or could represent a substantial proportion of the financial statements;
 - (iii) In relation to disclosures, are fundamental to users’ understanding of the financial statements.Which of the following is correct?
 - (a) (i), (iii)
 - (b) (ii), (iii)
 - (c) (i), (ii)
 - (d) (i), (ii) and (iii)



Ans: (d)

2. When expressing an unmodified opinion on financial statements, SAM & Company used the following phrase:

“In our opinion, the accompanying financial statements give a true and fair view of [...] in accordance with [the applicable financial reporting framework].”

Which is the other phrase which is regarded as being equivalent to the above phrase and could also be used by SAM & Company? (Chapter 8.1- SA 700- Forming an Opinion and Reporting on Financial Statements)

- (a) In our opinion, the accompanying financial statements give a true and correct view of [...] in accordance with [the applicable financial reporting framework];
- (b) In our opinion, the accompanying financial statements present correctly, in all material respects, [...] in accordance with [the applicable financial reporting framework];
- (c) In our opinion, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [the applicable financial reporting framework];
- (d) In our opinion, the accompanying financial statements give a correct and fair view of [...] in accordance with [the applicable financial reporting framework].

Ans: (c)

3. Which of the following statements is not included in the section with the heading “Basis for Opinion” in the Auditor’s Report? (Chapter 8.1- SA 700- Forming an Opinion and Reporting on Financial Statements)

- (a) Audit was conducted in accordance with the Accounting Standards.
- (b) Auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor’s other ethical responsibilities in accordance with these requirements.
- (c) Description of the auditor’s responsibilities under the SAs.
- (d) States whether the auditor believes that the audit evidence the auditor has obtained, is sufficient and appropriate to provide a basis for the auditor’s opinion.

Ans: (a)

4. A paragraph was included in the Auditor’s Report of Health is Wealth Limited that referred to a matter which was appropriately disclosed in the financial statements that, in the auditor’s judgment, was of such importance that it was fundamental to users’ understanding of the financial statements. What is this section of the Auditor’s Report called? (Chapter 8.3- SA 706- Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report)

- (a) Other Matters.
- (b) Emphasis of Matters.
- (c) Key Audit Matters.
- (d) Auditor’s Responsibilities for the Audit of the Financial Statements.

Ans: (b)

5. CA A explained the circumstances to Mr. R in which, when the corresponding figures are presented, auditor’s opinion referred to the corresponding figures. Which of these circumstances did he mention to Mr. R? (Chapter 8.5- SA 710- Comparative Information-Comparing Figures and Comparative Financial Statements)

- (a) If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which a modified opinion has been previously issued.
- (b) If the auditor’s report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is resolved.
- (c) Prior Period Financial Statements are audited by another auditor.
- (d) Prior Period Financial Statements not audited.

Ans: (d)



Rohan is part of an engagement team conducting statutory audit of branch of a nationalized bank. The financial statements to be audited include Balance sheet and Profit & Loss account of the branch drawn up in accordance with Form A and Form B respectively of the Third Schedule to the Banking Regulation Act, 1949. Besides, various advances and other returns are also to be verified as part of audit.

Rohan was part of all audit work pertaining to verification of deposits, advances, income and expenditure of the branch.

While verifying different items of profit and loss account, it was noticed that income included income on account of interest earned and other income.

The team also verified system of branch prior to sanction of advances like verifying creditworthiness of borrower etc. It was also verified whether there exists system for bringing to the notice of higher authorities, accounts which exceed the sanctioned limits or drawing power. Besides, the team also verified whether there exists a system for review of operations in accounts once a year and more frequently in case of large advances. During the course of audit, it was noticed that one advance, consisting of a term loan, having outstanding balance of ₹ 20 crore as on balance sheet date has been guaranteed by Uttar Pradesh government. The interest of term loan has remained overdue for more than 90 days. The branch has classified advance as non-performing asset and made applicable provision and reversed unrealized income. Rohan is perplexed as to whether classification, provisioning and reversal of unrealized income made by branch is proper.

The auditee branch is a CBS branch and uses FINACLE software. The core banking system (CBS) is the set of basic software components that manage the services provided by a bank to its customers through its branches. The bank's customers can execute their transactions from any branch, ATM, Service Outlets, Internet, Phone at their disposal. It helps banks to reduce risk that can result from manual data entry and out of date information. It also helps banks to improve service delivery quality and time to its customer. The software is accessed from different branches of bank via communication lines like telephones, satellite, internet, etc.

The engagement team has kept record of audit documentation in accordance with SA 230.

1. Which of the following does not constitute "Other income" in the profit and loss account of branch of a bank?

- (a) Discount on Bills purchased
- (b) Commission on Bills sent for collection
- (c) Loan processing fees
- (d) Credit card fees

Ans: (a)

2. Identify what the engagement team is trying to do in respect to advances of the branch.

- (a) The engagement team is carrying out analytical procedures in respect of advances.
- (b) The engagement team is carrying out substantive procedures in respect of advances.
- (c) The engagement team is evaluating internal control over advances.
- (d) The engagement team is trying to select samples for verification of advances.

Ans: (c)

3. Considering state government guaranteed advance of ₹20 crore and its NPA classification made by branch, which of the following statements is most appropriate?

- (a) The branch has correctly classified account as NPA and has rightly made provisioning and reversal of unrealized income in this regard. Uttar Pradesh government guarantee has no effect on provisioning and income recognition.
- (b) The branch has correctly classified account as NPA and has rightly made provisioning. However, unrealized income should not have been reversed due to Uttar Pradesh government guarantee.
- (c) The branch should have classified account as Standard asset due to Uttar Pradesh government guarantee without having recourse to provisioning and reversal of unrealized income.
- (d) The branch should have classified account as Standard asset due to Uttar Pradesh government guarantee. No provisioning is required. However, for purposes of income recognition, it should be treated as NPA and unrealized income should be reversed.

Ans: (a)



4. The branch is operating in CBS environment. In view of above, which of the following statements is most appropriate?

- (a) Due to CBS environment, substantive procedures alone are effective to reduce audit risk to an acceptably low level.
- (b) In CBS environment, in most situations, the auditors' ability to reduce audit risk to an acceptably low level would be affected by the internal control systems established by the management.
- (c) The extensive use of IT systems in CBS environment substantially reduces need to assess inherent and control risks.
- (d) Low level of branch staff sensitisation to the control expectations of management requires fewer audit procedures.

Ans: (b)

5. With regards to audit documentation, consider the following: -

- (P) NOC from previous auditor
- (Q) Management certified trial balance of branch for year under consideration
- (R) KYC verification details
- (S) Latest RBI master directions/circulars

Which of the following statements is correct as regards to audit documentation?

- (a) Only documents stated at Q and R form part of audit documentation.
- (b) Only documents stated at Q, R and S form part of audit documentation.
- (c) Only documents stated at Q and S form part of audit documentation.
- (d) All documents stated at P, Q, R and S form part of audit documentation.

Ans: (d)



VIVITSU
STRIVING TOWARDS KNOWLEDGE



Best Tea House is a Co-operative society formed as per the provisions of the Co-operative Societies Act, 1912. It runs a chain of restaurants serving mainly tea and snacks in Delhi. RAS & Associates, a Chartered Accountant firm, has been appointed to conduct the statutory audit of the society. None of the partners of the firm, CA R, CA A and CA S have ever conducted a Co-operative Society audit before and so familiarise themselves with the provisions of the particular Act governing the society before starting the audit.

During the audit, Best Tea House informs the auditors that they have been in operation for the last five years, and no audit was required earlier since their turnover had not exceeded the prescribed limit.

While examining the books of account of Best Tea House, RAS & Associates notice that as stated under section 43(h) of the Central Act, certain rules were framed prescribing the books and accounts to be kept by Best Tea House.

The auditors also understand that 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 a certain percentage of the total number of shares or of the value of shareholding to a specified amount. RAS & Associates were concerned with this provision so as to watch any breach relating to holding of shares.

While examining the loans of Best Tea House, the auditors notice that the society has given a loan to a relative named Mr. P, of a member of the society, Mr. T, of an amount not exceeding ₹ 1000.

RAS & Associates examined the overdue debts and checked its classification which they are required to report. During the audit, RAS & Associates notice few transactions for personal profiteering by members of the management committee, which are ultimately detrimental to the interest of the society. RAS & Associates report this matter to the required authority to take necessary action.

After the conclusion of the audit, in addition to the audit certificate in the prescribed form and various schedules, RAS & Associates also answered two sets of questionnaires called audit memos. The auditors also submitted the audit report in a narrative form addressed to the Chairman of the society which was divided into two parts styled as part I and part II.

Based on the above information, answer the following questions:

1. According to section 5 of the Central Act, what is maximum percentage of the total number of shares and what is the maximum value of shareholding that RAS & Associates were concerned with, so as to watch any breach relating to holding of shares?

- (a) Twenty-five percent of the total number of shares or of the value of shareholding upto ₹ 5,000
- (b) Twenty percent of the total number of shares or of the value of shareholding upto ₹ 5,000
- (c) Twenty-five percent of the total number of shares or of the value of shareholding upto ₹ 1,000
- (d) Twenty percent of the total number of shares or of the value of shareholding upto 1,000.

Ans: (d)

2. As per Section 29 of the Central Act, Best Tea House cannot give a loan to any person other than:

- (a) A member and with the special sanction of the Registrar, relatives of the member not exceeding an amount of ₹ 1000.
- (b) A member and with the special sanction of the Registrar, another registered society.
- (c) A member and with the special sanction of the Registrar, relatives of the member.
- (d) A member and with the special sanction of the Registrar, another registered society not exceeding an amount of ₹ 1000.

Ans: (b)

3. Overdue debts for a period from _____ to _____ and more than were classified and reported by RAS & Associates.

- (a) 3 months to 6 months and more than 6 months.
- (b) 6 months to 3 years and more than 3 years.
- (c) 6 months to 5 years and more than 5 years.
- (d) 3 months to 5 years and more than 5 years.

Ans: (c)



4. To whom does RAS & Associates report the few transactions noticed during audit?

- (a) Registrar of Co-operative Societies
- (b) Secretary of Best Tea House.
- (c) State Government
- (d) Management Committee of Best Tea House

Ans: (a)

5. Mistakes having an impact on the profitability of society were pointed out by RAS & Associates as it had a consequential effect on the financial position of society. In which of the following submissions was this information included?

- (a) Part I of the audit report
- (b) Part II of the audit report
- (c) Schedules to the audit report
- (d) Audit memos

Ans: (b)



VIVITSU
STRIVING TOWARDS KNOWLEDGE



GHB Ltd., a listed company, having its registered office at New Delhi, is in the business of blending, processing, packing and selling various brands of Tea. BPP & Co. LLP, Chartered Accountants, are appointed as the statutory auditors of the company for the financial year 2023-24, CA B is the engagement partner for the assignment.

The company has a centralised warehouse near the border of Himachal Pradesh. CA B's attendance, on 31 March, 2024, at the physical inventory counting in aspect of the said warehouse became impracticable on account of natural calamity in that area. It also became impossible for CA B to perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory.

The company had spent huge amount on employee benefits. Hence, CA B instructed his assistants to test the controls that the company had set around the employee benefit expenses. After being satisfied with the controls maintained by the company, he instructed his team to bifurcate the employee benefit expenses into salaries and wages, contribution to PF, expenses on ESOP/ ESPP and staff welfare expenses. The engagement partner CA B, while evaluating, validating and reporting on the design and efficiency of internal financial controls at GHB Ltd., also impressed upon the directors, independent directors and the audit committee the way in which the Companies Act, 2013 has placed a greater emphasis on the effective implementation and reporting on the internal controls of a company.

Due to time constraints, CA B is under pressure to issue a clean report in the limited time frame. He has insufficient time to properly perform or complete the relevant duties and issue appropriate audit report. The Board of Directors want CA B to certify the debtors to be sent to the bank without checking. CA B agrees, as most of the professional income of BPP & Co. LLP comes from GHB Ltd. They have undue dependence on the fees from GHB Ltd. hence; they are concerned about losing the engagement.

Based on the above facts, answer the following Q. Nos. 1 to 5.

1. Since it became impracticable for CA B, on 31 March, 2024, to attend physical inventory counting at the warehouse and also became impossible to perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and conditions of inventory, CA B shall: (Chapter 4.4: SA 501- Audit Evidence-Specific Considerations for Selected Items)
- Take Management Representation regarding the existence and valuation of inventory and mention in Emphasis of Matter paragraph.
 - Rely on GHB Ltd.'s perpetual inventory records as audit evidence and express unmodified opinion.
 - Omit altogether the audit procedure of physical inventory counting from the audit programme because of impracticability.
 - Modify the opinion in the auditor's report in accordance with SA 705 as a result of the scope limitation.
- Ans : (d)**

2. Which assertion concerning the bifurcation of employee expenses into various heads is being verified by CA B? (Chapter 4.1: SA 500- Audit Evidence)
- Occurrence
 - Measurement
 - Completeness
 - Disclosures
- Ans : (d)**

3. With reference to reporting on the internal financial controls system under the Companies Act, 2013, which of the following does not fall within the nature of responsibility of GHB Ltd? (Chapter 3: Risk Assessment and Internal Control)
- In accordance with the terms of reference specified in writing by the Board, act of every audit committee to include evaluation of internal financial controls and risk management systems.
 - Directors' responsibility statement to 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.
 - Board of Directors have to appoint an expert to state that the internal financial controls of the company are commensurate with the size and nature of its business.



- (d) In terms of code for Independent Directors, independent directors to get themselves satisfied that financial controls and systems of risk management are robust and defensible.

Ans : (c)

4. Due to tight deadlines, CA B has insufficient time to properly perform or complete the relevant duties and he has to sign off clean audit report. Which fundamental principle governing professional ethics is disregarded by him? (Chapter 11.1: Ethics)

- (a) Professional competence and due care
- (b) Professional behaviour
- (c) Integrity
- (d) Objectivity

Ans : (a)

5. Undue dependence on the fees from GHB Ltd. creates which threat of independence for the auditors? (Chapter 11.1: Ethics)

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

Ans : (c)



VIVITSU
STRIVING TOWARDS KNOWLEDGE