

CA Inter

Auditing and Assurance

Paper-6

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AIR 19



Aman Mahajan
CA Inter Dec-21

AIR 33



Sundar B
CA Inter Dec-21

AIR 49



Ria Gupta
CA Inter May-22

What Our Students have to Say...

Aman Mahajan (CA AIR 19)

I really liked your classes, especially the practical linkages explained with amazing graphics. The full subject test series helped a lot in improving my writing speed and presentation skills.

Sundar Sri Renganathan B (AIR 33)

I took Accounting from IndigoLearn and the classes were really good. They emphasized on conceptual clarity over getting things done quickly, which is really vital to score good marks in practical papers. Other resources like Notes, Quizzes and Forum was beneficial too.

Dwarakesh

Thank you IndigoLearn team for the guidance and support throughout the past few months. I had great conceptual clarity in all the subjects and the revision classes by Suraj Sir were very helpful. Study planner and Free resources were very useful. Thank you Team IndigoLearn.

Yug Manoj Kumar Bhattad

I have cleared my CA Foundation examination with the total of 286. And this was not possible without the efforts and support of IndigoLearn. The way of teaching with utmost conceptual clarity is the best thing at IndigoLearn.

Prakash Bhatt

Superb, one stop solution for All CA and Accountancy students they serve real Education at very very reasonable price

Naveen Kumar S

Good experience, unlimited views helped a lot in last one month preparation. Looking forward for

Bhagyasree Chougule

It was only because of IndigoLearn that my concepts became very clear, and I was able to crack the exam. I wasn't 100% prepared I needed more practice but luckily I got through. I'm definitely choosing IndigoLearn for group 2 preparation. A big thanks!

Mohd Thayyab

Theoretical subjects made easier through story based examples and charts. Concept clarity 100%. Fully exam+practical oriented classes will help not only to retain the concepts during exams but for the longer duration.

Lalit Chetan Sanpal

IndigoLearn has been fantastic and brilliant. Helped me a lot in my preparations. I cleared both the groups in first attempt with your brilliant classes and notes. Thanks to all the faculties, coordinators, forum admins and everyone at IndigoLearn. Really grateful. Will go for CA Finals at IndigoLearn For sure. Thank you so much IndigoLearn.

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Abishek M

I'd like to thank IndigoLearn for all the support they've provided me with. Modules were great. They were time saving and straight to the point. I extensively used the materials provided before exams, they were so helpful. Also I'd appreciate them for providing unlimited views as I kept looking into the maths modules till the end.

Munnur Nandini Sree

Accounting classes I have taken from IndigoLearn. Now I feel that it's a great choice that I have made (after seeing my result) because only in Accounting I got exemption. Thank you IndigoLearn.

Harshita G

Thank u so much IndigoLearn for your guidance. This is only possible because of u people.... For my finals also my journey will continue with IndigoLearn.

Bharathsha PS

I purchased Economics, IT, FM, EIS and Audit from IndigoLearn. All your classes are superb and anyone can easily crack the CA exams. What makes u special is your classes help us to understand the concepts very well. Special thanks to the FM faculty, I studied only 2 chapters in economics, and still managed to score exemption in the 8th paper.

Nayi Mihir kumar

This platform is very helpful in all activity like mcq practise, notes, teaching activities, revisions and the forum interaction with all students which I like the most. If anybody want to clear their exams in first attempt then IndigoLearn is the best platform for them. My all regards to IndigoLearn. Thank you so much.

Rajalaxmi CA Inter

Can't believe I cleared. Sathya Sir, Suraj Sir, Yogita Mam ... thanks to all my faculties. Basically an Eng student with zero accounts knowledge. Thanks IndigoLearn for making me clear in first attempt.

Priyanka Udeshi

All the faculties have excellent knowledge of the subject and deliver it in very crisp & effective manner. Also, quick response at Forums never let any of my doubts go unresolved no matter how small they were. Thank you once again to all the teachers & staff at IndigoLearn!

Naveen Kumar T

It been a great journey with indigo learn team. Thanks to all the faculties and forum friends who support me a lot.

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Nature, Objective and Scope of Audit

Q1. Nov 2022 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

Historical financial information relates to financial information based on assumptions about occurrence of future events and possible actions by an entity.

Answer

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

Q2. Nov 2022 Exam, 4 marks

CA P is appointed as an auditor of XYZ Limited for the F.Y. 2021-22. The management of XYZ Limited has requested the auditor to change the terms of original engagement as the company has diversified its business and few new products have been introduced by the company. Can CA P agree to the request made by the management? Under which circumstances can the client make a request to the auditor for a change in the terms of engagement?

Answer

Acceptance of a Change in Engagement:

The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, a significant change in nature or size of the entity's business is one of the factors which may make it appropriate to revise the terms of the audit engagement.

In the given situation, XYZ Limited has diversified its business and few new products have also been introduced by the Company which is indicative of significant change in nature or size of the entity's business. In view of above, CA. P can agree to the request made by the management to change the terms of the audit engagement. Therefore, request of Management to change the terms of audit engagement is appropriate.

A request from the client for the auditor to change the engagement may result from-

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

Q3. Dec 2021 Exam, 4 Marks | Sep 22 MTP

CA S is requested to accept the appointment as an auditor of Luck Ltd. With reference to SA 210, what should the auditor determine in order to establish whether the preconditions for an audit are present?

Answer

SA 210 – Agreeing the Terms of Audit Engagements:

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

- (1) Determine whether the financial reporting framework is acceptable; and
- (2) Obtain the agreement of management that it acknowledges and understands its responsibility:
 - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework;
 - (ii) For the internal control as management considers necessary; and
 - (iii) To provide the auditor with:
 - Access to all information such as records, documentation and other matters;

- Additional information that the auditor may request from management for the purpose of the audit; and
- Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Q4. Jul 2021 Exam, 2 Marks

There is a very thin difference between advocacy threats and intimidation threats to an auditor while performing his duty.

Answer

Incorrect: Advocacy threats, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised. e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes.

Intimidation threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

So, it can be concluded that there is not very thin difference between the advocacy threats and intimidation threats.

Q5. Jan 2021 Exam, 2 marks

The Auditor is expected to, reduce audit risk to zero and can therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.

Answer

Incorrect: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit.

Q6. Jan 2021 Exam, 4 marks | May 2019, RTP | May 2020, MTP

Explain the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements in accordance with Code of Ethics issued by ICAI.

Answer

The auditor is subject to relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the Code of Ethics issued by the Institute of Chartered Accountants of India.

The Code establishes the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements and provides a conceptual framework for applying those principles;

- Integrity;
- Objectivity;
- Professional competence and due care;
- Confidentiality; and
- Professional behaviour.

Q7. Nov 19 Exam, 4 Marks | Nov 2020, RTP

As per SA 220 "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. Explain clearly stating the meaning of engagement partner and also the actions of the engagement partner and

appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement.

Answer

As per **SA 220 "Quality Control for an Audit of Financial Statements"**, the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned.

The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise:

(a) The importance to audit quality of:

- (i) Performing work that complies with professional standards and regulatory and legal requirements;
- (ii) Complying with the firm's quality control policies and procedures as applicable;
- (iii) Issuing auditor's reports that are appropriate in the circumstances; and
- (iv) The engagement team's ability to raise concerns without fear of reprisals; and

(b) The fact that quality is essential in performing audit engagements.

Engagement partner refers to the partner or other person in the firm who is responsible for the audit engagement and its performance, and for the auditor's report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.

Q8. Nov 2020 Exam, 2 Marks

Even if law or regulation prescribes sufficient details of the terms of the audit engagement the auditor should record them in a written agreement.

Answer

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

Q9. Nov 2020 Exam, 4 Marks

Describe the guiding principles which the auditor should take into account which serves as the safeguards to eliminate the threats to independence.

Answer

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

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

Q10. May 2019 Exam, 2 Marks

Where the firm is appointed as an auditor of the entity the audit report is signed only in the name of audit firm.

Answer

Incorrect: Where the firm is appointed as the auditor, the rpr/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India along-with registration number for the firm.

Q11. May 2019 Exam, 3 Marks

CA Raj, an engagement partner wants to take decision, regarding acceptance and continuance of an audit engagement. Which informations, he should obtain before accepting an engagement?

Answer

SQC 1 requires the firm to obtain information before accepting an engagement. Information such as the following assists the engagement partner in determining whether the decisions regarding the acceptance and continuance of audit engagements are appropriate:

- (i) The integrity of the principal owners, key management and those charged with governance of the entity
- (ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources.
- (iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and
- (iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

Q12. May 2019 Exam, 3 Marks

"Independence of mind and independence in appearance are interlinked perspectives of Independence of auditors." Explain.

Answer

Independence implies that the judgment of a person is not subordinate to the wishes or direction of another person who might have engaged him. The auditor should be independent of the entity subject to the audit. There are two interlinked perspective of independence of auditors, one independence of mind and two, independence in appearance. The Code of Ethics for Professional Accountants issued by International Federation of Accountants (IFAC) defines the term "Independence" as comprising both-

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

Q13. May 2018 Exam, 2 Marks

An Auditor is considered to lack independence if the partner of the audit firm deals with shares and securities of the audited entity.

Answer

Correct: As per section 141 (3)(d), a person shall not be eligible for appointment as an auditor of a company namely- a person, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. From the above it can be concluded that if the partner deals with shares and securities of the audited entity, he would be lacking independence, hence, disqualified to be appointed as an auditor.

Further, the Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats and if partner of the firm deals with shares and securities of the audited firm then such threat is known as the Advocacy Threats and auditor will be lacking independence.

Q14. May 2018 Exam, 5 Marks

Principal aspects to be considered by an auditor while conducting an audit of final statements of accounts.

Answer

Aspects to be covered in an audit: The principal aspects to be covered in an audit concerning final statements of account are the following:

- (i) **An examination of the system of accounting and internal control** to ascertain whether it is appropriate for the business and helps in properly recording all transactions.
- (ii) **Reviewing the system and procedures** to find out whether they are adequate and comprehensive and incidentally whether material inadequacies and weaknesses exist to allow frauds and errors going unnoticed.
- (iii) **Checking of the arithmetical accuracy of the books of account** by the verification of postings, balances, etc.
- (iv) **Verification of the authenticity and validity of transaction** entered into by making an examination of the entries in the books of accounts with the relevant supporting documents.
- (v) **Ascertaining that a proper distinction has been made between items of capital and of revenue nature** and that the amounts of various items of income and expenditure adjusted in the accounts corresponding to the accounting period.
- (vi) **Comparison of the balance sheet and profit and loss account or other statements with the underlying record** in order to see that they are in accordance therewith.
- (vii) **Verification of the title, existence and value of the assets** appearing in the balance sheet.
- (viii) **Verification of the liabilities** stated in the balance sheet.
- (ix) **Checking the result shown by the profit and loss** and to see whether the results shown are true and fair.
- (x) **Where audit is of a corporate body, confirming that the statutory requirements** have been complied with.
- (xi) **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.

Q15. Nov 2022, RTP

For auditor's opinion, reasonable assurance is an absolute level of assurance.

Answer

Incorrect: Reasonable assurance is a high level but not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

Q16. Nov 2022, RTP | May 2020 RTP

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.

Answer

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 organised 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.

Q17. Nov 2022, RTP | Nov 2020 RTP

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

Answer

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

Professional skepticism includes being alert to, for example:

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

Professional skepticism is necessary to the critical assessment of audit evidence. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud, the SAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

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

Q18. Nov 2022, RTP

The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles. Explain stating clearly personnel issues addressed by such policies and procedures.

Answer

The firm should establish **policies and procedures** designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.

Such policies and procedures address the following personnel issues:

- (a) Recruitment.
- (b) Performance evaluation.
- (c) Capabilities.
- (d) Competence.
- (e) Career development.
- (f) Promotion;
- (g) Compensation; and
- (h) Estimation of personnel needs.

Q19. Nov 2022, RTP

An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so. Explain the circumstances which may contribute towards a request from the client for the auditor to change the engagement.

Answer

An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

A request from the client for the auditor to change the engagement may result from-

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

Q20. May 2022, RTP

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

Answer

The auditor shall comply with relevant ethical requirements, including those pertaining to independence, relating to financial statement audit engagements. Relevant ethical requirements ordinarily comprise the Code of Ethics for Professional Accountants (IESBA Code) related to an audit of financial statements.

First, broadly understand what are ethics? "Ethics" are the principles of conduct governing an individual or group. Professions like law, medicine have their code of ethics. Auditing profession is no exception. Rather, in profession of auditing, importance of ethics is manifold.

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

(a) Integrity

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

(b) Objectivity

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

(c) Professional competence and due care

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

(d) Confidentiality

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

(e) Professional behaviour

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

Q21. May 2022, RTP

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.

Answer

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

Q22. May 2022, RTP

The Code of Ethics for Professional Accountants, prepared by the International Federation of Accountants (IFAC) identifies five types of threats. Explain those threats in detail giving examples.

Answer

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

1. **Self-interest threats**, which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client.

Examples include (i) direct financial interest or materially significant indirect financial interest in a client, (ii) loan or guarantee to or from the concerned client, (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement, (iv) close business relationship with an audit client, (v) potential employment with the client, and (vi) contingent fees for the audit engagement. Like, in case an audit firm unduly relies on fees from a client, it may result in threat to self interest of auditor and he may not work objectively for the fear of losing client.

2. **Self-review threats**, which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are (i) when an auditor having recently been a director or senior officer of the company, and (ii) when auditors perform services that are themselves subject matters of audit.

3. **Advocacy threats**, which occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, e.g. when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes. In such situations, auditor can be perceived as backing and championing causes of auditee client and it may lead to belief that auditor is not acting and working objectively. Remember that auditor has not only to be independent but also appear to be acting so.

4. **Familiarity threats** are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways: (i) close relative of the audit team working in a senior position in the client company, (ii) former partner of the audit firm being a director or senior employee of the client, (iii) long association between specific auditors and their specific client counterparts, and (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees. Provisions in Companies Act, 2013 regarding rotation of auditors mainly address these very familiarity threats.

Such provisions prescribe that auditor is rotated after a certain number of years so that auditors do not become too familiar with their clients.

4. **Intimidation threats**, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees or being threatened with litigation. Such threats attempt to intimidate auditors to deter them from acting objectively.

Q23. Nov 2021, RTP

The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties. Explain.

Answer

The field of auditing as a discipline involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by the auditor on the same. Thus, it is quite logical and natural that the function of audit can be performed if and

only if the person also possesses a good knowledge about the fields in respect of which he is conducting such a review.

The discipline of behavioural science is closely linked with the subject of auditing. While it may be said that an auditor, particularly the financial auditor, deals basically with the figures contained in the financial statements but he shall be required to interact with a lot of people in the organisation. As against the financial auditor, the internal auditor or a management auditor is expected to deal with human beings rather than financial figures. One of the basic elements in designing the internal control system is personnel. However, if a sound internal control structure is designed, it cannot work until and unless the people who are working in the organisation are competent and honest. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties.

Q24. Nov 2021, RTP | May 2021 RTP | Nov 2019 RTP

Discuss a few guiding principles which are behind safeguards to eliminate threats to auditor's independence.

Answer

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

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

Q25. Nov 2021, RTP

The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles. Discuss the personnel issues addressed by such policies and procedures. Also explain how addressing the personnel issues would empower the firm.

Answer

The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.

Such policies and procedures address the following personnel issues:

- (a) Recruitment;
- (b) Performance evaluation;
- (c) Capabilities;
- (d) Competence;
- (e) Career development;
- (f) Promotion;
- (g) Compensation; and
- (h) Estimation of personnel needs.

Addressing these issues enables the firm to ascertain the number and characteristics of the individuals required for the firm's engagements. The firm's recruitment processes include procedures that help the firm select individuals of integrity as well as the capacity to develop the capabilities and competence necessary to perform the firm's work.

Q26. Nov 2021, RTP

There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain giving examples.

Answer

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 organised 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.

Q27. May 2021, RTP

Familiarity threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

Answer

Incorrect: Intimidation threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

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

Q28. May 2021, RTP

The auditor's opinion helps determination of the true and correct view of the financial position and operating results of an enterprise.

Answer

Incorrect: The auditor's opinion helps determination of the true and fair view of the financial position and operating results of an enterprise.

Q29. May 2021, RTP

On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. The auditor may decide not to send a new audit engagement letter or other written agreement each period. Explain the factors an auditor considers to be appropriate to revise the terms of the audit engagement or to remind the entity of existing terms.

Answer

On recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

- Any indication that the entity misunderstands the objective and scope of the audit.
- Any revised or special terms of the audit engagement.
- A recent change of senior management.
- A significant change in ownership.
- A significant change in nature or size of the entity's business.
- A change in legal or regulatory requirements.
- A change in the financial reporting framework adopted in the preparation of the financial statements.
- A change in other reporting requirements.

Q30. May 2021, RTP

Discuss preconditions for an audit as per SA 210. Explain how would an auditor proceed to establish the presence of pre conditions for an audit.

Answer

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.

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

- (a) Determine whether the financial reporting framework is acceptable; and
- (b) Obtain the agreement of management that it acknowledges and understands its responsibility:
 - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework;
 - (ii) For the internal control as management considers necessary; and
 - (iii) To provide the auditor with:
 - Access to all information such as records, documentation and other matters;
 - Additional information that the auditor may request from management for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Q31. May 2021, RTP

Through its policies and procedures, the firm seeks to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Explain the matters to be addressed in this context.

Answer

The firm should establish **policies and procedures** designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances.

Through its policies and procedures, the firm seeks to establish consistency in the quality of engagement performance. This is often accomplished **through written or electronic manuals**, software

tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed include the following:

- How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work.
- Processes for complying with applicable engagement standards.
- Processes of engagement supervision, staff training and coaching.
- Methods of reviewing the work performed, the significant judgments made and the form of report being issued.
- Appropriate documentation of the work performed and of the timing and extent of the review.
- Processes to keep all policies and procedures current.

Q32. Nov 2020, RTP

Both accounting and auditing are closely related with each other. Explain

Answer

Both accounting and auditing are closely related with each other as auditing reviews the financial statements which are nothing but a result of the overall accounting process. It naturally calls on the part of the auditor to have a thorough and sound knowledge of generally accepted principles of accounting before he can review the financial statements. In fact, auditing as a discipline is also closely related with various other disciplines as there is lot of linkages in the work which is done by an auditor in his day-to-day activities. To begin with, it may be noted that the discipline of auditing itself is a logical construct and everything done in auditing must be bound by the rules of logic. Ethical precepts are the basis on which the foundation of the entire accounting profession rests. The knowledge of language is also considered essential in the field of auditing as the auditor shall be required to communicate, both in writing as well as orally, in day-to-day work.

Q33. May 2020, RTP | Oct 2019, MTP, 4 Marks

The person conducting the audit should take care to ensure that financial statements would not mislead anybody. Explain stating clearly the meaning of Auditing.

Answer

“An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.”

Analysis of the Definition

1. Audit is Independent examination of Financial information.
2. of any entity – that entity may be profit oriented or not and irrespective of its size or legal form. For example – Profit oriented – Audit of Listed company engaged in business. On the other hand, Audit of NGO – not profit oriented.
3. The objective of the audit is to express an opinion on the financial statements.

The person conducting this task should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:

- (i) the accounts have been drawn up with reference to entries in the books of account;
- (ii) the entries in the books of account are adequately supported by sufficient and appropriate evidence;
- (iii) none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
- (iv) the information conveyed by the statements is clear and unambiguous;
- (v) the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and
- (vi) the statement of accounts present a true and fair picture of the operational results and of the assets and liabilities.

Q34. May 2020, RTP

Explain the objectives of an Audit as per SA 200.

Answer

As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and
- (b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

Q35. May 2020, RTP

In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters.

Answer

Other Matters that Affect the Limitations of an Audit: In the case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

Q36. Nov 2019, RTP

An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so. Explain stating the factors based on which client can request the auditor to change the engagement.

Answer

An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

A request from the client for the auditor to change the engagement may result from-

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

Q37. Nov 2019, RTP | Nov 2020, RTP

The firm should establish policies and procedures designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements. Explain in the above context the purpose of monitoring compliance with quality control policies and procedures.

Answer

The firm should **establish policies and procedures** designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice.

Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.

The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

- (a) Adherence to professional standards and regulatory and legal requirements;
 - (b) Whether the quality control system has been appropriately designed and effectively implemented; and
 - (c) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.
- Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.

Q38. Nov 2019, RTP

Write a note on "Self-review threats"

Answer

Self-review threats, which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are (i) when an auditor having recently been a director or senior officer of the company, and (ii) when auditors perform services that are themselves subject matters of audit.

Q39. May 2019, RTP

The preparation of financial statements does not involve judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity.

Answer

Incorrect: The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.

Q40. May 2019, RTP

Explain the overall objective of the auditor as contained in SA 200.

Answer

As per **SA-200 "Overall Objectives of the Independent Auditor"**, in conducting an audit of financial statements, the overall objectives of the auditor are:

- (i) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and
- (ii) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

Q41. May 2019, RTP

The IAASB functions as an independent standard-setting body under the auspices of IFAC. Explain stating the objective of IAASB and also how it achieves those objectives.

Answer

Objectives of International Auditing and Assurance Standards Board: In 1977, the International Federation of Accountants (IFAC) was set up with a view to bringing harmony in the profession of accountancy on an international scale. In pursuing this mission, the IFAC Board has established the International Auditing and Assurance Standards Board (IAASB) to develop and issue, in the public interest and under its own authority, high quality auditing standards for use around the world. The IFAC Board has

determined that designation of the IAASB as the responsible body, under its own authority and within its stated terms of reference, best serves the public interest in achieving this aspect of its mission.

The IAASB functions as an independent standard-setting body under the auspices of IFAC. The objective of the IAASB is to serve the public interest by setting high quality auditing standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of practice throughout the world and strengthening public confidence in the global auditing and assurance profession. The IAASB achieves this objective by:

- Establishing high quality auditing standards and guidance for financial statement audits that are generally accepted and recognized by investors, auditors, governments, banking regulators, securities regulators and other key stakeholders across the world;
- Establishing high quality standards and guidance for other types of assurance services on both financial and non-financial matters;
- Establishing high quality standards and guidance for other related services;
- Establishing high quality standards for quality control covering the scope of services addressed by the IAASB; and

Publishing other pronouncements on auditing and assurance matters, thereby advancing public understanding of the roles and responsibility of professional auditors and assurance service providers.

Q42. May 2019, RTP | March 2021, MTP, 4 Marks

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 also the qualities of Auditor.

Answer

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".

Q43. Nov 2018, RTP | Oct 2019 MTP, 3 Marks

The firm's system of quality control should include policies and procedures addressing each element. Explain

Answer

ELEMENTS OF A SYSTEM OF QUALITY CONTROL: The firm's system of quality control should include policies and procedures addressing each of the following elements:

- (a) Leadership responsibilities for quality within the firm.
- (b) Ethical requirements.
- (c) Acceptance and continuance of client relationships and specific engagements.
- (d) Human resources.
- (e) Engagement performance.
- (f) Monitoring.

Q44. Nov 2018, RTP

The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory. Explain.

Answer

The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory, these advantages are given below:

- (a) **It safeguards the financial interest of persons who are not associated with** the management of the entity, whether they are partners or shareholders, bankers, FI's, public at large etc.
- (b) **It acts as a moral check on the employees** from committing defalcations or embezzlement.
- (c) Audited statements of account are **helpful in settling liability for taxes**, negotiating loans and for determining the purchase consideration for a business.
- (d) These are **also useful for settling trade disputes** for higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.
- (e) An audit can also **help in the detection of wastages and losses** to show the different ways by which these might be checked, especially those that occur due to the absence or inadequacy of internal checks or internal control measures.
- (f) **Audit ascertains whether the necessary books of account and allied records have been properly kept** and helps the client in making good deficiencies or inadequacies in this respect.
- (g) As an appraisal function, **audit reviews the existence and operations of various controls in the organisations** and reports weaknesses, inadequacies, etc., in them.
- (h) Audited accounts are of great help in **the settlement of accounts at the time of admission or death of partner**.
- (i) **Government may require audited and certified statement** before it gives assistance or issues a license for a particular trade.

Q45. Nov 2018, RTP

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

Answer

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

(i) **The Nature of Financial Reporting:** The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.

(ii) **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 organised 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.

(iii) **Timeliness of Financial Reporting and the Balance between Benefit and Cost:** The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.

Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.

(iv) **Other Matters that Affect the Limitations of an Audit:** In the case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

Q46. Nov 2018, RTP | MTP Oct 2019, 4 marks

The relationship between auditing and law is very close one. Discuss.

Answer

The relationship between auditing and law is very close one. Auditing involves examination of various transactions from the view point of whether or not these have been properly entered into. It necessitates that an auditor should have a good knowledge of business laws affecting the entity. He should be familiar with the law of contracts, negotiable instruments, etc. The knowledge of taxation laws is also inevitable as entity is required to prepare their financial statements taking into account various provisions affected by various tax laws. In analysing the impact of various transactions particularly from the accounting aspect, an auditor ought to have a good knowledge about the direct as well as indirect tax laws.

Q47. May 2018, RTP

The objective of audit is to obtain absolute assurance and to report on the financial statements.

Answer

Incorrect: As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and
- (b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

Q48. May 2018, RTP

As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. Explain

Answer

Information which assist the Auditor in accepting and continuing of relationship with Client: As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. The following information would assist the auditor in accepting and continuing of relationship with the client:

- (i) The integrity of the principal owners, key management and those charged with governance of the entity;
- (ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
- (iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and
- (iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

Q49. May 2018, RTP

GST & Co., a firm of Chartered Accountants has been appointed to audit the accounts of XYZ Ltd. The partner wanted to cover principal aspects while conducting its audit of financial statements. Advise those principal aspects.

Answer

The principal aspects to be covered in an audit concerning final statements of account are the following:

- (i) **An examination of the system of accounting and internal control** to ascertain whether it is appropriate for the business and helps in properly recording all transactions.
- (ii) **Reviewing the system and procedures** to find out whether they are adequate and comprehensive and incidentally whether material inadequacies and weaknesses exist to allow frauds and errors going unnoticed.
- (iii) **Checking of the arithmetical accuracy of the books of account** by the verification of postings, balances, etc.
- (iv) **Verification of the authenticity and validity of transaction** entered into by making an examination of the entries in the books of accounts with the relevant supporting documents.
- (v) **Ascertaining that a proper distinction has been made between items of capital and of revenue nature** and that the amounts of various items of income and expenditure adjusted in the accounts corresponding to the accounting period.
- (vi) **Comparison of the balance sheet and profit and loss account or other statements with the underlying record** in order to see that they are in accordance therewith.
- (vii) **Verification of the title, existence and value of the assets** appearing in the balance sheet.

Assertions about account balances at the period end:

- (i) Existence—assets, liabilities, and equity interests exist.
- (ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
- (iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded.
- (iv) 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.

(viii) **Verification of the liabilities** stated in the balance sheet.

(ix) **Checking the result shown by the profit and loss** and to see whether the results shown are true and fair.

(x) **Where audit is of a corporate body, confirming that the statutory requirements** have been complied with.

(xi) **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.

Q50. May 2018, RTP

The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Explain.

Answer

Timeliness of Financial Reporting and the Balance between Benefit and Cost: The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive. Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. There is an expectation by users of financial statements that the auditor will form an opinion on the financial statements within a reasonable period of time and at a reasonable cost, recognising that it is impracticable to address all information that may exist or to pursue every matter exhaustively on the assumption that information is in error or fraudulent until proved otherwise.

Q51. May 2018, RTP

"An auditor who before the completion of the engagement is requested to change the engagement to one which provides a lower level of assurance should consider the appropriateness of doing so." Discuss.

Answer

Acceptance of a Change in Engagement: An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement, especially any legal or contractual implications.

If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would

be appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to-

(i) the original engagement; or

(ii) any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.

If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall-

(i) Withdraw from the audit engagement where possible under applicable law or regulation; and

(ii) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

Q52. Oct 2022, MTP, 2 Marks

Confidentiality requires an auditor to be straightforward and honest in all professional and business relationships.

Answer

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

Q53. Oct 2022, MTP, 2 Marks

The Auditor is expected to reduce audit risk to zero and can therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.

Answer

Incorrect: As per **SA 200** "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit.

Q54. March 2022, MTP, 2 Marks

The preparation of financial statements involves judgment by management.

Answer

Correct: The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.

Q55. March 2022, MTP, 4 Marks

As an auditor of XYZ Ltd, how would you consider the acceptance of a change in audit engagement?

Answer

Acceptance of a Change in Engagement:

1. An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.
2. A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or

related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement, especially any legal or contractual implications.

3. If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to:

(1) the original engagement; or

(2) any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.

4. The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.

5. If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

6. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:

(a) Withdraw from the audit engagement where possible under applicable law or regulation; and

(b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

Q56. Nov 2021, MTP, 4 Marks

As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client. Explain stating clearly the information that would assist the auditor in accepting and continuing of relationship with the client.

Answer

Information which assist the Auditor in accepting and continuing of relationship with Client: As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. The following information would assist the auditor in accepting and continuing of relationship with the client:

(i) The integrity of the principal owners, key management and those charged with governance of the entity;

(ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;

(iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and

(iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

Q57. Oct 2021, MTP, 4 Marks

The person conducting the audit should take care to ensure that financial statements would not mislead anybody. Explain

Answer

The person conducting the audit should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:

(i) the accounts have been drawn up with reference to entries in the books of account;

(ii) the entries in the books of account are adequately supported by sufficient and appropriate evidence;

- (iii) none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements;
- (iv) the information conveyed by the statements is clear and unambiguous;
- (v) the financial statement amounts are properly classified, described and disclosed in conformity with accounting standards; and
- (vi) the statement of accounts present a true and fair picture of the operational results and of the assets and liabilities.

Q58. Oct 2021, MTP, 2 Marks | March 2020 MTP, 2 Marks

The auditor is expected to, and can, reduce audit risk to zero and can therefore obtain absolute assurance.

Answer

Incorrect: As per SA 200, the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

Q59. Apr 2021, MTP, 2 Marks

There are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being conclusive rather than persuasive.

Answer

Incorrect: As per SA 200, the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

Q60. Oct 2020, MTP, 2 Marks

The audit engagement letter is sent by the client to auditor.

Answer

Incorrect: As per SA 210 "Agreeing the Terms of Audit Engagements", the Audit engagement letter is sent by the auditor to his client.

Q61. Oct 2020, MTP, 2 Marks

Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur.

Answer

Incorrect: Assertions refer to representations by management that are embodied in the financial statements as used by the auditor to consider the different types of the potential misstatements that may occur.

Q62. Oct 2020, MTP, 2 Marks

There are two interlinked perspectives of independence of auditors, one, independence of mind; and two, independence in appearance. Explain.

Answer

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

“Independence is: (i) Independence of mind – the state of mind that permits the provision of an opinion without being affected by influences allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and

(ii) Independence in appearance – the avoidance of facts and circumstances that are so significant that a third party would reasonably conclude an auditor’s integrity, objectivity or professional skepticism had been compromised.”

Q63. Oct 2022, MTP, 4 Marks

The auditor’s report shall include a section with a heading “Responsibilities of Management for the Financial Statements.” SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain.

Answer

Responsibilities for the Financial Statements: The auditor’s report shall include a section with a heading “Responsibilities of Management for the Financial Statements.”

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

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

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

(ii) Assessing the entity’s ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management’s responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

Q64. Oct 2019, MTP, 2 Marks

It is necessary for the auditor to maintain professional skepticism throughout the audit.

Answer

Correct. As per **SA 200**, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, professional skepticism is 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. Thus, it is necessary for the auditor to maintain professional skepticism throughout the audit.

Audit Strategy, Audit Planning & Audit Programme

Q1. Exam May 2022, 2 marks

Once the audit plan has been drafted and communicated, it is obligatory on the auditor to follow the same.

Answer

Incorrect: The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks. This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures.

Q2. Exam Dec 2021, 4 Marks

M/s TP & Co., a firm of Chartered Accountants, is auditor of KSR Ltd. for many years. KSR Ltd. has diversified their business into newer areas during the last year. The senior member of the audit team handed over the standard audit programme of earlier years to the audit assistants and instructed them to follow the same. The assistants are conducting the audit accordingly. Whether the attitude of the audit assistants is justified or they are required to keep an open mind? Guide them.

Answer

The Assistant Engaged – Be Encouraged to Keep an Open Mind:

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

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

Q3. Exam Jul 2021, 4 Marks

You have been appointed as an auditor of a health care service provider. Briefly discuss the special points that should be kept in mind as an auditor for developing an audit programme.

Answer

The special points to be kept in mind as an auditor for developing an audit programme of healthcare service provider are:

- 1. Register of Patients:** Auditors to 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:** Auditor to 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.

Q4. Exam Nov 2020, 2 Marks

It is not necessary for the auditor to periodically review the audit programme.

Answer

Incorrect: 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.

Q5. Exam Nov 2020, 2 Marks

The audit plan is more detailed than the overall audit strategy.

Answer

Correct: 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. Once the overall audit strategy has been established, an audit plan can be developed to achieve the audit objectives through the efficient use of the auditor's resources.

Q6. Exam Nov 2019, 2 Marks

Under a properly framed audit programme by the auditor, the danger is significantly less and audit can proceed systematically.

Answer

Correct: Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records.

Thus under a properly framed programme, the danger is significantly less and the audit can proceed systematically.

Q7. Exam Nov 2019, 4 Marks | MTP Nov 21

In establishing overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. Elucidate those cases by which auditor can ascertain the reporting objectives of the engagement.

Answer

In establishing the overall audit strategy, auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. The cases by which auditor can ascertain the reporting objectives of the engagement are:

(i) The entity's timetable for reporting, such as at interim and final stages.

- (ii) The organization of meetings with management and those charged with governance to discuss the nature, timing and extent of the audit work.
- (iii) The discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, both written and oral, including the auditor's report, management letters and communications to those charged with governance.
- (iv) The discussion with management regarding the expected communications on the status of audit work throughout the engagement.

Q8. Exam Nov 2019, 4 Marks | Exam May 2019 | RTP May 18

Discuss the points to be considered by auditor for the purpose of constructing an audit programme.

Answer

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

- (i) Stay within the scope and limitation of the assignment.
- (ii) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
- (iii) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
- (iv) Consider all possibilities of error.
- (v) Co-ordinate the procedures to be applied to related items.

Q9. Exam May 2019, 4 Marks | RTP May 20 | RTP Nov 18

Describe how the process of establishing the overall audit strategy assists the auditor in marshalling his human resources.

Answer

The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as:

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

Q10. Exam Nov 2018, 2 Marks

A well designed and drafted audit plan and audit strategy which takes care of all the uncertainties and conditions, need not be changed during the course of audit.

Answer

Incorrect: The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks.

Q11. Exam Nov 2018, 5 Marks | RTP Nov 21 | RTP Nov 19

"An adequate planning benefits the audit of financial statements." Discuss.

Answer

Benefits of Planning in the audit of financial statements: Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:

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

Q12. Exam Nov 2018, 5 Marks | RTP May 21 | RTP Nov 19

"Planning is not a discrete phase of an audit, but rather a continual and iterative process." Discuss.

Answer

Audit Planning- a Continuous Process

Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:

- (i) The analytical procedures to be applied as risk assessment procedures.
- (ii) Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
- (iii) The determination of materiality.
- (iv) The involvement of experts.
- (v) The performance of other risk assessment procedures.

Q13. Exam May 2018, 5 Marks | MTP Oct 20

M & Co. was appointed as auditor of IGI Ltd.. As an auditor what are the factors that would be considered in the development of overall audit plan?

Answer

Development of an Overall Plan: The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit-

- The terms of his engagement and any statutory responsibilities.
- The nature and timing of reports or other communication.
- The applicable legal or statutory requirements.
- The accounting policies adopted by the client and changes in those policies.
- The effect of new accounting or auditing pronouncements on the audit.
- The identification of significant audit areas.
- The setting of materiality levels for audit purposes.
- Conditions requiring special attention, such as the possibility of material error or fraud or the involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
- The degree of reliance he expects to be able to place on accounting system and internal control.
- Possible rotation of emphasis on specific audit areas.

- The nature and extent of audit evidence to be obtained.
- The work of internal auditors and the extent of their involvement, if any, in the audit.
- The involvement of other auditors in the audit of subsidiaries or branches of the client.
- The involvement of experts.
- The allocation of work to be undertaken between joint auditors and the procedures for its control and review.
- Establishing and coordinating staffing requirements.

Q14. RTP Nov 2022 | RTP Nov 21

The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors. Discuss those factors.

Answer

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

- The size and complexity of the entity
- The area of the audit.
- The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work).
- The capabilities and competence of the individual team members performing the audit work.

Q15. RTP Nov 2022

Explain what do you mean by documentation of audit plan. Discuss the purpose served by it and also elaborate the tools used by the auditor to reflect the particular engagement circumstances.

Answer

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

It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance.

The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

Q16. RTP Nov 2022 | RTP May 18 | MTP Oct 22

While developing an audit programme, the auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. Explain stating clearly the points to be kept in mind while developing an audit programme.

Answer

While developing an audit programme, the auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts.

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

- (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.

Q17. RTP May 2022

Engagement Partner CA Hitesh Kapur of Kapur and Associates wanted to develop an audit plan of Sampurna Fabrics Ltd. Discuss the matters to be described in such an audit plan.

Answer

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

- (i) 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".
- (ii) 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".
- (iii) 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.

Q18. RTP May 2022

Without adequate knowledge of client's business, a proper audit is not possible. The auditor shall obtain an understanding of the entity's objectives and strategies, and those related business risks that may result in risks of material misstatement. Explain giving examples.

Answer

Knowledge of the client's business is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

Example

1. If one of management's objectives is to grow the business, management may develop a strategy of steady but regular growth through specific marketing campaigns and development of new markets. Alternatively, management may develop a more aggressive, complex strategy of acquiring competitors. Each of these strategies gives rise to differing business risks and potentially differing risks of material misstatement.
2. Examples of potential business risks include:
 - (i) Failure to keep up to date with new products, technologies or services.
 - (ii) Excessive reliance on a key supplier, product or individual, such as the owner.

- (iii) Lack of personnel with expertise to react to changes in the industry.
- (iv) Insufficient or excessive production capacity caused by inaccurate estimation of demand.
- (v) Loss of financing due to the entity's inability to meet financial covenants

Q19. RTP May 2022 | RTP May 18

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?

Answer

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.

Q20. RTP Nov 2021

What could be considered material for all situations cannot be defined precisely and an amount or transaction material in one situation may not be material in other situation. Explain.

Answer

Materiality is an important consideration for an auditor to evaluate whether the financial statements reflect a true and fair view or not. SA 320 on "Materiality in Planning and Performing an Audit" requires that an auditor should consider materiality and its relationship with audit risk while conducting an audit. When planning the audit, the auditor considers what would make the financial information materially misstated. The auditor's preliminary assessment of materiality related to specific account balances and classes of transactions helps the auditor decide such questions as what items to examine and whether to use sampling and analytical procedures. This enables the auditor to select audit procedures that, in combination, can be expected to support the audit opinion at an acceptably low degree of audit risk. It may be noted that the auditor's assessment of materiality and audit risk may be different at the time of initially planning of the audit as against at the time of evaluating the results of audit procedures.

At the planning stage, the auditor needs to consider the materiality for the financial statements as a whole. The auditor has to carry out a preliminary identification of significant components and material classes of transactions, account balances and disclosure which he plans to examine. What could be considered material for all situations cannot be defined precisely and an amount or transaction material in one situation may not be material in other situation. For example, ₹ 5,000 may be material for a small entity, but even ₹ 100,000 may not be material for a large entity.

Q21. RTP May 2021

Without adequate knowledge of client's business, a proper audit is not possible. It is one of the important principles in developing an overall audit plan. Explain in context with relevant SA, knowledge to be obtained by the auditor in establishing overall plan.

Also explain how such an understanding would be helpful to the auditor.

Answer

Without adequate knowledge of client's business, a proper audit is not possible. It is one of the important principles in developing an overall audit plan. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the following:

(a) Relevant industry, regulatory and other external factors including the applicable financial reporting framework.

(b) The nature of the entity, including:

(i) its operations;

(ii) its ownership and governance structures;

(iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and

(iv) the way that the entity is structured and how it is financed; to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements.

(c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.

(d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

(e) The measurement and review of the entity's financial performance.

In addition to the importance of knowledge of the client's business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations and to make judgements regarding the appropriateness of accounting policies and disclosures.

Q22. RTP Nov 2021

The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, explain the auditor's assumptions about users of the financial statements.

Answer

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

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

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

(iii) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and

(iv) Make reasonable economic decisions on the basis of the information in the financial statements.

Q23. RTP Nov 2021

Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Explain

Answer

Financial reporting frameworks often discuss the concept of materiality in the context of the preparation and presentation of financial statements. Although financial reporting frameworks may discuss materiality in different terms, they generally explain that:

1. Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements;
2. Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and
3. Judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.

Q24. RTP Nov 2020 | MTP May 20

The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors. Explain giving examples.

Answer

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

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

1. The size and complexity of the entity.
2. The area of the audit.
3. The assessed risks of material misstatement

Example

An increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work.

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

Example

We may have identified a problem related to the production process that raised concerns about inventory obsolescence. After obtaining an understanding of the entity's process that raised concerns about inventory obsolescence (which we had identified as a significant class of transactions), we concluded that additional tests of details were required. Therefore, the senior will likely take part, along with the team, in the discussions with management about the provision for obsolescence and examine related documentation supporting the provision, rather than just reading the memo on file. These procedures should be completed as the work is being performed rather than as an after the fact review. The extent of the senior's involvement requires judgement, taking into consideration the complexity of the area and the experience of the team.

Q25. RTP Nov 2020 | RTP Nov 18

The auditor shall document the overall audit strategy, the audit plan and any significant changes made to the overall audit strategy or the audit plan. Explain in detail giving examples.

Answer

The auditor shall document:

- (a) the overall audit strategy;
- (b) the audit plan; and
- (c) any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

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

Example

The auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit.

The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance.

The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

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

Example

The following things should form part of auditor's documentation:

- A summary of discussions with the entity's key decisionmakers.
- Documentation of audit committee pre-approval of services, where required.
- Audit documentation access letters.
- Other communications or agreements with management or those charged with governance regarding the scope, or changes in scope, of our services.
- Auditor's report on the entity's financial statements.
- Other reports as specified in the engagement agreement (e.g., debt covenant compliance letter).

Q26. RTP Nov 2020 | RTP May 19 | RTP May 18 | RTP May 2019

Evolving one audit programme applicable to all business under all circumstances is not practicable. Explain clearly stating in detail the meaning of audit programme.

Answer

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. However, it becomes a necessity to specify in detail in the audit programme the nature of work to be done so that no time will be wasted on matters not pertinent to the engagement and any special matter or any specific situation can be taken care of.

It is desirable that in respect of each audit and more particularly for bigger audits an audit programme should be drawn up. Audit programme is a list of examination and verification steps to be applied and set out in such a way that the inter-relationship of one step to another is clearly shown and designed, keeping in view the assertions discernible in the statements of account produced for audit or on the basis of an appraisal of the accounting records of the client.

Definition : An audit programme consists of a series of verification procedures to be applied to the financial statements and accounts of a given company for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on such statements.

In other words, an audit programme is a detailed plan of applying the audit procedures in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.

Q27. RTP Nov 2020

In most of the assertions much of the evidence be drawn and each one should be considered and weighed to ascertain its weight to prove or disprove the assertion. An auditor picks up evidence from a variety of fields. Analyse and explain with the help of examples.

Answer

In most of the assertions much of the evidence be drawn and each one should be considered and weighed to ascertain its weight to prove or disprove the assertion. In this process, an auditor would be in a position to identify the evidence that brings the highest satisfaction to him about the appropriateness or otherwise of the assertion.

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

- (a) Documentary examination,
- (b) Physical examination,
- (c) Statements and explanation of management, officials and employees,
- (d) Statements and explanations of third parties,
- (e) Arithmetical calculations by the auditor,
- (f) State of internal controls and internal checks,
- (g) Inter-relationship of the various accounting data,
- (h) Subsidiary and memorandum records,
- (i) Minutes,
- (j) Subsequent action by the client and by others.

Example

1. For cash in hand, the best evidence is 'count'
2. For investment pledged with a bank, the banker's certificate.
3. For verifying assertions about book debts, the client's ledger invoices, debit notes, credit notes, monthly accounts statement sent to the customers are all evidence: some of these are corroborative, other being complementary. In addition, balance confirmation procedure is often resorted to, to obtain greater satisfaction about the reliability of the assertion.

The auditor, however, has to place appropriate weight on each piece of evidence and accordingly should prescribe the priority of verification. It is true that in all cases one procedure may not bring the highest satisfaction and it may be dangerous for the auditor to ignore any evidence that is available. By the word "available" we do not mean that the evidence available with the client is the only available evidence. The auditor should know what normally should be available in the context of the transaction having regard to the circumstances and usage.

Q28. RTP May 2020

Plans should be further developed and revised as necessary during the course of the audit. Explain.

Answer

Plans should be further developed and revised as necessary during the course of the audit.

SA-300, "Planning an Audit of Financial Statements" further expounds this principle. According to it, **planning is not a discrete phase of an audit, but rather a continual and iterative process** that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. 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.

Q29. RTP May 2020

Knowledge of the Client's business is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other

external factors including the applicable financial reporting framework. Substantiate with the help of examples.

Answer

Examples are :

- The competitive environment, including demand, capacity, product and price competition as well as cyclical or seasonal activity.
- Supplier and customer relationships, such as types of suppliers and customers (e.g., related parties, unified buying groups) and the related contracts with those entities.
- Technological developments, such as those related to the entity's products, energy supply and cost.
- The effect of regulation on entity operations.

Q30. RTP May 2020

Evidence is the very basis for formulation of opinion and an audit programme is designed to provide for that by prescribing procedures and techniques.

Analyse and explain with the help of example of evidence in respect of Sales.

Answer

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

Example

Sales are evidenced by:

- (i) invoices raised by the client;
- (ii) price list;
- (iii) forwarding notes to client;
- (iv) inventory-issue records;
- (v) sales managers' advice to the inventory section;
- (vi) acknowledgements of the receipt of goods by the customers; and
- (vi) collection of money against sales by the client.

Q31. RTP Nov 2019 | RTP Nov 18

Plans should be made to cover acquiring knowledge of the client's accounting systems, policies and internal control procedures. Explain.

Answer

The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business.

Plans should be made to cover, among other things:

- (a) acquiring knowledge of the client's accounting systems, policies and internal control procedures;
- (b) establishing the expected degree of reliance to be placed on internal control;
- (c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and
- (d) coordinating the work to be performed.

From the above, it is clear that statement given in the question is partly correct.

Q32. RTP Nov 2019 | RTP Nov 18

As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan. Explain.

Answer

The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks. This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures. **For example**, audit evidence obtained through the performance of substantive procedures may contradict the audit evidence obtained through tests of controls.

Q33. RTP May 2019

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. Explain

Answer

Periodic 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.

Example- if the audit programme for the audit of a branch of a financing house, drawn up a number of years ago, fails to take into consideration that the previous policy of financing of a vehicle has been changed to financing of real estate acquisition, the whole audit conducted thereunder would be entirely misdirected and may even result into nothing more than a farce. [Pacific Acceptance Corporation Ltd. v. Forsyth and Others.]

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. However, as a basic feature, 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 unflinchingly 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.

Q34. RTP Nov 2019

Explain the significant points auditor would consider while developing an audit programme.

Answer

Developing the Audit Programme :

- 1. Written Audit Programme:** The auditor should prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.
- 2. Audit objective and instruction to assistants:** The programme may also contain the audit objectives for each area and should have sufficient details to serve as a set of instructions to the assistants involved in the audit and as a means to control the proper execution of the work.
- 3. Reliance on Internal Controls:** In preparing the audit programme, the auditor, having an understanding of the accounting system and related internal controls, may wish to rely on certain internal controls in determining the nature, timing and extent of required auditing procedures. The auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. However, the auditor may decide not to rely on internal controls when there are other more efficient ways

of obtaining sufficient appropriate audit evidence. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts.

4. Timings of performance of audit procedures: The auditor normally has flexibility in deciding when to perform audit procedures. However, in some cases, the auditor may have no discretion as to timing, for example, when observing the taking of inventories by client personnel or verifying the securities and cash balances at the year-end.

5. Audit planning: The audit planning ideally commences at the conclusion of the previous year's audit, and along with the related programme, it should be reconsidered for modification as the audit progresses. Such consideration is based on the auditor's review of the internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures.

Q35. MTP Oct 2022, 2 Marks | MTP Oct 20

A detailed Audit Programme once prepared for a business can be used for all business under all circumstances.

Answer

Incorrect: 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.

Q36. MTP Oct 2022, 2 Marks

If during the audit it appears as though actual financial results are likely to be substantially different from the anticipated period end financial results that were used initially to determine materiality for the financial statements as a whole, the auditor revises that materiality.

Answer

Correct: Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a change in circumstances that occurred during the audit, new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.

Q37. MTP Apr 2022, 3 Marks | MTP Oct 21

You have been appointed as an auditor of MKP Ltd. for the first time. Discuss briefly, the factors to be considered by you while establishing overall audit strategy.

Answer

As per **SA-300**, "Planning an Audit of Financial Statements", 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. In establishing the overall audit strategy, the auditor shall:

- (i) Identify the characteristics of the engagement that define its scope;
- (ii) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
- (iii) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
- (iv) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
- (v) Ascertain the nature, timing and extent of resources necessary to perform the engagement.

Q38. MTP March 2022, 2 Marks

Evolving one audit programme applicable to all business under all circumstances is not practicable

Answer

Correct: 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.

Q39. MTP March 2022, 4 Marks

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

Answer

Some disadvantages are there in the use of audit programme. The disadvantages are:

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

Q40. MTP Nov 2021, 2 Marks

The concept of materiality is an important and relevant consideration for the auditor in financial statement.

Answer

Correct: The concept of materiality is fundamental to the process of accounting. It covers all the stages from recording to classification and presentation. It is very important for the auditor who has constantly to judge whether a particular item is material or not and ensure that a material item is disclosed separately and distinctly.

Q41. MTP Apr 2021, 2 Marks

Audit notes can serve as a guide in framing Audit programme.

Answer

Correct: Audit notes can serve as a guide in framing audit programme in the future as they indicate the weaknesses in the system of the client which specially need to be watched.

Q42. MTP Apr 2021, 3 Marks

"P India Ltd." is a manufacturer of various sports products. The company is having several cases of litigation pending in courts. The auditor wanted to identify litigation and claims, which may give rise to risk of material misstatements. Suggest the audit procedures in the given case.

Answer

The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

- (i) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
- (ii) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and

(iii) Reviewing legal expense accounts. If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel.

Q43. MTP Mar 2021, 2 Marks

The auditor should update and revise the audit plan as and when required, however, the overall audit strategy once established cannot be changed during the course of audit.

Answer

Incorrect: The auditor shall update and change the overall audit strategy and the audit plan as necessary during the course of the audit. As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks.

Q44. MTP Mar 2021, 4 Marks

"The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner." Explain stating the matters to be covered in plans.

Answer

"The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business".

Plans should be made to cover, among other things:

- (i) acquiring knowledge of the client's accounting systems, policies and internal control procedures;
- (ii) establishing the expected degree of reliance to be placed on internal control;
- (iii) determining and programming the nature, timing, and extent of the audit procedures to be performed;
- and
- (iv) coordinating the work to be performed.

Q45. MTP Mar 2021, 4 Marks

TRM Ltd. is a company engaged in manufacture of beauty products. It has hair care segment, skin care segment and kids' beauty products. The auditor wants to obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework. Suggest the audit procedures in the given case.

Answer

The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:

- (1) Obtaining an understanding of the methods used by management in determining segment information. Further,
 - (i) Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and
 - (ii) Where appropriate, testing the application of such methods; and
- (2) Performing analytical procedures or other audit procedures appropriate in the circumstances.

Audit Documentation & Audit Evidence

Q1. Exam Nov 2022, 2 marks

The auditor shall assemble the audit documentation in the audit file and complete the administrative process of assembling the final audit file before the date of the auditor's report.

Answer

Incorrect: 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. 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.

Alternative reason: 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.

Q2. Exam Nov 2022, 4 marks

The objective of auditing is to design and perform audit procedures in such a way as to enable the auditor to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion. This can be obtained by performing which procedures? Name the types of audit procedures the auditor can perform to obtain audit evidence?

Answer

Audit Procedures to Obtain Audit Evidence: Audit evidence to draw reasonable conclusions on which to base the auditor's opinion is obtained by performing:

- (I) Risk assessment procedures; and
- (II) Further audit procedures, which comprise:
 - i. Test of controls, when required by the SAs or when the auditor has chosen to do so; and
 - ii. Substantive procedures, including tests of details and substantive analytical procedures.

Audit procedures to obtain audit evidence can include

- (a) Inspection
- (b) Observation
- (c) External Confirmation
- (d) Recalculation
- (e) Reperformance
- (f) Analytical Procedures
- (g) Inquiry

Q3. Exam May 2022, 4 Marks

P Ltd. is a company from a business group "ABCD" and is engaged in trading of garments. The promoters of the company are promoters and directors of some other group companies also. You have been appointed as an auditor of P Ltd. P Ltd has entered into various inter company transactions (within group companies) during the year which are outside its normal course of business. What will be your duties as an auditor in relation to those transactions?

Answer

Duties of Auditor in identifying Significant Related Party Transactions: For identified significant related party transactions outside the P Ltd.'s normal course of business, the auditor shall:

1. Inspect the underlying contracts or agreements, if any, and evaluate whether:
 - (i) The business rationale (or lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets;
 - (ii) The terms of the transactions are consistent with management's explanations; and
 - (iii) The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and

2. Obtain audit evidence that the transactions have been appropriately authorised and approved.

Q4. Exam May 2022, 3 Marks

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

Answer

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

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

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

Q5. Exam May 2022, 3 Marks

SPR Ltd has been into the media business since 1990. During the F.Y 2021-2022 many notices were received by the company for hurting public sentiments and financial claims were filed against the company. As an auditor of the company, you requested the management for arranging the meeting with the company's external legal counsel. Management is of the view that such meetings are necessary in some certain circumstances only. Can you list down those certain circumstances?

Answer

Circumstances when becoming necessary to meet with external legal counsel: In the given case of SPR Ltd., Auditor requested the management for meeting with SPR's external legal counsel.

In certain circumstances, the auditor also may judge it necessary to meet with the entity's external legal counsel to discuss the likely outcome of the litigation or claims.

This may be the case, for example, where:

- (i) The auditor determines that the matter is a significant risk.
 - (ii) The matter is complex.
 - (iii) There is disagreement between management and the entity's external legal counsel.
- Ordinarily, such meetings require management's permission and are held with a representative of management in attendance.

Q6. Exam May 2022, 4 Marks

CA G, auditor of Sports Ltd., while auditing documented all the papers. He retained some of the documents of the company on which he has not worked along with the documents which were his working papers saying that as he was the auditor of the Company, so he has the right to retain all the documents as he may require them for future references. Comment on the action of the auditor.

Answer

Right of Lien on the Books and Documents of the Company: Under **section 128** of the Act, books of account of a company must be kept at the registered office. These provisions ordinarily make it

impracticable for the auditor to have possession of the books and documents. The company provides reasonable facility to auditor for inspection of the books of account by directors and others authorised to inspect under the Act. Taking an overall view of the matter, it seems that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints. His working papers being his own property, the question of lien, on them does not arise.

In view of above, CA G cannot retain the documents of the company and on which he did not work.

Alternative Solution:

In terms of the general principles of law, any person having the lawful possession of somebody else's property, on which he worked, may has retain the property for non- payment of his dues on account of the work done on the property. On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non- payment of fees, for work done on the books and documents. The Institute of Chartered Accountants in England and Wales has expressed a similar view on the following conditions:

- (i) Documents retained must belong to the client who owes the money.
- (ii) Documents must have come into possession of the auditor on the authority of the client. They must not have been received through irregular or illegal means. In case of a company client, they must be received on the authority of the Board of Directors.
- (iii) The auditor can retain the documents only if he has done work on the documents assigned to him.
- (iv) Such of the documents can be retained which are connected with the work on which fees have not been paid.

In view of above, CA G cannot retain the documents of the company and on which he did not work.

Q7. Exam Dec 2021, 2 marks

When inventory under the custody and control of a third party is material to the financial statements, the auditor can obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by taking written representation from management.

Answer

Incorrect: 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.

Q8. Exam Dec 2021, 2 marks

While auditing the books of accounts of ABC Ltd. The auditor of the company looked at the inventory counting process to obtain audit evidence. In the present case, audit procedure used by the auditor is known as "Inspection".

Answer

Incorrect: The audit procedure used by the auditor of ABC Ltd. is known as "observation". Whereas inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

Q9. Exam Dec 2021, 4 marks

CA K is re-appointed as the auditor of B Ltd. He wants to re-confirm certain matters and has asked the management to give written representations for the same. Under what circumstances can an auditor ask the management to reconfirm its acknowledgement and understanding of responsibilities in written representation?

Answer

Other Written Representation: Other SAs require the auditor to request written representations. If, in addition to such required representations, the auditor determines that it is necessary to obtain one or more written representations to support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements, the auditor shall request such other written representations.

The written representations draw on the agreed acknowledgement and understanding of management of its responsibilities by requesting confirmation that it has fulfilled them. **The auditor, CA K of B Ltd,** may also **ask management of B Ltd** to reconfirm its acknowledgement and understanding of those responsibilities in written representations.

This is particularly appropriate when:

- (i) Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
- (ii) The terms of the audit engagement were prepared in a previous year;
- (iii) There is any indication that management misunderstands those responsibilities; or
- (iv) Changes in circumstances make it appropriate to do so.

Q10. Exam Jul 2021, 4 marks

Documentation of audit plan serves as a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. What all activities in the planning phase should form part of auditor's documentation? State with examples.

Answer

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

Example

The following things should form part of auditor's documentation:

- ❖ A summary of discussions with the entity's key decision makers.
- ❖ Documentation of audit committee pre-approval of services, where required.
- ❖ Audit documentation access letters.
- ❖ Other communications or agreements with management or those charged with governance regarding the scope, or changes in scope, of our services.
- ❖ Auditor's report on the entity's financial statements.
- ❖ Other reports as specified in the engagement agreement (e.g., debt covenant compliance letter).

Q11. Exam Jul 2021, 4 marks

The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report, that requires adjustment of, or disclosure in, the financial statements have been identified. With reference to SA 560, what are the audit procedures included in the auditor's risk assessment?

Answer

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:

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

Q12. Exam Jul 2021, 4 marks

CA Rohit is appointed as an auditor of Grace Ltd., he wants to design a suitable confirmation request letter for a few debtors of Grace Ltd. As a senior auditor of the firm, explain to him with reference to SA 505 "External Confirmation" all the conditions that should be present to use Negative Confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level.

Answer

Negative confirmations is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request. Negative information provide less persuasive audit evidence than positive confirmations. Accordingly, CA Rohit, Auditor of Grace Ltd, shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

- (a) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
- (b) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;
- (c) A very low exception rate is expected; and
- (d) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

Q13. Exam Jan 2021, 2 marks

Sufficiency is the measure of the quantity of audit evidence.

Answer

Correct: 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).

Q14. Exam Jan 2021, 3 marks

Explain the objectives of the auditor regarding written representations.

Answer

The objectives of the auditor regarding written representation:

(i) To obtain written representations

To obtain written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

(ii) To support other evidence

To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations; and

(iii) To respond appropriately

To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.

Q15. Exam Jan 2021, 4 marks

In the context of SA 530 'Audit Sampling', explain the terms 'Sampling Risk' and 'Non- Sampling risk'.

Answer

Sampling Risk. The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

(i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

(ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Non-Sampling Risk. The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

Example

Examples of non-sampling risk include use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognize a misstatement or deviation.

Sources of Non Sampling risk are :

(i) Human Mistakes

(ii) Applying audit procedures not appropriate to the objectives of audit

(iii) Relying on erroneous information e.g. erroneous confirmation

(iv) Misinterpreting the sample results

Non sampling risk can never be mathematically measured.

Q16. Exam Nov 2020, 2 Marks

External confirmation procedures are restricted to the items of addressing assertions associated with account balances & their elements only.

Answer

Incorrect: External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmation need not be restricted to account balances only.

Q17. Exam Nov 2020, 4 Marks

While conducting the audit of Amrit Ltd. the auditor A of ABC and Associates, Chartered Accountants observes that there are a large number of trade receivables standing in the books of account as on 31st March. The auditor wanted to send confirmation request to a few large trade receivables but the management refused the auditor to send confirmation request. How would the auditor proceed?

Answer

In the given case of Amrit Ltd, the auditor wanted to send confirmation request to a few large trade receivables but the management did not want the auditor to send confirmation request.

If the management refuses to allow the auditor to send a confirmation request , the auditor shall-

1. Inquire as to management's reasons for the refusal and seek audit evidence as to their validity and reasonableness.
2. 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
3. Perform alternative audit procedures designed to obtain relevant and reliable evidences.

4. 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 evidences from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260.

The auditor shall also determine the implication for the audit and the auditor's opinion in accordance with SA 705.

Q18. Exam Nov 2020, 3 Marks

RJ Limited is in the business of trading of cycles having Head Office at Delhi and branch at Mumbai. Statutory audit of Head Office was to be done by CA D and statutory audit of branch at Mumbai was to be done by CA M. During the course of audit by CA D at head office, CA D Wanted to visit branch at Mumbai and verify the inventory records at Mumbai. The management of RJ Limited did not allow CA D to visit Mumbai office and verify the inventory records as the branch audit of Mumbai was already being undertaken by another CA M.

In the above situation, discuss the rights available with CA D in terms of the Companies Act, 2013.

Answer

Section 143(1) of the Act provides that the auditor of a company, at all times, shall have a right of access to the books of account and vouchers of the company, whether kept at the registered office of the company or at any other place and he is entitled to require from the officers of the company such information and explanation as he may consider necessary for the performance of his duties as auditor. The right of access is not limited to those books and records maintained at the registered or head office so that in the case of a company with branches, the right also extends to the branch records, if the auditor considers it necessary to have access thereto as per Section 143 (8).

In the given case where CA D was appointed as Statutory Auditor of Head office of RJ Ltd and CA M was appointed to conduct Statutory Audit of Branch office of RJ Ltd., CA D wanted to visit Mumbai Branch to verify the inventory records at Mumbai but management of RJ Ltd did not allow CA D to verify the inventory records at its Mumbai Branch on the ground that branch audit was already being undertaken by another CA M.

Keeping in view the above provisions of the Companies Act and facts of the case, it can be concluded that CA D has a right to visit the branch for verifying inventory records at Mumbai even if the branch accounts are audited by another auditor CA M, if he considers it necessary to do so for the performance of his duties as an auditor.

Q19. Exam Nov 19, 4 Marks

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

Answer

Professional skepticism includes being alert to, for example:

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

Q20. Exam Nov 19, 4 Marks

Discuss the various points which auditor needs to consider in determining whether it is appropriate to use audit evidence about operating effectiveness of controls obtained in previous audit, and if so, the length of the time period that may elapse before retesting.

Answer

In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:

- i. The effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process;
- ii. The risks arising from the characteristics of the control, including whether it is manual or automated;
- iii. The effectiveness of general IT-controls;
- iv. The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affects the application of the control;
- v. Whether the lack of a change in a particular control poses a risk due to changing circumstances; and
- vi. The risks of material misstatement and the extent of reliance on the control.

Q21. Exam May 2019, 2 Marks

Positive Confirmation request is a request where the confirming party respond only if it disagrees with the information provided in the request.

Answer

Incorrect -In Positive confirmation request confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information whereas Negative confirmation request is a request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

Q22. Exam May 2019, 3 Marks | MTP May 2020

"Completion Memorandum" is helpful as part of the audit documentation. Explain.

Answer

Completion Memorandum or Audit Documentation Summary.

The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes-

- (i) the significant matters identified during the audit.
- (ii) how they were addressed.

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

Q23. Exam Nov 2018, 2 Marks

Judgemental matters are transactions that are unusual due to either its size or nature and that therefore occur infrequently.

Answer

Incorrect: Significant risks often relate to significant non-routine transactions or judgemental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgemental matters may include the development of accounting estimates for which

there is significant measurement uncertainty. Thus judgemental matters are not always unusual due to their size or nature.

Q24. Exam Nov 2018, 2 Marks

An auditor is not concerned with consistency of accounting policies relating to opening balances.

Answer

Incorrect: In conducting an initial audit engagement, one of the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

Q25. Exam Nov 2018, 2 Marks

Audit evidence obtained from external confirmation is always reliable.

Answer

Incorrect: The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.

For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity.

Q26. Exam Nov 2018, 5 Marks

M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore he is not required to verify them. Is CA Pankaj correct in his approach?

Answer

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.

Q27. Exam May 2018, 2 Marks

Mr. A is a statutory auditor of ABC Ltd. The branch of ABC Ltd. is audited by Mr. B, another Chartered Accountant. Mr. A requests for the photocopies of the audit documentation of Mr. B pertaining to the branch audit.

Answer

Incorrect: SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

Q28. Exam Nov 2018, 2 Marks

The Audit Engagement documentations should ordinarily be retained by the auditor for minimum of six years from the date of the auditor's report or the date of the group auditor's report, whichever is later.

Answer

Incorrect: 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.

Q29. Exam Nov 2018, 5 Marks

What constitutes a 'true and fair' view, is the matter of an auditor's judgement in the particular circumstances of a case. In order to ensure 'true and fair' view, auditor has to review certain points. Mention any such 5 (five) points in brief.

Answer

True and Fair View: To ensure true and fair view, an auditor has to see:

- (i) that the assets are neither undervalued or overvalued, according to the applicable accounting principles,
- (ii) no material asset is omitted;
- (iii) the charge, if any, on assets are disclosed;
- (iv) material liabilities should not be omitted;
- (v) the profit and loss account and balance sheet discloses all the matters required to be disclosed;
- (vi) accounting policies have been followed consistently; and
- (vii) all unusual, exceptional or non-recurring items have been disclosed separately.

Q30. RTP Nov 2022

CA R comes to know some very critical information with regards to the business cycle of an entity for which he has issued the audit report, which become known to him as an auditor after the date of the auditor's report but which existed at that date and which, if known at that date, might have caused the financial statements to be amended or the auditor to modify the opinion in the auditor's report. He wants to perform additional audit procedures to satisfy himself. As an auditor what he shall document, on the matters arising after the date of audit report?

Answer

As per **SA 230, "Audit Documentation"**, if, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document:

- (i) The circumstances encountered;
- (ii) The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and
- (iii) When and by whom the resulting changes to audit documentation were made and reviewed.

Q31. RTP Nov 2022

The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor to understand significant matters arising during the audit. Explain the above statement and also give examples of significant matters.

Answer

The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include:

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

Q32. RTP Nov 2022

An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. Explain.

Answer

Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively.

Objective examination connotes critical examination and scrutiny of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a true and fair view about the financial results and state of affairs. An opinion founded on a rather reckless and negligent examination and evaluation may expose the auditor to legal action with consequential loss of professional standing and prestige.

He needs evidence to obtain information for arriving at his judgement.

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.

Q33. RTP Nov 2022

Manya Textiles is manufacturer of bed sheets, curtain cloths, other handloom items etc. having its plant at Panipat. Auditors SJ & Co. is having doubts over the reliability of information given to him as audit evidence. Also, auditors observed inconsistent information while conducting audit. Guide the auditor as to how they should proceed in the given situation.

Answer

If:

- (a) audit evidence obtained from one source is inconsistent with that obtained from another; or

(b) the auditor has doubts over the reliability of information to be used as audit evidence, the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.

Q34. RTP Nov 2022 | MTP Apr 22

External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. Apart from confirmations for bank balances and accounts receivables, what are the other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement?

Answer

Other examples of situations where external confirmations may be used include the following:

- Inventories held by third parties at bonded warehouses for processing or on consignment
- Property title deeds held by lawyers or financiers for safe custody or as security
- Investments held for safekeeping by third parties, or purchases from stockbrokers but not delivered at the balance sheet date
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- Accounts payable balances and terms
- Long outstanding share application money.

Q35. RTP May 2022

Written representation from management can be a substitute for other evidence that the auditor could expect to be reasonably available.

Answer

Incorrect: One of the objectives of the written representation is to support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representation. So it is clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available.

Q36. RTP May 2022

While conducting the audit of Pummy Limited, the statutory auditors collected written representations from the Management. The audit was finalized in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, state the importance of inquiry as one of the methods of collecting Audit Evidence.

Answer

Inquiry: As per SA 500 Audit Evidence: -

(i) Inquiry consists of seeking information of knowledgeable persons, financial and non - financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

(ii) Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

(iii) Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's

ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

(iv) In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

Q37. RTP May 2022

GPS & Co, Chartered Accountants, conducting the audit of Pratibha Ltd., a listed company for the year ended 31.03.2022 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GPS & Co wanted to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GPS & Co with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing.

Answer

The auditors, GPS & Co wanted to ensure and obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by obtaining an understanding of the methods used by management in determining segment information. SA 501 guides in this regard. As per SA 501- "Audit Evidence—Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

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

Q38. RTP May 2022

Pachranga International Ltd is manufacturer of pickles, ginger garlic paste, jams etc having its plant at Jaipur. Being in food industry, the company is facing many litigations in various courts across India. Auditors SPV & Co. wants to identify such litigations and claims involving the company which may give rise to risk of material misstatement. Guide the auditor as to how they should proceed for the purpose.

Answer

The auditor SPV & Co. shall design and perform audit procedures in order to identify litigation and claims involving the entity (Pachranga International Ltd) which may give rise to a risk of material misstatement, including:

- (i) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel.
- (ii) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
- (iii) Reviewing legal expense accounts.

Q39. RTP May 2022

TRS & Associates, Chartered Accountants, having completed the audit of Genuine Leathers Ltd has started the assembling of final audit file. TRS & Associates has established policies and procedures for the timely completion of the assembly of audit files. Explain the various aspects related to final audit file discussed in SA 230 giving specific reference to SQC 1, wherever required.

Answer

The auditor TRS & Associates, Chartered Accountants 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.

(i) 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.

(ii) 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.

(iii) 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:

(i) Deleting or discarding superseded documentation.

(ii) Sorting, collating and cross-referencing working papers.

(iii) Signing off on completion checklists relating to the file assembly process.

(iv) 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.

(v) 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.

(vi) 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.

Q40. RTP Nov 2021

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. Discuss the implications for auditor's report if:

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

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

Answer

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:

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

(b) 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.

Q41. RTP Nov 2021

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

Answer

The following are examples of Financial events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern :

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- Indications of withdrawal of financial support by creditors.
- Negative operating cash flows indicated by historical or prospective financial statements.
- Adverse key financial ratios.

Q42. RTP Nov 2021

SA 560, "Subsequent Events" deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements. Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Explain those events and also define subsequent events

Answer

SA 560, "Subsequent Events" deals with the auditor's responsibilities relating to subsequent events in an audit of financial statements.

Financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:

- (a) Those that provide evidence of conditions that existed at the date of the financial statements; and
- (b) Those that provide evidence of conditions that arose after the date of the financial statements.

SA 700 explains that the date of the auditor's report informs the reader that the auditor has considered the effect of events and transactions of which the auditor becomes aware and that occurred up to that date.

Subsequent events refer to events occurring between the date of the financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

Q43. RTP Nov 2021

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

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

Answer

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)

Q44. RTP May 2021

While documenting the nature, timing and extent of audit procedures performed in case of audit of PQR Ltd, explain the important matters its auditor should record.

Answer

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

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

Q45. RTP May 2021

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.

Answer

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:

- (i) Evaluate the competence, capabilities and objectivity of that expert;
- (ii) Obtain an understanding of the work of that expert; and
- (iii) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

Q46. RTP May 2021

When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor has determined that management of XYZ Ltd has already performed a preliminary assessment of the entity's ability to continue as a going concern. Explain how would auditor of XYZ Ltd proceed in the above case.

Also explain how would the auditor proceed if such an assessment has not yet been performed by the management.

Answer

When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern.

In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern, and:

- (i) If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or
- (ii) If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern basis of accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

Q47. RTP May 2021

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. Explain. Also discuss the objectives of an auditor regarding Going concern as per relevant standard on auditing.

Answer

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future.

General purpose financial statements are prepared using the going concern basis of accounting, unless management either

- (i) intends to liquidate the entity or to cease operations,
- (ii) or has no realistic alternative but to do so.

When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

The objectives of the auditor regarding Going Concern are:

- (1) To obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements;
- (2) To conclude, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern; and
- (3) To report in accordance with this SA.

Q48. RTP May 2021

As described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. Explain stating the auditor's responsibilities with regard to going concern.

Answer

The auditor's responsibilities are:

- (1) to obtain sufficient appropriate audit evidence regarding, and conclude on, the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements, and
- (2) to conclude, based on the audit evidence obtained, whether a material uncertainty exists about the entity's ability to continue as a going concern.

However, as described in SA 200, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for future events or conditions that may cause an entity to cease to continue as a going concern. The auditor cannot predict such future events or conditions. Accordingly, the absence of any reference to a material uncertainty about the entity's ability to continue as a going concern in an auditor's report cannot be viewed as a guarantee as to the entity's ability to continue as a going concern.

Q49. RTP Nov 2020 RTP May 2019 | RTP May 2018

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 and also by the quality of such audit evidence. Obtaining more audit evidence, however, may not compensate for its poor quality. Explain also stating the factors affecting auditor's judgment as to sufficiency of audit evidence.

Answer

Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality,

the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. **Auditor's judgement as to sufficiency may be affected by the factors such as:**

(i) Materiality

(ii) Risk of material misstatement

(iii) Size and characteristics of the population.

(a) **Materiality** 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.

(2) **Risk of material misstatement** 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 (a) Inherent risk—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls. (b) Control risk—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control. Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand if assertions have a higher risk of material misstatement, more evidence would be required.

(c) **Size of a population** 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.

Q50. RTP Nov 2020

There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements.

Explain in detail stating clearly the auditor's responsibility in the above context.

Answer

There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements.

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.

The auditor needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude whether the financial statements, insofar as they are affected by those relationships and transactions:

(a) Achieve a true and fair presentation ; or

(b) Are not misleading (for compliance frameworks).

In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether fraud risk factors are present as required by SA 240. This is because fraud may be more easily committed through related parties.

Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs. In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

- ❖ Management may be unaware of the existence of all related party relationships.
- ❖ Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.

Planning and performing the audit with professional skepticism as required by SA200 is therefore particularly important in this context, given the potential for undisclosed related party relationships and

transactions. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions, and in designing audit procedures to respond to the assessed risks.

Q51. RTP Nov 2020

The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. Explain with the help of examples.

Answer

The nature and timing of the audit procedures to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. For example, source documents, such as purchase orders and invoices, may exist only in electronic form when an entity uses electronic commerce, or may be discarded after scanning when an entity uses image processing systems to facilitate storage and reference.

Certain electronic information may not be retrievable after a specified period of time, for example, if files are changed and if backup files do not exist. Accordingly, the auditor may find it necessary as a result of an entity's data retention policies to request retention of some information for the auditor's review or to perform audit procedures at a time when the information is available.

Q52. RTP Nov 2020 | RTP Nov 2018

A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls. Explain and also state when will the auditor design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls.

Answer

Test of controls may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

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

- (a) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or
- (b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

Q53. RTP Nov 2020

When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls. Discuss the matters the auditor may consider in determining the extent of test of controls.

Answer

When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls. Matters the auditor may consider in determining the extent of test of controls include the following:

1. The frequency of the performance of the control by the entity during the period.
2. The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
3. The expected rate of deviation from a control.

4. The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
5. The extent to which audit evidence is obtained from tests of other controls related to the assertion.

Q54. RTP May 2020

Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Explain stating clearly objectives of the auditor regarding written representation.

Answer

Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence.

Written representations are requested from those responsible for the preparation and presentation of the financial statements.

Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.

The objectives of the auditor regarding written representation

The objectives of the auditor are:

(a) To obtain written representations

To obtain written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

(b) To support other evidence

To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations; and

(c) To respond appropriately

To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.

Q55. RTP May 2020

The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report. Explain the auditor's obligation in the above situation.

Answer

The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:

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

Q56. RTP May 2020

The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Explain with the help of at least three examples.

Answer

Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties.

Example

- Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
- Information systems may be ineffective at identifying or summarising transactions and outstanding balances between an entity and its related parties.
- Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.

Q57. RTP May 2020

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests including sending the requests, including follow-up requests when applicable, to the confirming party. Explain the other points as to when using external confirmation procedures, the auditor would be required to maintain control over external confirmation requests.

Answer

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

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

Q58. RTP May 2020

Define the following :

- (i) Positive confirmation request
- (ii) Negative confirmation request
- (iii) Non-response
- (iv) Exception

Answer

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

Negative confirmation request – A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

Non-response – A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.

Exception – A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.

Q59. RTP May 2020

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

Answer

Matters relevant in planning attendance at physical inventory counting include, for example:

- (a) Nature of inventory.
- (b) Stages of completion of work in progress.
- (c) The risks of material misstatement related to inventory.
- (d) The nature of the internal control related to inventory.
- (e) Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting.
- (f) The timing of physical inventory counting.
- (g) Whether the entity maintains a perpetual inventory system.
- (h) The locations at which inventory is held, including the materiality of the inventory and the risks of material misstatement at different locations, in deciding at which locations attendance is appropriate
- (i) Whether the assistance of an auditor's expert is needed.

Q60. RTP Nov 2019 | RTP May 2018

Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. He needs evidence to obtain information for arriving at his judgment. Discuss explaining clearly the detailed meaning of audit evidence.

Answer

Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively.

Objective examination connotes critical examination and scrutiny of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a true and fair view about the financial results and state of affairs. An opinion founded on a rather reckless and negligent examination and evaluation may expose the auditor to legal action with consequential loss of professional standing and prestige.

He needs evidence to obtain information for arriving at his judgment.

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 worksheets 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.

Q61. RTP Nov 2019 | RTP Nov 2018

Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Explain

Answer

Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management's expert. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence.

Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

As explained in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. The sufficiency and appropriateness of audit evidence are interrelated.

Q62. RTP Nov 2019 | RTP Nov 2018 | Exam Nov 2019, 3 Marks

SQC 1 requires firms to establish policies and procedures for the timely completion of the assembly of audit files. Explain

Answer

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.

Q63. RTP Nov 2019

When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. Explain stating also the objective of the auditor regarding going concern.

Answer

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business. Objectives of the auditor regarding going concern

The objectives of the auditor are:

- (a) To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
- (b) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and
- (c) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

Q64. RTP Nov 2019

Discuss the meaning and nature of Audit Documentation.

Answer

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:

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

Q65. RTP Nov 2019

Explain clearly objective of the auditor regarding written representation.

Answer

The objectives of the auditor regarding written representation

The objectives of the auditor are:

(a) To obtain written representations

To obtain written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

(b) To support other evidence

To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations; and

(c) To respond appropriately

To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor.

Q66. RTP May 2019 | Exam Nov 2022, 3 Marks | Mar 21 MTP | RTP May 2021

What do you mean by Audit Documentation? Also explain the nature and purpose of audit documentation.

Answer

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:

- (a) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and
- (b) 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.

Q67. RTP May 2019 | RTP Nov 2020 | MTP Oct 20, 3 Marks

Judging the significance of a matter requires an objective analysis of the facts and circumstances. Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Explain with the help of examples.

Answer

Documentation of Significant Matters and Related Significant Professional Judgments

Judging the significance of a matter requires an objective analysis of the facts and circumstances.

Examples of significant matters include:

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

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

Documentation of the professional judgments made, where significant, serves to explain the auditor's conclusions and to reinforce the quality of the judgment. Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits, when reviewing matters of continuing significance (for example, when performing a retrospective review of accounting estimates).

Some examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment include, where the matters and judgments are significant:

- The rationale for the auditor's conclusion when a requirement provides that the auditor 'shall consider' certain information or factors, and that consideration is significant in the context of the particular engagement.
- The basis for the auditor's conclusion on the reasonableness of areas of subjective judgments (for example, the reasonableness of significant accounting estimates).
- The basis for the auditor's conclusions about the authenticity of a document when further investigation (such as making appropriate use of an expert or of confirmation procedures) is undertaken in response to conditions identified during the audit that caused the auditor to believe that the document may not be authentic.

Q68. RTP May 2019

On the basis of which assumption the financial statements of a company are prepared. Explain. Also describe the objectives of the auditor regarding going concern.

Answer

Going Concern Basis of Accounting

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

Objectives of the auditor regarding going concern are :

- (i) To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
- (ii) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and
- (iii) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

Q69. RTP May 2019

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.

Answer

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:

- (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.

(b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.

(c) 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.

Q70. RTP May 2019

There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements. Analyse and explain stating the responsibility of auditor in this regard.

Answer

Responsibilities of the Auditor

There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements.

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.

The auditor needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude whether the financial statements, insofar as they are affected by those relationships and transactions:

(a) Achieve a true and fair presentation; or

(b) Are not misleading (for compliance frameworks).

In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether fraud risk factors are present as required by SA 240. This is because fraud may be more easily committed through related parties.

Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs. In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

- Management may be unaware of the existence of all related party relationships.
- Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.
- Planning and performing the audit with professional skepticism as required by SA 200 is therefore particularly important in this context, given the potential for undisclosed related party relationships and transactions. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions, and in designing audit procedures to respond to the assessed risks.

Q71. RTP Nov 2018

The form, content and extent of audit documentation depend on factors such as the size and complexity of the entity, the nature of the audit procedures to be performed etc. Explain in detail.

Answer

The form, content and extent of audit documentation depend on factors such as:

1. The size and complexity of the entity.
2. The nature of the audit procedures to be performed.
3. The identified risks of material misstatement.
4. The significance of the audit evidence obtained.

5. The nature and extent of exceptions identified.
6. The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
7. The audit methodology and tools used.

Q72. RTP Nov 2018

Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure. Analyse and explain.

Answer

Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure.

1. This requirement reflects the facts that:
 - (i) the auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement; and
 - (ii) there are inherent limitations to internal control, including management override.
2. Depending on the circumstances, the auditor may determine that:
 - Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level. For example, where the auditor's assessment of risk is supported by audit evidence from tests of controls.
 - Only tests of details are appropriate.
 - A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks.
3. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. SA 520, "Analytical Procedures" establishes requirements and provides guidance on the application of analytical procedures during an audit.
4. The nature of the risk and assertion is relevant to the design of tests of details. For example, tests of details related to the existence or occurrence assertion may involve selecting from items contained in a financial statement amount and obtaining the relevant audit evidence. On the other hand, tests of details related to the completeness assertion may involve selecting from items that are expected to be included in the relevant financial statement amount and investigating whether they are included.
5. Because the assessment of the risk of material misstatement takes account of internal control, the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory.
6. In designing tests of details, the extent of testing is ordinarily thought of in terms of the sample size. However, other matters are also relevant, including whether it is more effective to use other selective means of testing.

Q73. RTP Nov 2018

External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. Analyse and Explain.

Answer

External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements, but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties. External confirmation procedures also may be performed to obtain audit evidence about the absence of certain conditions. For example, a request may specifically seek confirmation that no "side agreement" exists that may be relevant to an entity's revenue cut-off assertion. Other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement include:

- Bank balances and other information relevant to banking relationships.
- Accounts receivable balances and terms.
- Inventories held by third parties at bonded warehouses for processing or on consignment.
- Property title deeds held by lawyers or financiers for safe custody or as security.
- Investments held for safekeeping by third parties, or purchased from stockbrokers but not delivered at the balance sheet date.
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants.

Q74. RTP May 2018

State the significant difficulties encountered during audit with reference to SA-260 (communication with those charged with governance).

Answer

Significant Difficulties Encountered During the Audit: As per SA 260 “Communication with Those Charged with Governance”, significant difficulties encountered during the audit may include such matters as:

- Significant delays in management providing required information.
- An unnecessarily brief time within which to complete the audit.
- Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
- The unavailability of expected information.
- Restrictions imposed on the auditor by management.
- Management’s unwillingness to make or extend its assessment of the entity’s ability to continue as a going concern when requested.

Q75. RTP May 2018

Evaluating responses to inquiries is an integral part of the inquiry process. Explain .

Answer

Inquiry – Audit Procedure to obtain Audit Evidence: Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management’s intent may be limited. In these cases, understanding management’s past history of carrying out its stated intentions, management’s stated reasons for choosing a particular course of action, and management’s ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry. In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries.

Q76. RTP May 2018 | MTP Mar 22, 3 Marks

“Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability”. Explain. Also state clearly generalisations about the reliability of audit evidence.

Answer

Reliability of Audit Evidence: SA 500 on "Audit Evidence" provides that the reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management's expert may lack objectivity. While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:

(1) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.

(2) The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.

(3) Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).

(4) Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).

(5) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

Q77. RTP May 2018

The auditor P of PAR and Co., a firm of Chartered Accountants is conducting audit of AB Industries Ltd. The auditor requests management to provide Banker's certificate in support of Fixed deposits whereas management provides only written representation on the matter.

Analyse how would you deal as an auditor

Answer

Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities, or about specific assertions.

Applying the above to the given problem, the auditor would further request the management to provide him with the Banker's certificate in support of fixed deposits held by the company.

Q78. MTP Oct 2022, 3 Marks

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?

Answer

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:

1. Evaluate the competence, capabilities and objectivity of that expert;
2. Obtain an understanding of the work of that expert; and

3. Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.
4. CA Amar should consider the above before using the work of the management's expert.

Q79. MTP Oct 2022, 2 Marks

Audit evidence obtained through observation of the application of a control is less reliable than audit evidence obtained by inquiry about the application of a control.

Answer

Incorrect: Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).

Q80. Sep 2022, 2 Marks

The auditor shall prepare audit documentation on a timely basis.

Answer

Correct: The auditor shall prepare audit documentation on a timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalised. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

Q81. Sep 2022, 2 Marks

The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation.

Answer

Correct: The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy, and the object of the audit may be altogether lost in the mass of entries and vouchers.

Q82. Apr 2022, MTP, 2 Marks

R Ltd. has asked for email responses for the purpose of external confirmation. The auditor, however, feels that external confirmation received electronically involves the risk of its reliability.

Answer

Correct: SA 505, "External Confirmations", responses received electronically, for example by facsimile or electronic mail, involve risks as to reliability because proof of origin and authority of the respondent may be difficult to establish, and alterations may be difficult to detect. Hence R Ltd. Should avoid using email responses as evidence for external confirmation.

Q83. Nov 2021, MTP, 2 Marks

Intentional errors are most difficult to detect and auditors generally devote greater attention to this type

Answer

Correct: Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.

Q84. Oct 2021, MTP, 2 Marks

Audit evidence obtained from external confirmation is always reliable.

Answer

Incorrect: The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability.

Q85. Oct 2021, MTP, 4 Marks

Audit documentation provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered. Further, it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Explain giving examples.

Answer

Audit documentation provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit. Further, it is unnecessary for the auditor to document separately (as in a checklist, for example) compliance with matters for which compliance is demonstrated by documents included within the audit file. For example:

- The existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- The existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.
- An auditor's report containing an appropriately qualified opinion demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SAs.
- In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
 - **For example**, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
 - Similarly, that the engagement partner has taken responsibility for the direction, supervision and performance of the audit in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussion required by SA 315.

Q86. Mar 2021, MTP, 3 Marks

The working papers of the branch auditor are also the property of the Principal Auditor and the Management of the Company, so they have right to access them. State the relevant SA and comment.

Answer

Ownership of Working Papers: As per SA 230 "Audit Documentation", working papers are the property of the auditor. He may at his discretion, make available portions or extracts from his working paper to his client. The auditor should adopt reasonable procedures for custody and confidentiality of his working papers.

An auditor is not required to provide the management/ clients or other auditors' access to his working papers. Main auditor of the company does not have right of access to the working papers of the branch auditor.

In the case of a company, the main auditor has to consider the report of the branch auditor and has a right to seek clarification and to visit the branch but cannot ask for the copy of working paper and

therefore, the branch auditor is under no compulsion to give photocopies of his working paper to the principal auditor.

From above, it is clear that working papers of the branch auditor are his property only and neither the Principal auditor nor management has right to access that. Therefore, statement given in the question is incorrect.

1FN by IndigoLearn

Risk Assessment and Internal Control

Q1. Exam Nov 2022 Exam, 4 marks

Z Ltd. is a manufacturer of ready-made garments. During the year 2021-22, they have opened two new branches and there is a substantial increase in their sales. The management has appointed CA R to review the internal control system of the company as they feel that there are lapses in the control environment of the company. What is included in the control environment and what will the auditor evaluate in order to obtain an understanding of the control environment?

Answer

Control Environment:

The control environment includes:

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

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

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

Q2. Exam Nov 2022, 3 marks

ABC Ltd. has many divisions and branches across the country. They have an internal control system which is well established maintained by the management on a regular basis. Explain the meaning of internal control as per SA-315 and also state the benefits of understanding the internal controls of a company.

Answer

Meaning and benefits of understanding Internal Control:

Meaning of Internal Control: As per SA-315, "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", the internal control may be defined as "the process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations. The term "controls" refers to any aspects of one or more of the components of internal control."

Benefits of Understanding of Internal Control: An understanding of internal control assists the auditor in:

- i. identifying types of potential misstatements;
- ii. identifying factors that affect the risks of material misstatement, and
- iii. designing the nature, timing, and extent of further audit procedures.

Q3. Exam Mar 2022, 2 Marks

Inappropriate management can override internal controls of any organization.

Answer

Correct: Controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.

Q4. Exam Mar 2022, 2 Marks

Materiality is not a matter of size.

Answer

Incorrect: Financial statements should disclose all 'material items', i.e., the items the knowledge of which might influence the decisions of the user of the financial statement. Materiality is not always a matter of relative size. For example -a small amount lost by fraudulent practices of certain employees can indicate a serious flaw in the enterprise's internal control system requiring immediate attention to avoid greater losses in future. In certain cases, quantitative limits of materiality are specified.

Q5. Exam Mar 2022, 4 Marks

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.

Answer

Improvement in Effectiveness of Internal Control: Internal Audit means "An independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system".

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 non-financial activities of an entity.

Q6. Exam Dec 2021, 2 Marks

Internal control cannot eliminate risk of material misstatements in the financial statements.

Answer

Correct: Control risk is a function of the effectiveness of the design, implementation and maintenance of internal control by management. However, internal control can only reduce but not eliminate risks of material misstatement in the financial statements. This is because of the inherent limitations of internal control.

There is possibility of human errors or mistakes, or of controls being circumvented by collusion. Accordingly, some control risk will always exist.

Q7. Exam Dec 2021, 3 marks

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

Answer

Risk of Material Misstatement – Greater for Significant Non-Routine Transactions:

Significant risks often relate to significant non-routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently.

Risks of Material Misstatement– Greater for Significant Non-Routine Transactions Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

- (a) Greater management intervention to specify the accounting treatment.
- (b) Greater manual intervention for data collection and processing.

(c) Complex calculations or accounting principles.

(d) The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

Keeping in view above, view of Auditor of Sunshine Ltd is correct.

Q8. Exam Jul 2021, 3 marks

In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Explain such assertions or subject matters.

Answer

In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

Q9. Exam Jul 2021, 3 marks

CA L is in the process of finalizing his Risk Assessment Procedures of Effluent Limited which include observation and inspection that may support inquiries of management and others. Discuss few examples of audit procedures which include observation or inspection of the entity's operations.

Answer

Observation and inspection may support inquiries of management and others, and may also provide information about the entity and its environment.

Examples of audit procedures which include observation or inspection of the entity's operations are:

- (1) Documents (such as business plans and strategies), records, and internal control manuals.
- (2) Reports prepared by management (such as quarterly management reports and interim financial statements) and those charged with governance (such as minutes of board of director's meetings)
- (3) The entity's premises and plant facilities.

Q10. Exam Jul 2021, 3 marks

Foreceful Limited is a company dealing in mobile spare parts and having its showrooms in almost all the states in the country. For FY 2020-21, the company transferred its accounts from manual to computerized system (SAP). PQR & Co., Chartered Accountants have specialization in the system audit and have been appointed as the system auditor. PQR & Co., at the end of the audit concludes that there are certain findings or exceptions in IT environment and IT controls of the company which needs to be assessed and reported. Mention those points of consideration.

Answer

At the conclusion of each audit, it is possible that there will be certain findings or exceptions in IT environment and IT controls of the company that need to be assessed and reported to relevant stakeholders including management and those charged with governance viz., Board of directors, Audit committee.

Some points to consider are as follows:

- ❖ Are there any weaknesses in IT controls?
- ❖ What is the impact of these weaknesses on overall audit?
- ❖ Report deficiencies to management – Internal Controls Memo or Management Letter.
- ❖ Communicate in writing any significant deficiencies to Those Charged With Governance.

The auditor needs to assess each finding or exception to determine impact on the audit and evaluate if the exception results in a deficiency in internal control.

Q11. Exam Jan 2021, 2 marks

Determining materiality involves the exercise of professional judgement.

Answer

Correct: 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.

Q12. Exam Jan 2021, 2 marks

The objectives and scope of internal audit functions are restricted to activities relating to evaluation of internal control only.

Answer

Incorrect: As per SA-610, "Using the Work of an Internal Auditor", the objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance.

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.

From the above, it can be concluded that the objective and scope of internal audit function are not restricted to activities relating to evaluation of control only.

Q13. Exam Jan 2021, 4 marks

Explain how Internal Financial Control and Internal controls over financial reporting differ?

Answer

Difference between internal financial control and internal control over financial reporting

Internal Financial Control as per Section 134(5)(e), "the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information."

On the other hand, Internal controls over financial reporting-is required where auditors are required to express an opinion on the effectiveness of an entity's **internal controls over financial reporting**, such opinion is in addition to and distinct from the opinion expressed by the auditor on the financial statements.

Q14. Exam Jan 2021, 3 marks

Discuss the objectives and scope of internal audit functions with respect to activities relating to internal control.

Answer

The objectives and scope of internal audit functions relating to Internal Control are:

(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 non financial activities of an entity.

(iv) 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.

Q15. Exam Nov 2020, 2 Marks

Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates.

Answer

Correct: Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:

- ❖ Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
- ❖ Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

Q16. Exam Nov 2020, 4 Marks

With Ref. to SA 320 "Materiality in planning and performing an audit" Indicate the factors which may effect the identification of an appropriate benchmark while determining materiality for the financial statements as a whole.

Answer

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

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

Q17. Exam Nov 2020, 4 Marks

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.

Answer

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.

Q18. Exam Nov 2020, 3 Marks

What factors are to be considered by an auditor while making control risk assessments?

Answer

Auditor assesses control risk as Rely or Not rely on Controls. When making control risk assessments, the factors an auditor would consider are:

- ❖ The control environment's influence over internal control. A control environment that supports the prevention, detection and correction of material misstatements allows greater confidence in the reliability of internal control and audit evidence generated within the entity.
- ❖ Evaluations of the related IT processes that support application and IT-dependent manual controls.
- ❖ Our testing approach over SCOTs and disclosure processes (i.e., controls reliance or substantive only strategy).
- ❖ The expectation of the operating effectiveness of controls based on the understanding.

Q19. Exam Nov 19, 2 Marks

For an auditor, the Risk assessment procedure provides sufficient appropriate audit evidence to base the audit opinion.

Answer

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

Q20. Exam May 2018, 6 Marks

Briefly discuss the limitations of Internal Control.

Answer

Limitations of Internal Control:

(i) Internal control can provide only reasonable assurance: Internal control, no matter how effective, can provide an entity with only reasonable assurance about achieving the entity's financial reporting objectives. The likelihood of their achievement is affected by inherent limitations of internal control.

(ii) Human judgment in decision-making: Realities that human judgment in decision-making can be faulty and that breakdowns in internal control can occur because of human error.

(iii) Lack of understanding the purpose: Equally, the operation of a control may not be effective, such as where information produced for the purposes of internal control (for example, an exception report) is not effectively used because the individual responsible for reviewing the information does not understand its purpose or fails to take appropriate action.

(iv) Collusion among People: Additionally, controls can be circumvented by the collusion of two or more people or inappropriate management override of internal control. For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled.

(v) Judgements by Management: Further, in designing and implementing controls, management may make judgments on the nature and extent of the controls it chooses to implement, and the nature and extent of the risks it chooses to assume.

(vi) Limitations in case of Small Entities: Smaller entities often have fewer employees due to which segregation of duties is not practicable. However, in a small owner-managed entity, the owner-manager may be able to exercise more effective oversight than in a larger entity. This oversight may compensate for the generally more limited opportunities for segregation of duties.

On the other hand, the owner-manager may be more able to override controls because the system of internal control is less structured. This is taken into account by the auditor when identifying the risks of material misstatement due to fraud.

Q21. Exam May 2018, 5 Marks | MTP Apr 2021, 2 Marks

XYZ & Associates, Chartered Accountants, while evaluating the operating effectiveness of internal controls, detects deviation from controls. In such a situation, state the specific inquiries to be made by an auditor to understand these matters and their potential consequences.

Answer

Evaluating the Operating Effectiveness of Controls: When evaluating the operating effectiveness of relevant controls, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective.

When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

- (a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;
- (b) Additional tests of controls are necessary; or
- (c) The potential risks of misstatement need to be addressed using substantive procedures.

A material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control.

Q22. RTP Nov 2022

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?

Answer

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.

Q23. RTP Nov 2022

Explain the matters which should be included for factors relevant to the auditors' judgement about whether a control is relevant to the audit.

Answer

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

- (i) Materiality.
- (ii) The significance of the related risk.
- (iii) The size of the entity.
- (iv) The nature of the entity's business, including its organisation and ownership characteristics.
- (v) The diversity and complexity of the entity's operations.
- (vi) Applicable legal and regulatory requirements.

- (vii) The circumstances and the applicable component of internal control.
- (viii) The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
- (ix) Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

Q24. RTP Nov 2022

The review of internal controls will enable the auditor to know the areas where control is weak. Explain stating clearly the benefits of evaluation of internal control to the auditor.

Answer

Benefits of Evaluation of Internal Control to the Auditor

The review of internal controls will enable the auditor to know:

- (i) whether errors and frauds are likely to be located in the ordinary course of operations of the business;
- (ii) whether an adequate internal control system is in use and operating as planned by the management;
- (iii) whether an effective internal auditing department is operating;
- (iv) whether any administrative control has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);
- (v) whether the controls adequately safeguard the assets;
- (vi) how far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned;
- (vii) how reliable the reports, records and the certificates to the management can be;
- (viii) the extent and the depth of the examination that he needs to carry out in the different areas of accounting;
- (ix) what would be appropriate audit technique and the audit procedure in the given circumstances;
- (x) what are the areas where control is weak and where it is excessive; and
- (xi) whether some worthwhile suggestions can be given to improve the control system.

Q25. RTP May 2022

Generally, IT benefits an entity's internal control by enabling an entity to enhance the timeliness, availability, and accuracy of information. Discuss explaining the other relevant points in the above context.

Answer

Generally, IT benefits an entity's internal control by enabling an entity to:

- (i) Consistently apply predefined business rules and perform complex calculations in processing large volumes of transactions or data;
- (ii) Enhance the timeliness, availability, and accuracy of information;
- (iii) Facilitate the additional analysis of information;
- (iv) Enhance the ability to monitor the performance of the entity's activities and its policies and procedures;
- (v) Reduce the risk that controls will be circumvented; and
- (vi) Enhance the ability to achieve effective segregation of duties by implementing security controls in applications, databases, and operating systems.

Q26. RTP May 2022

While conducting the audit of Smart TV Ltd, engagement team of HTR& Co, has considered materiality and audit risk throughout the audit. Discuss explaining the meaning of audit risk.

Answer

Audit risk is the risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk. Materiality and audit risk are considered throughout the audit, in particular, when:

- (a) Identifying and assessing the risks of material misstatement;

- (b) Determining the nature, timing and extent of further audit procedures; and
- (c) Evaluating the effect of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report.

Q27. RTP May 2022

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.

Answer

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 non financial 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.

Q28. RTP Nov 2021

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

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

Answer

As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

- (a) Whether the risk is a risk of fraud;
- (b) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;
- (c) The complexity of transactions;
- (d) Whether the risk involves significant transactions with related parties;

- (e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- (f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

Q29. RTP Nov 2021

Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as complex calculations. Also, risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as accounting principles for accounting estimates may be subject to differing interpretation etc. Explain in detail.

Answer

Risks of Material Misstatement- Greater for Significant Non-Routine Transactions

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

- ❖ Greater management intervention to specify the accounting treatment.
- ❖ Greater manual intervention for data collection and processing.
- ❖ Complex calculations or accounting principles.
- ❖ The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

Risks of material misstatement- Greater for Significant Judgmental Matters

Risks of material misstatement may be greater for significant judgmental matters that require the development of accounting estimates, arising from matters such as the following:

- ❖ Accounting principles for accounting estimates or revenue recognition may be subject to differing interpretation.
- ❖ Required judgment may be subjective or complex, or require assumptions about the effects of future events, for example, judgment about fair value.

Q30. RTP Nov 2021

Explain clearly the difference between Internal Financial Control and Internal Controls over financial reporting.

Answer

Internal Financial Control as per Section 134(5)(e), “the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.”

On the other hand, Internal controls over financial reporting-is required where auditors are required to express an opinion on the effectiveness of an entity’s **internal controls over financial reporting**, such opinion is in addition to and distinct from the opinion expressed by the auditor on the financial statements.

Q31. RTP Nov 2021

Auditor’s reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in case of reporting on financial statements prepared under the Act and reported under Section 143. Explain in detail quoting specifically the Law in the above context covering each and every aspect.

Answer

Auditor’s reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in case of reporting on financial statements prepared under the Act and reported under Section 143.

Accordingly, reporting on internal financial controls will not be applicable with respect to interim financial statements, such as quarterly or half-yearly financial statements, unless such reporting is required under any other law or regulation.

Objectives of an auditor in an audit of internal financial controls over financial reporting: The auditor's objective in an audit of internal financial controls over financial reporting is, " to express an opinion on the effectiveness of the company's internal financial controls over financial reporting." It is carried out along with an audit of the financial statements.

Reporting under Section 143(3)(i) is dependent on the underlying criteria for internal financial controls over financial reporting adopted by the management. However, any system of internal controls provides only a reasonable assurance on achievement of the objectives for which it has been established. Also, the auditor shall use the concept of materiality in determining the extent of testing such controls.

Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 requires the board report of all companies to state the details in respect of adequacy of internal financial controls with reference to the financial statements.

The inclusion of the matters relating to internal financial controls in the directors responsibility statement is in addition to the requirement of the directors stating that they have taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the 2013 Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

Q32. RTP May 2021

Auditor GR and Associates have been appointed to conduct audit of PNG Ltd, a manufacturing company engaged in manufacturing of various food items. While planning an audit, the auditors do not think that it would be necessary to understand internal controls. Advise the auditor in this regard explaining clearly the benefits of understanding the internal control.

Answer

The auditor shall obtain an understanding of internal control relevant to the audit. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a matter of the auditor's professional judgment whether a control, individually or in combination with others, is relevant to the audit.

Benefits of Understanding the Internal Control

An understanding of internal control assists the auditor in:

- (i) identifying types of potential misstatements;
- (ii) identifying factors that affect the risks of material misstatement, and
- (iii) designing the nature, timing, and extent of further audit procedures.

Q33. RTP May 2021

Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as materiality, the significance of the related risk etc. Explain in detail.

Answer

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

- ❖ Materiality.
- ❖ The significance of the related risk.
- ❖ The size of the entity.
- ❖ The nature of the entity's business, including its organisation and ownership characteristics.
- ❖ The diversity and complexity of the entity's operations.
- ❖ Applicable legal and regulatory requirements.
- ❖ The circumstances and the applicable component of internal control.
- ❖ The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
- ❖ Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

Q34. RTP May 2021

The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the classes of transactions in the entity's operations that are significant to the financial statements, controls surrounding journal entries etc. Explain the other considerations in this regard.

Answer

The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following are as:

- (a) The classes of transactions in the entity's operations that are significant to the financial statements;
- (b) The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
- (c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions;
- (d) How the information system captures events and conditions that are significant to the financial statements;
- (e) The financial reporting process used to prepare the entity's financial statements;
- (f) Controls surrounding journal entries.

Q35. RTP May 2021

The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the classes of transactions in the entity's operations that are significant to the financial statements, controls surrounding journal entries etc. Explain the other considerations in this regard.

Answer

The auditor shall obtain an understanding of control activities relevant to the audit, which the auditor considers necessary to assess the risks of material misstatement. An audit requires an understanding of only those control activities related to significant class of transactions, account balance, and disclosure in the financial statements and the assertions which the auditor finds relevant in his risk assessment process. Control activities are the policies and procedures that help ensure that management directives are carried out.

Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels.

Examples of specific control activities include those relating to the following:

Control activities that are relevant to the audit are:

- Control activities that relate to significant risks and those that relate to risks for which substantive procedures alone do not provide sufficient appropriate audit evidence; or
- Those that are considered to be relevant in the judgment of the auditor;
- As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk.

Q36. RTP Nov 2020

The risks of material misstatement may exist at the financial statement level and assertion level. Explain the two levels.

Answer

Risks of Material Misstatement at Two levels

The risks of material misstatement may exist at two levels:

(i) The overall financial statement level- Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.

(ii) The assertion level for classes of transactions, account balances, and disclosures-

Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

Q37. RTP Nov 2020 | MTP Sep, 4 Marks

For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall identify risks throughout the process of obtaining an understanding of the entity and its environment. Explain in detail along with other relevant points.

Answer

For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall:

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

Q38. RTP Nov 2020 | MTP Sep 22

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

Explain with the help of examples.

Answer

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.

Q39. RTP Nov 2020

Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Explain in detail.

Answer

Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold.

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

However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures.

Q40. RTP May 2020

When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements. Explain

Answer

Control risk assessment when control deficiencies are identified: When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements.

When control deficiencies are identified and auditor identifies and tests more than one control for each relevant assertion, he evaluates control risk considering all of the controls he has tested. If auditor determines that they support a 'rely on controls' risk assessment, or if compensating controls are identified, tested and evaluated to be effective, he may conclude that the 'rely on controls' is still appropriate. Otherwise we change our control risk assessment to 'not rely on controls.'

When a deficiency relates to an ineffective control that is the only control identified for an assertion, he revises risk assessment to 'not rely on controls' for associated assertions, as no other controls have been identified that mitigate the risk related to the assertion. If the deficiency relates to one WCGW (what can go wrong) out of several WCGW's, he can 'rely on controls' but performs additional substantive procedures to adequately address the risks related to the deficiency.

Q41. RTP May 2020

Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. Analyse and explain giving examples.

Answer

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

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

Q42. RTP May 2020

Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. Explain stating clearly the objectives of Internal Control.

Answer

Objectives of Internal Control

Internal control over safeguarding of assets against unauthorised acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. The auditor's consideration of such controls is generally limited to those relevant to the reliability of financial reporting. For example, use of access controls, such as passwords, that limit access to the data and programs that process cash disbursements may be relevant to a financial statement audit. Conversely, safeguarding controls relating to operations objectives, such as controls to prevent the excessive use of materials in production, generally are not relevant to a financial statement audit.

Objectives of Internal Control are :

- (i) transactions are executed in accordance with managements general or specific authorization;
- (ii) all transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;
- (iii) assets are safeguarded from unauthorised access, use or disposition; and
- (iv) the recorded assets are compared with the existing assets at reasonable intervals and appropriate action is taken with regard to any differences.

Q43. RTP May 2020

It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Explain with the help of example in respect of the procedure for sales.

Answer

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, authorisation, recording and documentation of transaction at each stage through which it flows.

For example, the procedure for sales requires the following:

1. Before acceptance of any order the position of inventory of the relevant article should be known to ascertain whether the order can be executed in time.
2. An advice under the authorisation of the sales manager should be sent to the party placing the order, internal reference number, and the acceptance of the order. This advice should be prepared on a

standardised form and copy thereof should be forwarded to inventory section to enable it to prepare for the execution of the order in time.

3. The credit period allowed to the party should be the normal credit period. For any special credit period a special authorisation of the sales manager would be necessary.

4. The rate at which the order has been accepted and other terms about transport, insurance, etc., should be clearly specified.

5. Before deciding upon the credit period, a reference should be made to the credit section to know the creditworthiness of the party and particularly whether the party has honoured its commitments in the past.

Q44. RTP Nov 2019

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.

Answer

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, authorisation, recording and documentation of transaction at each stage through which it flows.

Q45. RTP Nov 2019

The extent and the nature of the audit programme is substantially influenced by the internal control system in operation. Analyse and explain.

Answer

The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy and the object of the audit may be altogether lost in the mass of entries and vouchers. It is also important for him to know whether the system is actually in operation. Often, after installation of a system, no proper follow up is there by the management to ensure compliance. The auditor, in such circumstances, may be led to

believe that a system is in operation which in reality may not be altogether in operation or may at best operate only partially. This state of affairs is probably the worst that an auditor may come across and he would be in the midst of confusion, if he does not take care.

It would be better if the auditor can undertake the review of the internal control system of client. This will give him enough time to assimilate the controls and implications and will enable him to be more objective in the framing of the audit programme. He will also be in a position to bring to the notice of the management the weaknesses of the system and to suggest measures for improvement. At a further interim date or in the course of the audit, he may ascertain how far the weaknesses have been removed. From the foregoing, it can be concluded that the extent and the nature of the audit programme is substantially influenced by the internal control system in operation. In deciding upon a plan of test checking, the existence and operation of internal control system is of great significance.

A proper understanding of the internal control system in its content and working also enables an auditor to decide upon the appropriate audit procedure to be applied in different areas to be covered in the audit programme.

In a situation where the internal controls are considered weak in some areas, the auditor might choose an auditing procedure or test that otherwise might not be required; he might extend certain tests to cover a large number of transactions or other items than he otherwise would examine and at times he may perform additional tests to bring him the necessary satisfaction.

Q46. RTP Nov 2019

The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". Explain.

Answer

The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

It can be concluded from the above that-

Risk of Material Misstatement = Inherent Risk x Control Risk

Q47. RTP Nov 2019 | RTP May 2018

The auditor of FAST CARS Ltd obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether management has created and maintained a culture of honesty and ethical behaviour and the strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

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

Answer

Control Environment – Component of Internal Control: The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:

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

What is included in Control Environment?

The control environment includes:

- (i) the governance and management functions and
- (ii) the attitudes, awareness, and actions of those charged with governance and management.

(iii) The control environment sets the tone of an organization, influencing the control consciousness of its people.

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

(a) **Communication and enforcement of integrity and ethical values** – These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.

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

(c) **Participation by those charged with governance – Attributes of those charged with governance such as:**

- ❖ Their independence from management.
- ❖ Their experience and stature.
- ❖ The extent of their involvement and the information they receive, and the scrutiny of activities.
- ❖ The appropriateness of their actions, including the degree to which difficult questions are raised and pursued with management, and their interaction with internal and external auditors.

(d) **Management's philosophy and operating style – Characteristics such as management's:**

- ❖ Approach to taking and managing business risks.
- ❖ Attitudes and actions toward financial reporting.
- ❖ Attitudes toward information processing and accounting functions and personnel.

(e) **Organisational structure** – The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed.

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

(g) **Human resource policies and practices** – Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.

Q48. RTP May 2019

Explain the meaning, objectives and scope of internal audit functions as per SA 610. Also discuss who can be appointed as Internal Auditor?

Answer

Who can be appointed as Internal Auditor? As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not), or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies. The internal auditor may or may not be an employee of the company.

Internal audit function: A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.

The objectives and scope of internal audit functions: As per SA-610, "Using the Work of an Internal Auditor", the objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance.

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 following:

1. Activities Relating to Governance: The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

2. Activities Relating to Risk Management: The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk

management and internal control (including effectiveness of the financial reporting process). The internal audit function may perform procedures to assist the entity in the detection of fraud.

3. 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 non financial 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.

Q49. RTP May 2019

IT poses specific risks to an entity's internal control. Explain

Answer

IT also poses specific risks to an entity's internal control, including, for example:

- ❖ Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- ❖ Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
- ❖ The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- ❖ Unauthorised changes to data in master files.
- ❖ Unauthorised changes to systems or programs.
- ❖ Failure to make necessary changes to systems or programs.
- ❖ Inappropriate manual intervention.
- ❖ Potential loss of data or inability to access data as required.

Q50. RTP May 2019 | RTP May 2018

The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. Analyse and explain.

Answer

Satisfactory Control Environment - not an absolute deterrent to fraud:

The existence of a satisfactory control environment can be a positive factor when the auditor assesses the risks of material misstatement. However, although it may help reduce the risk of fraud, a satisfactory control environment is not an absolute deterrent to fraud. Conversely, deficiencies in the control environment may undermine the effectiveness of controls, in particular in relation to fraud. For example, management's failure to commit sufficient resources to address IT security risks may adversely affect internal control by allowing improper changes to be made to computer programs or to data, or unauthorized transactions to be processed. As explained in SA 330, the control environment also influences the nature, timing, and extent of the auditor's further procedures.

The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the

monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement.

Q51. RTP May 2019

So far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal control normally contributes to such assurance. Explain stating clearly the benefits of evaluation of internal control to the auditor.

Answer

So far as the auditor is concerned, the examination and evaluation of the internal control system is an indispensable part of the overall audit programme. The auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal control normally contributes to such assurance. The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operations of these internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

Benefits of Evaluation of Internal Control to the Auditor

The review of internal controls will enable the auditor to know:

- (i) whether errors and frauds are likely to be located in the ordinary course of operations of the business;
- (ii) whether an adequate internal control system is in use and operating as planned by the management;
- (iii) whether an effective internal auditing department is operating;
- (iv) whether any administrative control has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);
- (v) whether the controls adequately safeguard the assets;
- (vi) how far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned;
- (vii) how reliable the reports, records and the certificates to the management can be;
- (viii) the extent and the depth of the examination that he needs to carry out in the different areas of accounting;
- (ix) what would be appropriate audit technique and the audit procedure in the given circumstances;
- (x) what are the areas where control is weak and where it is excessive; and
- (xi) whether some worthwhile suggestions can be given to improve the control system.

Q52. RTP Nov 2018

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. Analyse and Explain.

Answer

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, authorisation, recording and documentation of transaction at each stage through which it flows.

Q53. RTP Nov 2018

A Flow Chart is a graphic presentation of each part of the company's system of internal control. Explain elaborating each and every aspect about flow chart.

Answer

A Flow Chart: It is a graphic presentation of each part of the company's system of internal control. A flow chart is considered to be the most concise way of recording the auditor's review of the system. It minimises the amount of narrative explanation and thereby achieves a consideration or presentation not possible in any other form. It gives bird's eye view of the system and the flow of transactions and integration and in documentation, can be easily spotted and improvements can be suggested.

It is also necessary for the auditor to study the significant features of the business carried on by the concern; the nature of its activities and various channels of goods and materials as well as cash, both inward and outward; and also a comprehensive study of the entire process of manufacturing, trading and administration. This will help him to understand and evaluate the internal controls in the correct perspective.

Q54. RTP Nov 2018

The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. Analyse and explain.

Answer

The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy and the object of the audit may be

altogether lost in the mass of entries and vouchers. It is also important for him to know whether the system is actually in operation. Often, after installation of a system, no proper follow up is there by the management to ensure compliance. The auditor, in such circumstances, may be led to believe that a system is in operation which in reality may not be altogether in operation or may at best operate only partially. This state of affairs is probably the worst that an auditor may come across and he would be in the midst of confusion, if he does not take care.

It would be better if the auditor can undertake the review of the internal control system of client. This will give him enough time to assimilate the controls and implications and will enable him to be more objective in the framing of the audit programme. He will also be in a position to bring to the notice of the management the weaknesses of the system and to suggest measures for improvement. At a further interim date or in the course of the audit, he may ascertain how far the weaknesses have been removed.

From the foregoing, it can be concluded that the extent and the nature of the audit programme is substantially influenced by the internal control system in operation. In deciding upon a plan of test checking, the existence and operation of internal control system is of great significance.

A proper understanding of the internal control system in its content and working also enables an auditor to decide upon the appropriate audit procedure to be applied in different areas to be covered in the audit programme.

In a situation where the internal controls are considered weak in some areas, the auditor might choose an auditing procedure or test that otherwise might not be required; he might extend certain tests to cover a large number of transactions or other items than he otherwise would examine and at times he may perform additional tests to bring him the necessary satisfaction.

Q55. RTP Nov 2018

Auditor's reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in case of reporting on financial statements prepared under the Act and reported under Section 143. Explain stating clearly the auditor's responsibility for reporting on internal financial controls over financial reporting.

Answer

Auditors' Responsibility for Reporting on Internal Financial Controls over Financial Reporting in India

Clause (i) of Sub-section 3 of Section 143 of the Act requires the auditors' report to state whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls.

It may be noted that auditor's reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in case of reporting on financial statements prepared under the Act and reported under Section 143.

Accordingly, reporting on internal financial controls will not be applicable with respect to interim financial statements, such as quarterly or half-yearly financial statements, unless such reporting is required under any other law or regulation.

Objectives of an auditor in an audit of internal financial controls over financial reporting: The auditor's objective in an audit of internal financial controls over financial reporting is, "to express an opinion on the effectiveness of the company's internal financial controls over financial reporting." It is carried out along with an audit of the financial statements.

Reporting under Section 143(3)(i) is dependent on the underlying criteria for internal financial controls over financial reporting adopted by the management. However, any system of internal controls provides only a reasonable assurance on achievement of the objectives for which it has been established. Also, the auditor shall use the concept of materiality in determining the extent of testing such controls.

Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 requires the board report of all companies to state the details in respect of adequacy of internal financial controls with reference to the financial statements.

The inclusion of the matters relating to internal financial controls in the directors responsibility statement is in addition to the requirement of the directors stating that they have taken proper and sufficient care for the maintenance of adequate accounting records in accordance with the provisions of the 2013 Act for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

Q56. RTP May 2018

As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk.

In exercising judgment as to which risks are significant risks, state the factors which shall be considered by the auditor.

Explain the above in context of SA-315.

Answer

Identification of Significant Risks: SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the Entity and its Environment" defines 'significant risk' as an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following-

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

Q57. RTP May 2018

Discuss what is included in risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls.

Answer

Risk assessment procedures to obtain audit evidence about the design and implementation of relevant controls may include-

- ❖ Inquiring of entity personnel.
- ❖ Observing the application of specific controls.
- ❖ Inspecting documents and reports.
- ❖ Tracing transactions through the information system relevant to financial reporting.

Q58. MTP Oct 2022, 3 Marks

Explain what understanding should an auditor obtain regarding an entity's risk assessment process (one of the components of the internal control of the entity).

Answer

The Entity's Risk Assessment Process- Component of Control Environment

The auditor shall obtain an understanding of whether the entity has a process for:

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

The entity's risk assessment process forms the basis for the risks to be managed. If that process is appropriate, it would assist the auditor in identifying risks of material misstatement. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment .

Q59. MTP Oct 2022, 4 Marks

In exercising judgment as to which risks are significant risks, the auditor shall consider various factors. Explain.

Answer

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

- (a) Whether the risk is a risk of fraud;
- (b) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;
- (c) The complexity of transactions;

- (d) Whether the risk involves significant transactions with related parties;
- (e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- (f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

Q60. MTP Apr 2022, Marks

Control environment can prevent, detect and correct a material misstatement.

Answer

Incorrect: The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement.

Q61. MTP Apr 2022, Marks

There is an inverse relationship between detection risks and the combined level of inherent and control risks.

Answer

Correct: There is an inverse relationship between detection risks and the combined level of inherent and control risks. For example, when inherent and control risks are high, acceptable detection risks need to be low to reduce audit risk to an acceptably low level. On the other hand, when inherent and control risks are low, an auditor can accept a higher detection risks and still reduce audit risks to an acceptably low level.

Q62. MTP March 2022, 2 Marks | MTP, Nov 21

The SAs do not ordinarily refer to inherent risk and control risk separately.

Answer

Correct: The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non - quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

Q63. MTP March 2022, 2 Marks

Intentional errors are most difficult to detect and auditors generally devote greater attention to this type

Answer

Correct: Intentional errors are most difficult to detect and auditors generally devote greater attention to this type because out of long and sometimes unfortunate experience, auditors have developed a point of view that, if they direct their procedures of discovering the more difficult intentional errors, they are reasonably certain to locate the more simple and far more common unintentional errors on the way.

Q64. MTP Oct 2021, 3 Marks | MTP Oct 2020

The division of internal control into five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit. Mention those components of internal control.

Answer

Division of Internal Control into Components: The division of internal control into the following five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit:

- (i) The control environment;
- (ii) The entity's risk assessment process;
- (iii) Monitoring of controls.
- (iv) Control activities; and
- (v) The information system, including the related business processes, relevant to financial reporting, and communication;

Q65. MTP Oct 2019, 2 Marks

'Test of Control' may be defined as an audit procedure designed to detect material misstatements at the assertion level

Answer

Incorrect: 'Substantive procedure' may be defined as an audit procedure designed to detect material misstatements at the assertion level whereas 'tests of controls' is an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Q66. MTP Oct 2020, 2 Marks

There is no relation between Inherent risk, Control risk and Detection risk.

Answer

Incorrect: There is an inverse relationship between detection risks and the combined level of inherent and control risks. When inherent and control risks are high, acceptable detection risk needs to be low to reduce audit risk to an acceptably low level. When inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risks to an acceptably low level.

Fraud And Responsibilities Of The Auditor In This Regard

Q1. Exam Nov 2022, 2 marks

As per SA 240, the primary responsibility of an auditor is to detect fraud and error in the financial statements.

Answer

Incorrect: As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.

Q2. Exam Nov 2022, 3 marks

Incorrect: As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.

Answer

Inability of auditor to continue the engagement: If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- (a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and

(c) If the auditor withdraws:

i. Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

ii. Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Q3. Exam May 2022, 2 marks

Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged with proper authorization.

Answer

Incorrect: Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

Q4. Exam May 2022, 4 marks | MTP Oct 21 | RTP Nov 21 | RTP Nov 19

The auditor of RMP Limited has identified a fraud that, in his opinion, causes a material misstatement in the financial statements. Management personnel in higher management cadre are associated with manipulation of accounts of the company. But the auditor has not been able to understand as to why this type of fraud is generally committed. Guide him with some reasons.

Answer

Fraudulent Financial reporting – Manipulation of Accounts: In the given case of RMP Ltd, the auditor identified fraud causing material misstatement in the financial statements. Auditor did not understand the reasons of the type of fraud given in the case of RMP Ltd.

Detection of manipulation of accounts with a view to presenting a false state of affairs is a task requiring great tact and intelligence because generally management personnel in higher management cadre are associated with this type of fraud and this is perpetrated in methodical way. This type of fraud is generally committed:

(1) to avoid incidence of income-tax or other taxes;

(2) for declaring a dividend when there are insufficient profits;

(3) to withhold declaration of dividend even when there is adequate profit (this is often done to manipulate the value of shares in stock market to make it possible for selected persons to acquire shares at a lower cost); and

(4) for receiving higher remuneration where managerial remuneration is payable by reference to profits.

Q5. Exam May 2022, 3 marks

The accountant of CHB Limited observed that amount received from Mr. A has been recorded in the account of Mr. B and this mistake was found at the time of tallying account statement provided by Mr. A. What type of error is this? Can you give two more examples of such error and how the same will be detected?

Answer

Self-Revealing Error:

Situation mentioned in the case is a Self-Revealing Error. These are such errors the existence of which becomes apparent in the process of compilation of accounts.

Below are two more examples of such errors:

(a) Omission to post a part of a journal entry in to the ledger. (Trial Balance is thrown out of agreement) – Statement of account of parties will reveal the mistake.

(b) Wrong totalling of the Purchase register. Control Account (e.g., the Sundry Trade Payables Account) balances and the aggregate of the balance in the personal ledger will disagree.

Alternative Solution:

Errors of Commission: When a transaction has been mis-recorded either wholly or partially it is called as an error of commission. Error of commission can happen in the following ways-

- (i) Errors in posting,
- (ii) Errors in Casting,
- (iii) Errors in carrying forward,
- (iv) Errors occurring during extraction of balances, etc.

The case given in the question is an error of posting.

Posting errors may be of a wrong account, wrong amount or wrong file.

For example,

- (i) Omission of posting of any part of the journal entry – Can be detected through trial balance.
- (ii) Purchase of ₹ 360 from Mr. A posted in his account at ₹ 630 or sales returns from Mr. X posted as the debit of his account – This error can be detected by verifying entries with underlying vouchers.

Errors of posting in the wrong account may be detected by performing external confirmation as an audit procedure.

Q6. Exam Dec 2021, 2 Marks

Reporting of fraud of INR 150 Lakhs by auditor will be done within three days of the fraud coming to the knowledge of the auditor to the Board or the Audit Committee along with remedial action taken.

Answer

Incorrect: The auditor shall 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. Company is bound to disclose remedial action taken in Board's report.

Q7. Exam Dec 2021, 4 Marks

M/s S & Associates are the Statutory Auditors of Real Ltd., a company engaged in the business of manufacturing of garments. The auditor has completed the audit and is in the process of forming an opinion on the financial statements for the F.Y. 2020-2021. CA K, the engagement partner, wants to conclude that whether the financial statements as a whole are free from material misstatements, whether due to fraud or error. What factors he should consider to reach that conclusion?

Answer

Factors to be considered to form an opinion:

The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:

- (a) The auditor's conclusion, in accordance with SA 330, whether sufficient appropriate audit evidence has been obtained
- (b) The auditor's conclusion, in accordance with SA 450, whether uncorrected misstatements are material, individually or in aggregate.
- (c) The evaluations required
 - (i) The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.
 - (ii) This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

Q8. Exam Dec 2021, 4 marks

CA R is the statutory auditor and Mr. P is the cost auditor of DEF Ltd., a company engaged in the production of tyres. Mr. P noticed a fraud of INR 1.25 crores done by the senior manager of the company and immediately informed the audit committee even before CA R was aware of the fraud. State the duty of CA R under section 143(12) of the Companies Act on reporting on frauds already detected and reported.

Answer

Reporting on Frauds already detected and reported:

The auditor, CA R should apply professional skepticism to evaluate/verify that the fraud was indeed identified/detected in all aspects by the management or through the company's vigil/whistle blower

mechanism so that distinction can be clearly made with respect to frauds identified/detected due to matters raised by the auditor vis-à-vis those identified/detected by the company through its internal control mechanism.

Since reporting on fraud under section 143(12) is required even by the cost auditor and the secretarial auditor of the company, it is possible that a suspected offence involving fraud may have been reported by them even before the auditor became aware of the fraud.

Here too, if a suspected offence of fraud has already been reported under section 143(12) by such other person, and the auditor becomes aware of such suspected offence involving fraud, he need not report the same since he has not per se identified the suspected offence of fraud.

However, in case of a fraud which involves or is expected to involve individually, an amount of ₹ 1 crore or more, the auditor should review the steps taken by the management/those charged with governance with respect to the reported instance of suspected offence of fraud stated above, and if he is not satisfied with such steps, he should state the reasons for his dissatisfaction in writing and request the management/ those charged with governance to perform additional procedures to enable the auditor to satisfy himself that the matter has been appropriately addressed. If the management/those charged with governance fail to undertake appropriate additional procedures within 45 days of his request, the auditor would need to evaluate if he should report the matter to the Central Government in accordance with Rule 13 of the Companies (Audit and Auditors) Rules, 2014.

Q9. Exam Jul 2021, 2 marks

Misstatement in the financial statements is always because of a fraud.

Answer

Incorrect: Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Hence misstatement can arise from error or fraud.

Alternative solution: Misstatement refers to a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation or disclosure that is required for the item to be in accordance with the applicable financial reporting frame work. Hence misstatement can arise from error or fraud.

Q10. Exam Jul 2021, 3 marks

List out any three circumstances which induce the management/ employee to commit the fraud.

Answer

Circumstances which induce the management/ employee to commit fraud are :

- ❖ Financial obligations/ Pressure.
- ❖ Management's unrealistic goals.
- ❖ Dissatisfied Employees or Lack of motivation among employees.
- ❖ Name game (eg. management using power of authority by asking employees to do something illegal).
- ❖ Opportunity to commit fraud.

Q11. Exam Jan 2021, 4 marks

CA Raj, an auditor was removed by PQR Ltd. before the expiry of his term. Discuss the procedure to be taken by PQR Ltd to appoint an auditor other than retiring auditor under Sec. 140(4) of the Companies Act, 2013.

Answer

In the given question, CA Raj was removed by PQR Ltd. before the expiry of his term and PQR Ltd wants to appoint an auditor other than retiring auditor i.e CA Raj who was removed.

Section 140(4) lays down procedure to appoint an auditor other than retiring auditor who was removed-

(1) Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or as the case may be, ten years, as provided under sub-section (2) of section 139.

(2) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.

(3) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so,-

(a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and

(b) send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company. and if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting.

Q12. Exam Jan 2021, 3 marks

ABC Limited has a closing balance of work in progress of inventories aggregating ₹ 850 lakhs in their balance sheet as at March 31, 2020.

As Statutory Auditor of ABC Limited, explain various audit procedures which need to be performed to confirm Work-in-progress of inventories have been valued appropriately and as per generally accepted accounting policies and practices.

Answer

Audit procedure which needs to be performed to confirm work in progress worth Rs.850 lakhs has been valued appropriately and as per generally accepted accounting policies and practices is given hereunder :

(1) Ascertain how the various stages of production/ value add are measured and in case estimates are made, understand the basis for such estimates.

(2) Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity.

(3) Ensure that material costs exclude any abnormal wastage factors.

Q13. Exam Nov 2020, 4 Marks

As an auditor of PQR Ltd., you came across a misstatement resulting from fraud or suspected fraud which brings into question your ability to continue performing the audit. Explain the courses of actions available to you.

Answer

In the given case of PQR Ltd, the auditor came across a misstatement resulting from fraud or suspected fraud that brought into question the auditor's ability to continue performing the audit. In such a situation, the auditor shall :

(a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and

(c) If the auditor withdraws:

(i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal.

(ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Q14. Exam Nov 19, 3 Marks | MTP March 2022, 4 Marks

"Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets." State any three examples of such occurrence of misappropriation of such assets.

Answer

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- (i) Inadequate segregation of duties or independent checks.
- (ii) Inadequate oversight of senior management expenditures, such as travel and other reimbursements
- (iii) Inadequate record keeping with respect to assets.
- (iv) Inadequate system of authorization and approval of transactions (for example, in purchasing).
- (v) Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- (vi) Lack of complete and timely reconciliations of assets.
- (vii) Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
- (viii) Lack of mandatory vacations for employees performing key control functions.
- (ix) Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
- (x) Inadequate access controls over automated records, including controls over and review of computer systems event logs.

Q15. Exam May 2019, 2 Marks

Satisfactory Control environment is not an absolute deterrent to fraud.

Answer

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

Q16. Exam May 2019, 4 Marks

Board of Directors of "XYZ Ltd." found the auditors of the Company acted in a fraudulent manner, and decided to remove the auditors in board's meeting. Comment on the action of Board of Directors and describe correct procedure to be followed for removal of auditors before expiry of their term.

Answer

Board of Directors of "XYZ Ltd" cannot remove the auditors in Board meeting. According to Section 140(1), the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per Rule 7 of CAAR, 2014-

- i. The application to the Central Government for removal of auditor shall be made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.
- ii. The application shall be made to the Central Government within 30 days of the resolution passed by the Board.
- iii. The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.
- iv. It is important to note that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard.

Q17. Exam Nov 2018, 5 Marks

Write any five circumstances of conflicting or missing evidence that indicate the possibility of fraud.

Answer

Conflicting or missing evidence, including:

- (i) Missing documents.
- (ii) Documents that appear to have been altered.
- (iii) Significant unexplained items on reconciliations.
- (iv) Unusual discrepancies between the entity's records and confirmation replies.
- (v) Large numbers of credit entries and other adjustments made to accounts receivable records.
- (vi) Missing or non-existent cancelled cheques in circumstances where cancelled cheques are ordinarily returned to the entity with the bank statement.
- (vii) Missing inventory or physical assets of significant magnitude.
- (viii) Unavailable or missing electronic evidence, inconsistent with the entity's record retention practices or policies.

Q18. RTP Nov 2022

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Illustrate techniques by which fraud can be committed by management overriding controls.

Answer

Techniques of frauds committed by Management: Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

- (1) Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives
- (2) Inappropriately adjusting assumptions and changing judgments used to estimate account balances
- (3) Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period
- (4) Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements
- (5) Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity
- (6) Altering records and terms related to significant and unusual transactions.

Q19. RTP Nov 2022

Write the examples of circumstances that indicate the possibility of fraud due to problematic or unusual relationship between the auditor and management.

Answer

Examples of circumstances that indicate the possibility of fraud due to problematic or unusual relationship between the auditor and management are:

- 1. Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.
- 2. Undue time pressures imposed by management to resolve complex or contentious issues.
- 3. Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.
- 4. Unusual delays by the entity in providing requested information.
- 5. Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques.
- 6. Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel.
- 7. An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable.
- 8. An unwillingness to address identified deficiencies in internal control on a timely basis.
- 9. Unwillingness by management to permit the auditor to meet privately with those charged with governance

10. Accounting Policy that appears to be variance with industry norms
11. Frequent changes in accounting estimates that do not appear to result from changed circumstances
12. Tolerance of variations in the entity's code of conduct

Q20. RTP May 2022

CA Dev of D R Sanduja & Co., statutory auditor of company, Girija Fabs Ltd, in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud to the tune of Rs 1.25 Crores has been committed in the company by its employees. CA Dev, the auditor wanted to report the matter to the Central Government as per Law. He refers to Rule 13 of the Companies (Audit and Auditors) Rules, 2014. Sub-rule (1) of the said rule states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

In the above context, explain the manner of reporting the matter to the Central Government.

Answer

The manner of reporting the matter to the Central Government is as follows:

- (a) the auditor shall 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;
- (b) 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) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
- (d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;
- (e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
- (f) the report shall be in the form of a statement as specified in Form ADT-4.

Q21. RTP May 2022

While conducting audit of Always Best Company Ltd, auditor B of B L Kapur & Co. observes lot of intentional misstatements, e.g. fake invoices etc., and considers these encounters as exceptional circumstances and this brings into question his ability to continue performing the audit. Advise B as to what should he do?

Answer

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- (a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- (b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and
- (c) If the auditor withdraws:

- (i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
- (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Q22. RTP Nov 2021

Misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect.

Misappropriation of assets can be accomplished in a variety of ways. Explain those particular ways.

Answer

Misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways including:

- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
- Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).
- Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).
- Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

Q23. RTP May 2021

Where the auditor notices that any fraud by the company or on the company by its officers or employees has been noticed by or reported during the year, the auditor should, apart from reporting the existence of fraud, also report under clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016, the nature of fraud and amount involved.

Explain the considerations an auditor would keep in mind for reporting under this clause.

Answer

Where the auditor notices that any fraud by the company or on the company by its officers or employees has been noticed by or reported during the year, the auditor should, apart from reporting the existence of fraud, also required to report under clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016, the nature of fraud and amount involved. For reporting under this clause, the auditor may consider the following:

- (i) This clause requires all frauds noticed or reported during the year shall be reported indicating the nature and amount involved. As specified the fraud by the company or on the company by its officers or employees are only covered.
- (ii) Of the frauds covered under section 143(12) of the Act, only noticed frauds shall be included here and not the suspected frauds.
- (iii) While reporting under this clause with regard to the nature and the amount involved of the frauds noticed or reported, the auditor may also consider the principles of materiality outlined in Standards on Auditing.

Q24. RTP May 2021

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. Explain.

Answer

The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management. It is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behavior which can be reinforced by an active oversight by those charged with governance. In exercising oversight responsibility, those charged with governance consider the potential for override of controls or other inappropriate influence over the financial reporting process, such as efforts by management to manage earnings in order to influence the perceptions of analysts as to the entity's performance and profitability.

Q25. RTP Nov 2020

Explain what an auditor is expected to do if, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit.

Answer

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- (a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- (b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and
- (c) If the auditor withdraws:
 - (i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
 - (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Q26. RTP Nov 2020

As per sub-section (12) of section 143 of the Companies Act, 2013, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.

In this regard, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has been prescribed. Sub-rule (1) of the said rule states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of **₹ 1 crore or above**, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

Explain the manner of reporting the matter to the Central Government in the above context.

Answer

The manner of reporting the matter to the Central Government is as follows:

- (a) the auditor shall 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;

- (b) 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) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
- (d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;
- (e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
- (f) the report shall be in the form of a statement as specified in Form ADT-4.

Q27. RTP May 2020

Auditor of A Ltd while conducting audit in the course of the performance of his duties as auditor, believes with reasons that "an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed". Analyse and also explain the manner of reporting the matter to the Central Government.

Answer

Reporting to the Central Government: As per sub-section (12) of section 143 of the Companies Act, 2013, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.

In this regard, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has been prescribed. Sub-rule (1) of the said rule states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

The manner of reporting the matter to the Central Government is as follows:

- (a) the auditor shall 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;
- (b) 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) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
- (d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;
- (e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
- (f) the report shall be in the form of a statement as specified in Form ADT-4.

Q28. RTP May 2020

Discrepancies in the accounting records, including transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy is one of the example of circumstances that indicate the possibility of fraud. Explain at least four other such examples relating to discrepancies in the accounting records.

Answer

Discrepancies in the accounting records, including:

- Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy.
- Unsupported or unauthorized balances or transactions.
- Last-minute adjustments that significantly affect financial results.
- Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties.
- Tips or complaints to the auditor about alleged fraud.

Q29. RTP Nov 2019 | RTP May 2018

The scope of auditor's inquiry under clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016 is restricted to frauds 'noticed or reported' during the year. Explain.

Answer

Reporting under Companies (Auditor's Report) Order, 2016 [CARO, 2016]: The auditor is also required to report under clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016, whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.

The scope of auditor's inquiry under clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016 is restricted to frauds 'noticed or reported' during the year. It may be noted that this clause of the Order, by requiring the auditor to report whether any fraud by the company or on the company by its Officer or employees has been noticed or reported, does not relieve the auditor from his responsibility to consider fraud and error in an audit of financial statements. In other words, irrespective of the auditor's comments under this clause, the auditor is also required to comply with the requirements of SA 240, "The Auditor's Responsibility Relating to Fraud in an Audit of Financial Statements".

Audit Procedures and Reporting under CARO:

(1) While planning the audit, the auditor should discuss with other members of the audit team, the susceptibility of the company to material misstatements in the financial statements resulting from fraud. While planning, the auditor should also make inquiries of management to determine whether management is aware of any known fraud or suspected fraud that the company is investigating.

(2) The auditor should examine the reports of the internal auditor with a view to ascertain whether any fraud has been reported or noticed by the management. The auditor should examine the minutes of the audit committee, if available, to ascertain whether any instance of fraud pertaining to the company has been reported and actions taken thereon.

The auditor should enquire from the management about any frauds on the company that it has noticed or that have been reported to it. The auditor should also discuss the matter with other employees including officers of the company. The auditor should also examine the minute book of the board meeting of the company in this regard.

(3) The auditor should obtain written representations from management that:

- (i) it acknowledges its responsibility for the implementation and operation of accounting and internal control systems that are designed to prevent and detect fraud and error;
- (ii) it believes the effects of those uncorrected misstatements in financial statements, aggregated by the auditor during the audit are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

A summary of such items should be included in or attached to the written representation;

(iii) it has

(a) disclosed to the auditor all significant facts relating to any frauds or suspected frauds known to management that may have affected the entity;

and

(b) disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud.

(4) Because management is responsible for adjusting the financial statements to correct material misstatements, it is important that the auditor obtains written representation from management that any uncorrected misstatements resulting from fraud are, in management's opinion, immaterial, both individually and in the aggregate. Such representations are not a substitute for obtaining sufficient appropriate audit evidence. In some circumstances, management may not believe that certain of the uncorrected financial statement misstatements aggregated by the auditor during the audit are misstatements. For that reason, management may want to add to their written representation words such as, "We do not agree that items constitute misstatements because [description of reasons]."

The auditor should consider if any fraud has been reported by them during the year under section 143(12) of the Act and if so whether that same would be reported under this Clause. It may be mentioned here that section 143(12) of the Act requires the auditor has reasons to believe that a fraud is being committed or has been committed by an employee or officer. In such a case the auditor needs to report to the Central Government or the Audit Committee. However, this Clause will include only the reported frauds and not suspected fraud.

(5) Where the auditor notices that any fraud by the company or on the company by its officers or employees has been noticed by or reported during the year, the auditor should, apart from reporting the existence of fraud, also required to report, the nature of fraud and amount involved. For reporting under this clause, the auditor may consider the following:

(i) This clause requires all frauds noticed or reported during the year shall be reported indicating the nature and amount involved. As specified the fraud by the company or on the company by its officers or employees are only covered.

(ii) Of the frauds covered under section 143(12) of the Act, only noticed frauds shall be included here and not the suspected frauds.

(iii) While reporting under this clause with regard to the nature and the amount involved of the frauds noticed or reported, the auditor may also consider the principles of materiality outlined in Standards on Auditing.

Q30. RTP May 2019

Explain how would you deal as an auditor if, as a result of a misstatement resulting from fraud or suspected fraud, you encounter exceptional circumstances that bring into question your ability to continue performing the audit.

Answer

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

(a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;

(b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and

(c) If the auditor withdraws:

(i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and

- (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.
- (a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- (b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and
- (c) If the auditor withdraws:
 - (i) Discuss with the appropriate level of management and those charged with governance the auditor's withdrawal from the engagement and the reasons for the withdrawal; and
 - (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Q31. RTP May 2019 | RTP Nov 2018 | MTP Sep 22

Discuss the different ways in which defalcation of cash may take place.

Answer

Defalcation of Cash: Defalcation of cash has been found to perpetrate generally in the following ways:

(a) By inflating cash payments.

Examples of inflation of payments:

- (1) Making payments against fictitious vouchers.
- (2) Making payments against vouchers, the amounts whereof have been inflated.
- (3) Manipulating totals of wage rolls either by including therein names of dummy workers or by inflating them in any other manner.
- (4) Casting a larger totals for petty cash expenditure and adjusting the excess in the totals of the detailed columns so that cross totals show agreement.

(b) By suppressing cash receipts.

Few techniques of how receipts are suppressed are:

- (1) Teeming and Lading: Amount received from a customer being misappropriated; also to prevent its detection the money received from another customer subsequently being credited to the account of the customer who has paid earlier.

Similarly, moneys received from the customer who has paid thereafter being credited to the account of the second customer and such a practice is continued so that no one account is outstanding for payment for any length of time, which may lead the management to either send out a statement of account to him or communicate with him.

- (2) Adjusting unauthorised or fictitious rebates, allowances, discounts, etc. to customer' accounts and misappropriating amount paid by them.
- (3) Writing off as debts in respect of such balances against which cash has already been received but has been misappropriated.
- (4) Not accounting for cash sales fully.
- (5) Not accounting for miscellaneous receipts, e.g., sale of scrap, quarters allotted to the employees, etc.
- (6) Writing down asset values in entirety, selling them subsequently and misappropriating the proceeds.

(c) By casting wrong totals in the cash book.

Q32. RTP Nov 2018

Misappropriation of Assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways. Analyse and Explain

Answer

Misappropriation of Assets:

It involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways including:

- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
- Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).
- Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).

Example

Vineet is a manager in Zed Ex Ltd. He is having authority to sign cheques up to ₹ 10,000. While performing the audit, Rajan, the auditor, noticed that there were many cheques of ₹ 9,999 which had been signed by Vineet. Further Vineet had split large payments (amounting to more than ₹ 10,000 each, into two or more cheques less than ₹ 10,000 each so that he may authorize the payments). This raised suspicion in the auditor.

The auditor found that the cheques of ₹ 9,999 were deposited in Vineet's personal account i.e. Vineet had misappropriated the amount.

Splitting the cheques into lower amounts involves manipulation of accounts.

The fraud was committed by an employee.

- Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

Q33. RTP Nov 2018

The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. Explain

Answer

The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.

Q34. RTP May 2018

Although fraud is a broad legal concept, for the purposes of the SAs, the auditor is concerned with fraud that causes a material misstatement in the financial statements. Explain.

Answer

The Standard on Auditing (SA) 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" defines the term 'fraud' as-

"an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage".

Although fraud is a broad legal concept, for the purposes of the SAs, the auditor is concerned with fraud that causes a material misstatement in the financial statements.

Two types of intentional misstatements are relevant to the auditor–

- misstatements resulting from fraudulent financial reporting and
- misstatements resulting from misappropriation of assets.

Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred.

Q35. MTP Apr 2022, 4 Marks

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively.

Illustrate any three techniques by which fraud can be committed by management overriding controls.

Answer

Techniques of fraud committed by Management:

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

- (1) Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives
- (2) Inappropriately adjusting assumptions and changing judgments used to estimate account balances
- (3) Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period
- (4) Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements
- (5) Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity
- (6) Altering records and terms related to significant and unusual transactions.

Q36. MTP Nov 2021, 2 Marks

Intentional errors are most difficult to detect and auditors generally devote greater attention to this type

Answer

Correct: Intentional errors are most difficult to detect and auditors generally devote greater attention to this type because out of long and sometimes unfortunate experience, auditors have developed a point of view that, if they direct their procedures of discovering the more difficult intentional errors, they are reasonably certain to locate the more simple and far more common unintentional errors on the way.

Q37. MTP Nov 2021, 4 Marks

Fraud in the form of misappropriation of goods is still more difficult to detect. Explain.

Answer

Fraud in the form of misappropriation of goods is still more difficult to detect; for this, management has to rely on various measures. Apart from the various requirements of record keeping about the physical quantities and their periodic checks, there must be rules and procedures for allowing persons inside the area where goods are kept. In addition there should be external security arrangements to see that no goods are taken out without proper authority. Goods can be anything in the premises; it may be machinery. It may even be the daily necessities of the office like stationery. The goods may be removed by subordinate employees or even by persons quite higher up in the management. Auditors can detect this by undertaking a thorough and strenuous checking of records followed by physical verification process. Also, by resorting to intelligent ratio analysis, auditors may be able to form an idea whether such fraud exists.

Q38. MTP Oct 2021, 2 Marks

Satisfactory Control environment is an absolute deterrent to fraud.

Answer

Incorrect: The existence of a Satisfactory Control environment can be a positive factor when an auditor assesses the risk of material misstatement. However, although it may help reduce the risk of fraud, a satisfactory Control environment is not an absolute deterrent to fraud.

Q39. MTP Apr 2021, 4 Marks

Write any six circumstances of conflicting or missing evidence that indicate the possibility of fraud.

Answer

Conflicting or missing evidence, including:

- (i) Missing documents.
- (ii) Documents that appear to have been altered.
- (iii) Significant unexplained items on reconciliations.
- (iv) Unusual discrepancies between the entity's records and confirmation replies.
- (v) Large numbers of credit entries and other adjustments made to accounts receivable records.
- (vi) Missing or non-existent cancelled cheques in circumstances where cancelled cheques are ordinarily returned to the entity with the bank statement.
- (vii) Missing inventory or physical assets of significant magnitude.
- (viii) Unavailable or missing electronic evidence, inconsistent with the entity's record retention practices or policies.

Q40. MTP Mar 2021, 2 Marks

The primary responsibility for the prevention and detection of fraud rests with the statutory auditor of the company.

Answer

Incorrect: As per SA 240 the primary responsibility for the prevention and detection of fraud rests with management. An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Q41. MTP Mar 2021, 3 Marks

Detection of manipulation of accounts with a view to presenting a false state of affairs is a task requiring great tact and intelligence. Explain stating clearly why and how such type of fraud is committed.

Answer

Detection of manipulation of accounts with a view to presenting a false state of affairs is a task requiring great tact and intelligence because generally management personnel in higher management cadre are associated with this type of fraud and this is perpetrated in methodical way.

This type of fraud is generally committed:

- (1) to avoid incidence of income-tax or other taxes;
 - (2) for declaring a dividend when there are insufficient profits;
 - (3) to withhold declaration of dividend even when there is adequate profit (this is often done to manipulate the value of shares in stock market to make it possible for selected persons to acquire shares at a lower cost); and
 - (4) for receiving higher remuneration where managerial remuneration is payable by reference to profits.
- There are numerous ways of committing this type of fraud. Some of the methods are given below:
- (i) inflating or suppressing purchases and expenses;
 - (ii) inflating or suppressing sales and other items of income,
 - (iii) inflating or deflating the value of closing inventory;
 - (iv) failing to adjust outstanding liabilities or prepaid expenses; and
 - (v) charging items of capital expenditure to revenue or by capitalising revenue expenses.

Q42. MTP Oct 2020, 4 Marks

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Explain the techniques used to commit fraud by management overriding controls.

Answer

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

- ❖ Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
- ❖ Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
- ❖ Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
- ❖ Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.
- ❖ Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
- ❖ Altering records and terms related to significant and unusual transactions.

Q43. MTP May 2020, 3 Marks

Fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act. Explain with examples

Answer

Fraud, whether fraudulent financial reporting or misappropriation of assets, involves incentive or pressure to commit fraud, a perceived opportunity to do so and some rationalization of the act. For example:

- Incentive or pressure to commit fraudulent financial reporting may exist when management is under pressure, from sources outside or inside the entity, to achieve an expected (and perhaps unrealistic) earnings target or financial outcome.
- A perceived opportunity to commit fraud may exist when an individual believes internal control can be overridden, for example, because the individual is in a position of trust or has knowledge of specific deficiencies in internal control.

Individuals may be able to rationalize committing a fraudulent act. Some individuals possess an attitude, character or set of ethical values that allow them knowingly and intentionally to commit a dishonest act. However, even otherwise honest individuals can commit fraud in an environment that imposes sufficient pressure on them.

Q44. MTP Oct 2019, 2 Marks

Teeming and lading is one of the techniques of inflating cash payments.

Answer

Incorrect: Teeming and Lading is one of the techniques of suppressing cash receipts and not of inflating cash payments. Money received from one customer is misappropriated and the account is adjusted with the subsequent receipt from another customer and so on.

Q45. MTP Oct 2019, 3 Marks

"Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users." Discuss.

Answer

Fraudulent Financial Reporting: Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. It can be caused by the efforts of management to manage earnings in order to deceive financial statement users by influencing their perceptions as to the entity's performance and profitability. Such earnings management may start out with small actions or inappropriate adjustment of assumptions and changes in judgments by management. Pressures and incentives may lead these actions to increase to the extent that they result in fraudulent financial reporting.

In some entities, management may be motivated to reduce earnings by a material amount to minimize tax or to inflate earnings to secure bank financing.

Fraudulent financial reporting may be accomplished by the following:

- (i) Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.
- (ii) Misrepresentation in or intentional omission from, the financial statements of events, transactions or other significant information.
- (iii) Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively.

Audit In Automated Environment Past Exams and RTP Questions Compiler

Q1. Exam Nov 2022, 2 marks

In an automated environment, the relationship between the application controls and the General IT controls over IT systems are not interrelated.

Answer

Incorrect: The relationship between the application controls and the General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems. These two categories of control over IT systems are interrelated.

Q2. Exam Nov 2022, 3 marks

In an automated environment, General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. One such area is access security. What is the objective of access security and what are the activities included in it?

Answer

Access Security in Automated Environment:

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

Activities:

- (i) Security Organization & Management
- (ii) Security Policies & Procedures
- (iii) Application Security
- (iv) Data Security
- (v) Operating System Security
- (vi) Network Security – internal network, perimeter network
- (vii) Physical Security – access controls, environment controls
- (viii) System Administration & Privileged Accounts – Sysadmins, DBAs, Super users

Q3. Exam May 2022, 2 Marks

Audit findings and control deficiencies can be evaluated or assessed arbitrarily.

Answer

Incorrect: Evaluation and assessment of audit findings and control deficiencies involves applying professional judgement that include considerations for quantitative and qualitative measures. Each finding should be looked at individually and in the aggregate by combining with other findings/deficiencies.

Q4. Exam May 2022, 3 Marks

The Auditor of HK Limited completed the audit of the company in an automated environment. Management of the company requested the auditor to give an idea about any exceptions observed in IT environment that need to be assessed. How the auditor should consider this request and report in light of an audit perspective?

Answer

Assess and report Audit Findings in audit in Automated Environment: At the conclusion of each audit, it is possible that there will be certain findings or exceptions in IT environment and IT controls of the company that need to be assessed and reported to relevant stakeholders including management and those charged with governance viz., Board of directors, Audit committee. Some points to consider are as follows:

- (1) Are there any weaknesses in IT controls?
- (2) What is the impact of these weaknesses on overall audit?
- (3) Report deficiencies to management – Internal Controls Memo or Management Letter.
- (4) Communicate in writing any significant deficiencies to Those Charged with Governance.

The auditor of HK Ltd needs to assess each finding or exception to determine impact on the audit and evaluate if the exception results in a deficiency in internal control.

Q5. Exam May 2022 | Exam May 18, 5 Marks | RTP Nov 22 | RTP Nov 19 | RTP May 18

When the company is working in an automated environment, it is not necessary for its auditor to understand its automated environment and depends upon the professional judgement of the auditor as to whether gaining knowledge of company's IT systems is required or not. Do you agree with this statement?

Answer

Understanding and Documenting Automated Environment: When a business operates in a more automated environment it is likely that auditor will see several business functions and activities happening within the systems. Consider the following aspects instead of:

- (i) Computation and Calculations are automatically carried out (for example, bank interest computation and inventory valuation).
- (ii) Accounting entries are posted automatically (for example, sub-ledger to GL postings is automatic).
- (iii) Business policies and procedures, including internal controls, are applied automatically (for example, delegation of authority for journal approvals, customer credit limit checks are performed automatically).
- (iv) Reports used in business are produced from systems. Management and other stakeholders rely on these reports and information produced (for example, debtors ageing report).
- (v) User access and security are controlled by assigning system roles to users (for example, segregation of duties can be enforced effectively).

Companies derive benefit from the use of IT systems as an enabler to support various business operations and activities. Auditors need to understand the relevance of these IT systems to an audit of financial statements.

While it is true that the use of IT systems and automation benefit the business by making operations more accurate, reliable, effective and efficient, such systems also introduce certain new risks, including IT specific risks, which need to be considered, assessed and addressed by management.

To the extent that it is relevant to an audit of financial statements, even auditors are required to understand, assess and respond to such risks that arise from the use of IT systems.

From the above discussion, it is quite apparent that it is necessary for an auditor to understand the automated environment.

Alternative Solution

Understanding and Documenting Automated Environment: In an audit of financial statements, an auditor is required to understand the entity and its business, including IT as per SA 315. Understanding the entity and its automated environment involves understanding how IT department is organised, IT activities, the IT dependencies, relevant risks and controls.

Given below are some of the points that an auditor should consider to obtain an **understanding of the company's automated environment**:

- (i) Information systems being used (one or more application systems and what they are).
- (ii) Their purpose (financial and non-financial).
- (iii) Location of IT systems - local vs global.
- (iv) Architecture (desktop based, client-server, web application, cloud based).
- (v) Version (functions and risks could vary in different versions of same application).
- (vi) Interfaces within systems (in case multiple systems exist).
- (vii) In-house vs Packaged.
- (viii) Outsourced activities (IT maintenance and support).
- (ix) Key persons (CIO, CISO, Administrators).

The understanding of a company's IT environment that is obtained should be documented.

From the above discussion, it is quite apparent that it is necessary for an auditor to understand the automated environment.

Q6. Exam Dec 2021, 3 Marks | RTP Nov 20 | RTP Nov 18 | MTP Apr 22

When a business operates in a more automated environment, we are likely to see several business functions and activities happening within the systems. List down the business functions and activities happening within the systems.

Answer

Relevance of Information Technology in an Audit:

When a business operates in a more automated environment it is likely that we will see several business functions and activities happening within the systems. Consider the following aspects instead of:

- (i) Computation and Calculations are automatically carried out (for example, bank interest computation and inventory valuation).
- (ii) Accounting entries are posted automatically (for example, sub-ledger to GL postings is automatic).
- (iii) Business policies and procedures, including internal controls, are applied automatically (for example, delegation of authority for journal approvals, customer credit limit checks are performed automatically).
- (iv) Reports used in business are produced from systems. Management and other stakeholders rely on these reports and information produced (for example, debtors ageing report).
- (v) User access and security are controlled by assigning system roles to users (for example, segregation of duties can be enforced effectively).

Q7. Exam Jul 2021, 2 Marks

With reference to General IT control, the objective of Data Center and Network Operations is to ensure that systems are developed, configured and implemented to meet financial reporting objectives.

Answer

Incorrect: Objective of Data Center and Network Operations is to ensure that production systems are processed to meet financial reporting objectives.

Objective of Application system acquisition, development, and maintenance is to ensure that systems are developed, configured and implemented to meet financial reporting objectives.

Q8. Exam Jan 2021, 2 marks

The Complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be less complex.

Answer

Incorrect: The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven. The complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be more complex. If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.

Q9. Exam Jan 2021, 4 marks | RTP May 2020

Discuss the common methods applied by the auditor when testing in an automated environment is done by him.

Answer

There are basically four types of audit tests that should be used. They are inquiry, observation, inspection and reperformance. Inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient.

When testing in an automated environment, some of the more common methods are as follows:

- ❖ Obtain an understanding of how an automated transaction is processed by doing a walkthrough of one end-to-end transaction using a combination of inquiry, observation and inspection.
- ❖ Observe how a user processes transactions under different scenarios.
- ❖ Inspect the configuration defined in an application.
- ❖ Inspect the system logs to determine any changes made since last audit testing.
- ❖ Inspect technical manual / user manual of systems and applications.
- ❖ Carry out a test check (negative testing) and observe the error message displayed by the application.
- ❖ Conduct reperformance using raw source data and independently applying formulae, business rules or validations on the source data using CAATs.

Q10. Exam Nov 2020, 3 Marks | RTP Nov 2021 | MTP Sep 22, 3 Marks

Analyse how risks in the IT system if not mitigated could have an impact on the audit.

Answer

When risks in IT systems are not mitigated, the audit impact could be as follows:

- (i) First, we may not be able to rely on the reports, data obtained from systems where such risk exist. This means all forms of data, information or reports that we obtains from system for the purpose of audit has to be thoroughly tested and corroborated for completeness and accuracy.
- (ii) Second, we will not be able to rely on automated controls, calculations and accounting procedures that are built into the application. Additional audit work may be required in this case.
- (iii) Third, due to the regulatory requirement of auditors to report on internal financial controls of a company, the audit report also may have to be modified in some instances.

Q11. Exam Nov 2019, 3 Marks

The auditor's responsibility includes reporting on Internal Financial Controls over Financial Reporting which includes an understanding IT environment of the company and relevant risks and controls. Mention any three situations where IT will be relevant to an audit.

Answer

With the introduction of the Companies Act 2013, there is greater emphasis given to internal financial controls (IFC) from a regulatory point of view. Directors and those charged with governance (including Board of directors, Audit committee) are responsible for the implementation of internal controls framework within the company. The auditors' responsibilities now include reporting on Internal Financial Controls over Financial Reporting which include and understanding IT environment of the company and relevant risks & controls.

Following are some situations in which IT will be relevant to an audit,

- (i) Increased use of Systems and Application software in Business (for example, use of ERPs)
- (ii) Complexity of transactions has increased (multiple systems, network of systems)
- (iii) Hi-tech nature of business (Telecom, e-Commerce).
- (iv) Volume of transactions are high (Insurance, Banking, Railways ticketing).
- (v) Company Policy (Compliance).
- (vi) Regulatory requirements - Companies Act 2013 IFC, IT Act 2008.
- (vii) Required by Indian and International Standards - ISO, PCI-DSS, SA 315, SOC, ISAE
- (viii) Increases efficiency and effectiveness of audit.

Q12. Exam May 2019, 4 Marks | RTP Nov 22

Which are specific risks to the company's internal control having IT environment?

Answer

IT poses specific risks to the Company's internal control, which include-

- (i) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- (ii) Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or nonexistent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
- (iii) The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- (iv) Unauthorised changes to data in master files.
- (v) Unauthorised changes to systems or programs.
- (vi) Failure to make necessary changes to systems or programs. Inappropriate manual intervention.
- (vii) Potential loss of data or inability to access data as required.

Q13. Exam Nov 2018, 5 Marks | MTP Oct 22 | MTP May 20

With respect to audit in an automated environment, explain the following:

- (i) CAATs
- (ii) Data Analytics
- (iii) Database
- (iv) Information Systems
- (v) Privileged access

Answer

(i) CAATs: Short form for Computer Assisted Audit Techniques, are a collection of computer based tools and techniques that are used in an audit for analysing data in electronic form to obtain audit evidence.

(ii) Data Analytics: A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information

(iii) Database: A logical subsystem within a larger information system where electronic data is stored in a predefined form and retrieved for use.

(iv) Information Systems: Refers to a collection of electronic hardware, software, networks and processes that are used in a business to carry out operations and transactions.

(v) Privileged access: A type of super user access to information systems that enforces less or no limits on using that system.

Q14. Exam May 2018, 5 Marks | RTP Nov 19

The auditor should understand and consider the risks that may arise from the use of Information Technology (IT) Systems.

Answer

Having obtained an understanding of the IT systems and the automated environment of a company, the auditor should now understand the risks that arise from the use of IT systems.

Given below are some such risks that should be considered,

- Inaccurate processing of data, processing inaccurate data, or both
- Unauthorized access to data
- Direct data changes (backend changes)
- Excessive access / Privileged access (super users)
- Lack of adequate segregation of duties
- Unauthorized changes to systems or programs
- Failure to make necessary changes to systems or programs
- Loss of data

Q15. RTP May 2022

With respect to audit in an automated environment, explain the following:

- (i) Applications
- (ii) Automated
- (iii) CAATs
- (iv) Data Processing
- (v) General (IT) Controls

Answer

(i) Applications: These are computer software programs that provide a medium for recording, storage and retrieval of business operations or transactions in electronic format.

(ii) Automated: A task or activity that is routinely performed by a computer system and does not require manual effort

(iii) CAATs: Short form for Computer Assisted Audit Techniques, are a collection of computer-based tools and techniques that are used in an audit for analysing data in electronic form to obtain audit evidence.

(iv) Data Processing: Refers to the systematic recording, storage, retrieval, modification and transformation of electronic data using information systems.

(v) General (IT) Controls: Are a type of internal controls that help in mitigating risks that arise due to use of information technology and information systems in a business.

Q16. RTP May 2022

Explain the meaning of Internal Financial Controls clearly stating reporting requirement (with reference to audit) on adequacy of internal financial controls. Also discuss about its (reporting requirement on adequacy of internal financial controls) applicability on various types of Companies.

Answer

Explanation given in Clause (e) of Sub-section 5 of Section 134 explains the meaning of internal financial controls as, "the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information."

From the above definition, it is clear that internal financial controls are the policies and procedures adopted by the company for:

1. ensuring the orderly and efficient conduct of its business, including adherence to company's policies,
2. the safeguarding of its assets,
3. the prevention and detection of frauds and errors,
4. the accuracy and completeness of the accounting records, and
5. the timely preparation of reliable financial information."

Section 143(3)(i) of the Act requires an auditor to report whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls.

However, it may be noted that the reporting requirement on adequacy of internal financial controls (IFCs) with reference to financial statements shall not be applicable to a private company which is a-

- (i) One person company; or
- (ii) Small company; or

(iii) Company having turnover less than ₹ 50 crore as per latest audited financial statement and having aggregate borrowings from banks or financial institutions or anybody corporate at any point of time during the financial year less than ₹ 25 crore.

Q17. RTP Nov 2021 | MTP Sep 22,3 Marks

The auditor should consider relevance of IT in an audit of financial statements. Explain giving reasons.

Answer

The auditor should consider relevance of IT in an audit of financial statements for the following reasons:

- (a) Since auditors rely on the reports and information generated by IT systems, there could be risk in the IT systems that could have an impact on audit.
- (b) Standards on auditing SA 315 and SA 330 require auditors to understand, assess and respond to risks that arise from the use of IT systems.
- (c) By relying on automated controls and using data analytics in an audit, it is possible to increase the effectiveness and efficiency of the audit process.

Q18. RTP May 2021

Objective of Data Center and Network Operations is to ensure that production systems are processed to meet financial reporting objectives. Discuss the activities performed by Data Center and Network operations. Also explain the meaning of General IT Controls in detail.

Answer

"General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, miniframe, and end-user environments. General IT-controls that maintain the integrity of information and **security of data** commonly include controls over the following:"

- (i) Data center and network operations
- (ii) Program change
- (iii) Access security
- (iv) Application system acquisition, development, and maintenance (Business Applications)

These are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes. Hence, General IT controls are known as "pervasive" controls or "indirect" controls. Let us now learn about each of the General IT controls in more detail.

Data Center and Network Operations

Objective: To ensure that production systems are processed to meet financial reporting objectives.

Activities:

1. Overall Management of Computer Operations Activities
2. Batch jobs – preparing, scheduling and executing
3. Backups – monitoring, storage & retention
4. Performance Monitoring – operating system, database and networks
5. Recovery from Failures – BCP, DRP
6. Help Desk Functions – recording, monitoring & tracking
7. Service Level Agreements – monitoring & compliance
8. Documentation – operations manuals, service reports

Q19. RTP Nov 2020

With the increasing adoption of information technology, business today relies on software systems and applications more than ever. Many of these IT systems generate and process data that is used in the preparation of financial statements of a company. The auditors also often rely on the data and reports that are generated from these systems. Explain stating clearly the meaning of Automated environment with example.

Answer

With the increasing adoption of information technology, business today relies on software systems and applications more than ever. Many of these IT systems generate and process data that is used in the preparation of financial statements of a company. The auditors also often rely on the data and reports that are generated from these systems. In this context, it is critical to understand the IT specific risks that could potentially impact the integrity and reliability of financial transactions and data flowing through a company's systems.

An automated environment basically refers to a business environment where the processes, operations, accounting and even decisions are carried out by using computer systems – also known as Information

Systems (IS) or Information Technology (IT) systems. Nowadays, it is very common to see computer systems being used in almost every type of business.

Example

Think about how banking transactions are carried out using ATMs (Automated Teller Machines), or how tickets can be purchased using “apps” on mobile phones, etc. In these examples, you can see how these computer systems enable us to transact business at any time and any day.

Q20. RTP May 2019

Explain the meaning of an automated environment. Also discuss the key features of an automated environment.

Answer

An automated environment basically refers to a business environment where the processes, operations, accounting and even decisions are carried out by using computer systems – also known as Information Systems (IS) or Information Technology (IT) systems.

Nowadays, it is very common to see computer systems being used in almost every type of business.

For example, think about how banking transactions are carried out using ATMs (Automated Teller Machines), or how tickets can be purchased using “apps” on mobile phones, etc. In these examples, you can see how these computer systems enable us to transact business at any time and any day.

Some of the key features of an automated environment are as follows:

Key features of an Automated Environment

- ❖ Enables faster business operations
- ❖ Accuracy in data processing & computation
- ❖ Ability to process large volume of transactions
- ❖ Integration between business operations
- ❖ Better security & controls
- ❖ Less prone to human errors
- ❖ Provides latest information
- ❖ Connectivity & networking capability

The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven. The complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be more complex.

For example, if a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.

Similarly, there are several other aspects that an auditor should consider to determine the level of automation and complexity of a business environment which we will look at in the following sections.

Q21. RTP May 2019

Discuss the situations in which IT will be relevant to an audit.

Answer

Given below are some situations in which IT will be relevant to and audit,

- Increased use of Systems and Application software in Business (for example, use of ERPs)
- Complexity of transactions has increased (multiple systems, network of systems)
- Hi-tech nature of business (Telecom, e-Commerce)
- Volume of transactions are high (Insurance, Banking, Railways ticketing)
- Company Policy (Compliance)
- Regulatory requirements - Companies Act 2013 IFC, IT Act 2008
- Required by Indian and International Standards - ISO, PCI-DSS, SA 315, SOC, ISAE
- Increases efficiency and effectiveness of audit

Q22. RTP Nov 2018 | RTP May 21 | RTP May 20 | Exam Nov 20, 4 Marks | MTP Oct 20

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.

Answer

In today's digital age when companies rely on more and more on IT systems and networks to operate business, the amount of data and information that exists in these systems is enormous. 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

Q23. RTP May 2018

Discuss the impact of IT related risks on Substantive Audit, Controls and Reporting.

Answer

Impact of IT related risks i.e. on Substantive Audit, Controls and Reporting: The above risks, if not mitigated, could have an impact on audit in different ways. Let us understand how:

Impact on Substantive Audit	Impact on Controls	Impact on Reporting
<ul style="list-style-type: none"> • Cannot rely on the data obtained from systems. 	<ul style="list-style-type: none"> • Cannot rely on automated controls, system calculations & accounting procedures built into applications 	<ul style="list-style-type: none"> • communication to those charged with governance
<ul style="list-style-type: none"> • system data & reports should be tested substantively for completeness & accuracy 	<ul style="list-style-type: none"> • Cannot rely on IT dependent manual controls 	<ul style="list-style-type: none"> • modified auditors report.
<ul style="list-style-type: none"> • more audit evidence is needed 	<ul style="list-style-type: none"> • system data & report should be tested substantively for completeness & accuracy. 	
	<ul style="list-style-type: none"> • more substantive audit work is needed. 	

- First, we may not be able to rely on the data obtained from systems where such risks exist. This means, all forms of data, information or reports that we obtain from systems for the purpose of audit has to be thoroughly tested and corroborated for completeness and accuracy.
- Second, we will not be able to rely on automated controls, calculations, accounting procedures that are built into the applications. Additional audit work may be required in this case.
- Third, due to the regulatory requirement of auditors to report on internal financial controls of a company, the audit report also may have to be modified in some instances.

In all the above scenarios, it is likely that the auditor will be required to obtain more audit evidence and perform additional audit work. The auditor should also be able to demonstrate how the risks were identified and what audit evidence was obtained and validated to address these IT risks.

Here, we should remember that as the complexity, automation and dependence of business operations on IT systems increases, the severity and impact of IT risks too increases accordingly. The auditor should apply professional judgement in determining and assessing such risks and plan the audit response appropriately.

Q24. MTP Oct 2022, 3 Marks

Explain the objective and enlist the activities involved in the General IT Controls over "Program Change".

Answer

General IT Controls are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes. Hence, General IT controls are known as "pervasive" controls or "indirect" controls.

Program Change

Objective: To ensure that modified systems continue to meet financial reporting objectives.

Activities:

- Change Management Process – definition, roles & responsibilities
- Change Requests – record, manage, track
- Making Changes – analyze, design, develop
- Test Changes – test plan, test cases, UAT
- Apply Changes in Production
- Emergency & Minor Changes
- Documentation – user/technical manuals
- User Training

Q25. MTP March 2022, 2 Marks | MTP Nov 21

All automated environments are not complex.

Answer

Correct: The complexity of an automated environment depends on various factors including the nature of business, level of automation, volume of transactions, use of ERP and so on. There could be an environment where dependence on IT and automation is relatively less or minimal and hence, considered less complex or even non-complex.

Q26. MTP March 2022, 2 Marks | MTP Nov 21

A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is known as meaningful data.

Answer

Incorrect: A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is known as Data Analytics.

Q27. MTP Apr 2022, 2 Marks

Electronic payment of Income Tax cannot be made by an assessee from the account of any other person.

Answer

Incorrect: Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards. The assessee can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. It is not necessary for the assessee to make payment of taxes from his own account in an authorized bank.

Q28. MTP Nov 2021, 3 Marks

Describe how risks in IT systems, if not mitigated, could have an impact on audit.

Answer

When risks in IT systems are not mitigated the audit impact could be as follows:

- (i) The auditor may not be able to rely on the reports, data obtained, automated controls, calculations and accounting procedures in the IT system.
- (ii) The auditor has to perform additional audit work by spending more time and efforts.
- (iii) The auditor may have to issue a modified opinion, if necessary.

Q29. MTP Oct 2021, 2 Marks

When auditing in an automated environment, inquiry is often the most efficient and effective audit testing method.

Answer

Incorrect: There are basically four types of audit tests that should be used in an automated environment. They are inquiry, observation, inspection and re-performance. Inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient. Applying inquiry in combination with inspection gives the most effective and efficient audit evidence.

Q30. MTP Apr 2021, 4 Marks

With respect to audit in an automated environment, explain the following:

- (i) Applications
- (ii) Control Deficiency
- (iii) Data Processing
- (iv) Enterprise Resource Planning
- (v) Software

Answer

(i) Applications: These are computer software programs that provide a medium for recording, storage and retrieval of business operations or transactions in electronic format.

(ii) Control Deficiency: It exists when an internal control is either missing or not operating effectively to prevent or detect a misstatement in a timely manner by management.

(iii) Data Processing: It refers to the systematic recording, storage, retrieval, modification and transformation of electronic data using information systems.

(iv) Enterprise Resource Planning: A type of business application software that provides an integrated platform to automate multiple interrelated business processes and operations.

(v) Software: A computer program or a collection of computer programs that provides an interface to a user for performing a specific activity, task, operation or transaction in electronic form through a computer or information system.

Q31. MTP Mar 2021, 4 Marks

With respect to audit in an automated environment, explain the following:

- (i) Data Processing
- (ii) ERP (Enterprise Resource Planning)
- (iii) General IT control
- (iv) Automated
- (v) Direct Data change

Answer

- (i) Data Processing:** Refers to the systematic recording, storage, retrieval, modification and transformation of electronic data using information systems.
- (ii) ERP (Enterprise Resource Planning):** A type of business application software that provides an integrated platform to automate multiple interrelated business processes and operations.
- (iii) General IT Control:** Are a type of internal controls that help in mitigating risks that arise due to use of information technology and information systems in a business.
- (iv) Automated:** A task or activity that is routinely performed by a computer system and does not require manual effort.
- (v) Direct Data Change:** A backend modification that is made directly to data that is stored in a database bypassing business rules built-in to a business application software.

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Audit In Automated Environment

Q1. Exam Nov 2022, 2 marks

In an automated environment, the relationship between the application controls and the General IT controls over IT systems are not interrelated.

Answer

Incorrect: The relationship between the application controls and the General IT Controls is such that General IT Controls are needed to support the functioning of application controls, and both are needed to ensure complete and accurate information processing through IT systems. These two categories of control over IT systems are interrelated.

Q2. Exam Nov 2022, 3 marks

In an automated environment, General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. One such area is access security. What is the objective of access security and what are the activities included in it?

Answer

Access Security in Automated Environment:

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

Activities:

- (i) Security Organization & Management
- (ii) Security Policies & Procedures
- (iii) Application Security
- (iv) Data Security
- (v) Operating System Security
- (vi) Network Security – internal network, perimeter network
- (vii) Physical Security – access controls, environment controls
- (viii) System Administration & Privileged Accounts – Sysadmins, DBAs, Super users

Q3. Exam May 2022, 2 Marks

Audit findings and control deficiencies can be evaluated or assessed arbitrarily.

Answer

Incorrect: Evaluation and assessment of audit findings and control deficiencies involves applying professional judgement that include considerations for quantitative and qualitative measures. Each finding should be looked at individually and in the aggregate by combining with other findings/deficiencies.

Q4. Exam May 2022, 3 Marks

The Auditor of HK Limited completed the audit of the company in an automated environment. Management of the company requested the auditor to give an idea about any exceptions observed in IT environment that need to be assessed. How the auditor should consider this request and report in light of an audit perspective?

Answer

Assess and report Audit Findings in audit in Automated Environment: At the conclusion of each audit, it is possible that there will be certain findings or exceptions in IT environment and IT controls of the

company that need to be assessed and reported to relevant stakeholders including management and those charged with governance viz., Board of directors, Audit committee. Some points to consider are as follows:

- (1) Are there any weaknesses in IT controls?
- (2) What is the impact of these weaknesses on overall audit?
- (3) Report deficiencies to management – Internal Controls Memo or Management Letter.
- (4) Communicate in writing any significant deficiencies to Those Charged with Governance.

The auditor of HK Ltd needs to assess each finding or exception to determine impact on the audit and evaluate if the exception results in a deficiency in internal control.

Q5. Exam May 2022 | Exam May 18, 5 Marks | RTP Nov 22 | RTP Nov 19 | RTP May 18

When the company is working in an automated environment, it is not necessary for its auditor to understand its automated environment and depends upon the professional judgement of the auditor as to whether gaining knowledge of company's IT systems is required or not. Do you agree with this statement?

Answer

Understanding and Documenting Automated Environment: When a business operates in a more automated environment it is likely that auditor will see several business functions and activities happening within the systems. Consider the following aspects instead of:

- (i) Computation and Calculations are automatically carried out (for example, bank interest computation and inventory valuation).
- (ii) Accounting entries are posted automatically (for example, sub-ledger to GL postings is automatic).
- (iii) Business policies and procedures, including internal controls, are applied automatically (for example, delegation of authority for journal approvals, customer credit limit checks are performed automatically).
- (iv) Reports used in business are produced from systems. Management and other stakeholders rely on these reports and information produced (for example, debtors ageing report).
- (v) User access and security are controlled by assigning system roles to users (for example, segregation of duties can be enforced effectively).

Companies derive benefit from the use of IT systems as an enabler to support various business operations and activities. Auditors need to understand the relevance of these IT systems to an audit of financial statements.

While it is true that the use of IT systems and automation benefit the business by making operations more accurate, reliable, effective and efficient, such systems also introduce certain new risks, including IT specific risks, which need to be considered, assessed and addressed by management.

To the extent that it is relevant to an audit of financial statements, even auditors are required to understand, assess and respond to such risks that arise from the use of IT systems.

From the above discussion, it is quite apparent that it is necessary for an auditor to understand the automated environment.

Alternative Solution

Understanding and Documenting Automated Environment: In an audit of financial statements, an auditor is required to understand the entity and its business, including IT as per SA 315. Understanding the entity and its automated environment involves understanding how IT department is organised, IT activities, the IT dependencies, relevant risks and controls.

Given below are some of the points that an auditor should consider to obtain an **understanding of the company's automated environment**:

- (i) Information systems being used (one or more application systems and what they are).
- (ii) Their purpose (financial and non-financial).
- (iii) Location of IT systems - local vs global.
- (iv) Architecture (desktop based, client-server, web application, cloud based).
- (v) Version (functions and risks could vary in different versions of same application).
- (vi) Interfaces within systems (in case multiple systems exist).
- (vii) In-house vs Packaged.
- (viii) Outsourced activities (IT maintenance and support).
- (ix) Key persons (CIO, CISO, Administrators).

The understanding of a company's IT environment that is obtained should be documented.

From the above discussion, it is quite apparent that it is necessary for an auditor to understand the automated environment.

Q6. Exam Dec 2021, 3 Marks | RTP Nov 20 | RTP Nov 18 | MTP Apr 22

When a business operates in a more automated environment, we are likely to see several business functions and activities happening within the systems. List down the business functions and activities happening within the systems.

Answer

Relevance of Information Technology in an Audit:

When a business operates in a more automated environment it is likely that we will see several business functions and activities happening within the systems. Consider the following aspects instead of:

- (i) Computation and Calculations are automatically carried out (for example, bank interest computation and inventory valuation).
- (ii) Accounting entries are posted automatically (for example, sub-ledger to GL postings is automatic).
- (iii) Business policies and procedures, including internal controls, are applied automatically (for example, delegation of authority for journal approvals, customer credit limit checks are performed automatically).
- (iv) Reports used in business are produced from systems. Management and other stakeholders rely on these reports and information produced (for example, debtors ageing report).
- (v) User access and security are controlled by assigning system roles to users (for example, segregation of duties can be enforced effectively).

Q7. Exam Jul 2021, 2 Marks

With reference to General IT control, the objective of Data Center and Network Operations is to ensure that systems are developed, configured and implemented to meet financial reporting objectives.

Answer

Incorrect: Objective of Data Center and Network Operations is to ensure that production systems are processed to meet financial reporting objectives.

Objective of Application system acquisition, development, and maintenance is to ensure that systems are developed, configured and implemented to meet financial reporting objectives.

Q8. Exam Jan 2021, 2 marks

The Complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be less complex.

Answer

Incorrect: The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven. The complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be more complex. If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.

Q9. Exam Jan 2021, 4 marks | RTP May 2020

Discuss the common methods applied by the auditor when testing in an automated environment is done by him.

Answer

There are basically four types of audit tests that should be used. They are inquiry, observation, inspection and reperformance. Inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient.

When testing in an automated environment, some of the more common methods are as follows:

- ❖ Obtain an understanding of how an automated transaction is processed by doing a walkthrough of one end-to-end transaction using a combination of inquiry, observation and inspection.
- ❖ Observe how a user processes transactions under different scenarios.
- ❖ Inspect the configuration defined in an application.
- ❖ Inspect the system logs to determine any changes made since last audit testing.
- ❖ Inspect technical manual / user manual of systems and applications.
- ❖ Carry out a test check (negative testing) and observe the error message displayed by the application.
- ❖ Conduct reperformance using raw source data and independently applying formulae, business rules or validations on the source data using CAATs.

Q10. Exam Nov 2020, 3 Marks | RTP Nov 2021 | MTP Sep 22, 3 Marks

Analyse how risks in the IT system if not mitigated could have an impact on the audit.

Answer

When risks in IT systems are not mitigated, the audit impact could be as follows:

- (i) First, we may not be able to rely on the reports, data obtained from systems where such risk exist. This means all forms of data, information or reports that we obtains from system for the purpose of audit has to be thoroughly tested and corroborated for completeness and accuracy.
- (ii) Second, we will not be able to rely on automated controls, calculations and accounting procedures that are built into the application. Additional audit work may be required in this case.
- (iii) Third, due to the regulatory requirement of auditors to report on internal financial controls of a company, the audit report also may have to be modified in some instances.

Q11. Exam Nov 2019, 3 Marks

The auditor's responsibility includes reporting on Internal Financial Controls over Financial Reporting which includes an understanding IT environment of the company and relevant risks and controls. Mention any three situations where IT will be relevant to an audit.

Answer

With the introduction of the Companies Act 2013, there is greater emphasis given to internal financial controls (IFC) from a regulatory point of view. Directors and those charged with governance (including Board of directors, Audit committee) are responsible for the implementation of internal controls framework within the company. The auditors' responsibilities now include reporting on Internal Financial

Controls over Financial Reporting which include and understanding IT environment of the company and relevant risks & controls.

Following are some situations in which IT will be relevant to an audit,

- (i) Increased use of Systems and Application software in Business (for example, use of ERPs)
- (ii) Complexity of transactions has increased (multiple systems, network of systems)
- (iii) Hi-tech nature of business (Telecom, e-Commerce).
- (iv) Volume of transactions are high (Insurance, Banking, Railways ticketing).
- (v) Company Policy (Compliance).
- (vi) Regulatory requirements - Companies Act 2013 IFC, IT Act 2008.
- (vii) Required by Indian and International Standards - ISO, PCI-DSS, SA 315, SOC, ISAE
- (viii) Increases efficiency and effectiveness of audit.

Q12. Exam May 2019, 4 Marks | RTP Nov 22

Which are specific risks to the company's internal control having IT environment?

Answer

IT poses specific risks to the Company's internal control, which include-

- (i) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- (ii) Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or nonexistent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
- (iii) The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- (iv) Unauthorised changes to data in master files.
- (v) Unauthorised changes to systems or programs.
- (vi) Failure to make necessary changes to systems or programs. Inappropriate manual intervention.
- (vii) Potential loss of data or inability to access data as required.

Q13. Exam Nov 2018, 5 Marks | MTP Oct 22 | MTP May 20

With respect to audit in an automated environment, explain the following:

- (i) CAATs
- (ii) Data Analytics
- (iii) Database
- (iv) Information Systems
- (v) Privileged access

Answer

(i) CAATs: Short form for Computer Assisted Audit Techniques, are a collection of computer based tools and techniques that are used in an audit for analysing data in electronic form to obtain audit evidence.

(ii) Data Analytics: A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information

(iii) Database: A logical subsystem within a larger information system where electronic data is stored in a predefined form and retrieved for use.

(iv) Information Systems: Refers to a collection of electronic hardware, software, networks and processes that are used in a business to carry out operations and transactions.

(v) Privileged access: A type of super user access to information systems that enforces less or no limits on using that system.

Q14. Exam May 2018, 5 Marks | RTP Nov 19

The auditor should understand and consider the risks that may arise from the use of Information Technology (IT) Systems.

Answer

Having obtained an understanding of the IT systems and the automated environment of a company, the auditor should now understand the risks that arise from the use of IT systems.

Given below are some such risks that should be considered,

- Inaccurate processing of data, processing inaccurate data, or both
- Unauthorized access to data
- Direct data changes (backend changes)
- Excessive access / Privileged access (super users)
- Lack of adequate segregation of duties
- Unauthorized changes to systems or programs
- Failure to make necessary changes to systems or programs
- Loss of data

Q15. RTP May 2022

With respect to audit in an automated environment, explain the following:

- Applications
- Automated
- CAATs
- Data Processing
- General (IT) Controls

Answer

(i) Applications: These are computer software programs that provide a medium for recording, storage and retrieval of business operations or transactions in electronic format.

(ii) Automated: A task or activity that is routinely performed by a computer system and does not require manual effort

(iii) CAATs: Short form for Computer Assisted Audit Techniques, are a collection of computer-based tools and techniques that are used in an audit for analysing data in electronic form to obtain audit evidence.

(iv) Data Processing: Refers to the systematic recording, storage, retrieval, modification and transformation of electronic data using information systems.

(v) General (IT) Controls: Are a type of internal controls that help in mitigating risks that arise due to use of information technology and information systems in a business.

Q16. RTP May 2022

Explain the meaning of Internal Financial Controls clearly stating reporting requirement (with reference to audit) on adequacy of internal financial controls. Also discuss about its (reporting requirement on adequacy of internal financial controls) applicability on various types of Companies.

Answer

Explanation given in Clause (e) of Sub-section 5 of Section 134 explains the meaning of internal financial controls as, "the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets,

the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.”

From the above definition, it is clear that internal financial controls are the policies and procedures adopted by the company for:

1. ensuring the orderly and efficient conduct of its business, including adherence to company's policies,
2. the safeguarding of its assets,
3. the prevention and detection of frauds and errors,
4. the accuracy and completeness of the accounting records, and
5. the timely preparation of reliable financial information.”

Section 143(3)(i) of the Act requires an auditor to report whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such controls.

However, it may be noted that the reporting requirement on adequacy of internal financial controls (IFCs) with reference to financial statements shall not be applicable to a private company which is a-

- (i) One person company; or
- (ii) Small company; or
- (iii) Company having turnover less than ₹ 50 crore as per latest audited financial statement and having aggregate borrowings from banks or financial institutions or anybody corporate at any point of time during the financial year less than ₹ 25 crore.

Q17. RTP Nov 2021 | MTP Sep 22,3 Marks

The auditor should consider relevance of IT in an audit of financial statements. Explain giving reasons.

Answer

The auditor should consider relevance of IT in an audit of financial statements for the following reasons:

- (a) Since auditors rely on the reports and information generated by IT systems, there could be risk in the IT systems that could have an impact on audit.
- (b) Standards on auditing SA 315 and SA 330 require auditors to understand, assess and respond to risks that arise from the use of IT systems.
- (c) By relying on automated controls and using data analytics in an audit, it is possible to increase the effectiveness and efficiency of the audit process.

Q18. RTP May 2021

Objective of Data Center and Network Operations is to ensure that production systems are processed to meet financial reporting objectives. Discuss the activities performed by Data Center and Network operations. Also explain the meaning of General IT Controls in detail.

Answer

“General IT controls are policies and procedures that relate to many applications and support the effective functioning of application controls. They apply to mainframe, miniframe, and end-user environments.

General IT-controls that maintain the integrity of information and **security of data** commonly include controls over the following:”

- (i) Data center and network operations
- (ii) Program change
- (iii) Access security
- (iv) Application system acquisition, development, and maintenance (Business Applications)

These are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes. Hence, General IT controls are known as “pervasive” controls or “indirect” controls. Let us now learn about each of the General IT controls in more detail.

Data Center and Network Operations

Objective: To ensure that production systems are processed to meet financial reporting objectives.

Activities:

1. Overall Management of Computer Operations Activities
2. Batch jobs – preparing, scheduling and executing
3. Backups – monitoring, storage & retention
4. Performance Monitoring – operating system, database and networks
5. Recovery from Failures – BCP, DRP
6. Help Desk Functions – recording, monitoring & tracking
7. Service Level Agreements – monitoring & compliance
8. Documentation – operations manuals, service reports

Q19. RTP Nov 2020

With the increasing adoption of information technology, business today relies on software systems and applications more than ever. Many of these IT systems generate and process data that is used in the preparation of financial statements of a company. The auditors also often rely on the data and reports that are generated from these systems. Explain stating clearly the meaning of Automated environment with example.

Answer

With the increasing adoption of information technology, business today relies on software systems and applications more than ever. Many of these IT systems generate and process data that is used in the preparation of financial statements of a company. The auditors also often rely on the data and reports that are generated from these systems. In this context, it is critical to understand the IT specific risks that could potentially impact the integrity and reliability of financial transactions and data flowing through a company's systems.

An automated environment basically refers to a business environment where the processes, operations, accounting and even decisions are carried out by using computer systems – also known as Information Systems (IS) or Information Technology (IT) systems. Nowadays, it is very common to see computer systems being used in almost every type of business.

Example

Think about how banking transactions are carried out using ATMs (Automated Teller Machines), or how tickets can be purchased using “apps” on mobile phones, etc. In these examples, you can see how these computer systems enable us to transact business at any time and any day.

Q20. RTP May 2019

Explain the meaning of an automated environment. Also discuss the key features of an automated environment.

Answer

An automated environment basically refers to a business environment where the processes, operations, accounting and even decisions are carried out by using computer systems – also known as Information Systems (IS) or Information Technology (IT) systems.

Nowadays, it is very common to see computer systems being used in almost every type of business.

For example, think about how banking transactions are carried out using ATMs (Automated Teller Machines), or how tickets can be purchased using “apps” on mobile phones, etc. In these examples, you can see how these computer systems enable us to transact business at any time and any day.

Some of the key features of an automated environment are as follows:

Key features of an Automated Environment

- ❖ Enables faster business operations
- ❖ Accuracy in data processing & computation
- ❖ Ability to process large volume of transactions
- ❖ Integration between business operations
- ❖ Better security & controls
- ❖ Less prone to human errors
- ❖ Provides latest information
- ❖ Connectivity & networking capability

The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven. The complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be more complex.

For example, if a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.

Similarly, there are several other aspects that an auditor should consider to determine the level of automation and complexity of a business environment which we will look at in the following sections.

Q21. RTP May 2019

Discuss the situations in which IT will be relevant to an audit.

Answer

Given below are some situations in which IT will be relevant to and audit,

- Increased use of Systems and Application software in Business (for example, use of ERPs)
- Complexity of transactions has increased (multiple systems, network of systems)
- Hi-tech nature of business (Telecom, e-Commerce)
- Volume of transactions are high (Insurance, Banking, Railways ticketing)
- Company Policy (Compliance)
- Regulatory requirements - Companies Act 2013 IFC, IT Act 2008
- Required by Indian and International Standards - ISO, PCI-DSS, SA 315, SOC, ISAE
- Increases efficiency and effectiveness of audit

Q22. RTP Nov 2018 | RTP May 21 | RTP May 20 | Exam Nov 20, 4 Marks | MTP Oct 20

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.

Answer

In today's digital age when companies rely on more and more on IT systems and networks to operate business, the amount of data and information that exists in these systems is enormous. 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

Q23. RTP May 2018

Discuss the impact of IT related risks on Substantive Audit, Controls and Reporting.

Answer

Impact of IT related risks i.e. on Substantive Audit, Controls and Reporting: The above risks, if not mitigated, could have an impact on audit in different ways. Let us understand how:

Impact on Substantive Audit	Impact on Controls	Impact on Reporting
<ul style="list-style-type: none"> • Cannot rely on the data obtained from systems. 	<ul style="list-style-type: none"> • Cannot rely on automated controls, system calculations & accounting procedures built into applications 	<ul style="list-style-type: none"> • communication to those charged with governance
<ul style="list-style-type: none"> • system data & reports should be tested substantively for completeness & accuracy 	<ul style="list-style-type: none"> • Cannot rely on IT dependent manual controls 	<ul style="list-style-type: none"> • modified auditors report.
<ul style="list-style-type: none"> • more audit evidence is needed 	<ul style="list-style-type: none"> • system data & report should be tested substantively for completeness & accuracy. 	
	<ul style="list-style-type: none"> • more substantive audit work is needed. 	

- First, we may not be able to rely on the data obtained from systems where such risks exist. This means, all forms of data, information or reports that we obtain from systems for the purpose of audit has to be thoroughly tested and corroborated for completeness and accuracy.
- Second, we will not be able to rely on automated controls, calculations, accounting procedures that are built into the applications. Additional audit work may be required in this case.
- Third, due to the regulatory requirement of auditors to report on internal financial controls of a company, the audit report also may have to be modified in some instances.

In all the above scenarios, it is likely that the auditor will be required to obtain more audit evidence and perform additional audit work. The auditor should also be able to demonstrate how the risks were identified and what audit evidence was obtained and validated to address these IT risks.

Here, we should remember that as the complexity, automation and dependence of business operations on IT systems increases, the severity and impact of IT risks too increases accordingly. The auditor should

apply professional judgement in determining and assessing such risks and plan the audit response appropriately.

Q24. MTP Oct 2022,3 Marks

Explain the objective and enlist the activities involved in the General IT Controls over "Program Change".

Answer

General IT Controls are IT controls generally implemented to mitigate the IT specific risks and applied commonly across multiple IT systems, applications and business processes. Hence, General IT controls are known as "pervasive" controls or "indirect" controls.

Program Change

Objective: To ensure that modified systems continue to meet financial reporting objectives.

Activities:

- Change Management Process – definition, roles & responsibilities
- Change Requests – record, manage, track
- Making Changes – analyze, design, develop
- Test Changes – test plan, test cases, UAT
- Apply Changes in Production
- Emergency & Minor Changes
- Documentation – user/technical manuals
- User Training

Q25. MTP March 2022, 2 Marks | MTP Nov 21

All automated environments are not complex.

Answer

Correct: The complexity of an automated environment depends on various factors including the nature of business, level of automation, volume of transactions, use of ERP and so on. There could be an environment where dependence on IT and automation is relatively less or minimal and hence, considered less complex or even non-complex.

Q26. MTP March 2022, 2 Marks | MTP Nov 21

A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is known as meaningful data.

Answer

Incorrect: A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is known as Data Analytics.

Q27. MTP Apr 2022, 2 Marks

Electronic payment of Income Tax cannot be made by an assessee from the account of any other person.

Answer

Incorrect: Electronic payment of taxes means payment of taxes by way of internet banking facility or credit or debit cards. The assessee can make electronic payment of taxes also from the account of any other person. However, the challan for making such payment must clearly indicate the Permanent Account Number (PAN) of the assessee on whose behalf the payment is made. It is not necessary for the assessee to make payment of taxes from his own account in an authorized bank.

Q28. MTP Nov 2021, 3 Marks

Describe how risks in IT systems, if not mitigated, could have an impact on audit.

Answer

When risks in IT systems are not mitigated the audit impact could be as follows:

- (i) The auditor may not be able rely on the reports, data obtained, automated controls, calculations and accounting procedures in the IT system.
- (ii) The auditor has to perform additional audit work by spending more time and efforts.
- (iii) The auditor may have to issue a modified opinion, if necessary.

Q29. MTP Oct 2021, 2 Marks

When auditing in an automated environment, inquiry is often the most efficient and effective audit testing method.

Answer

Incorrect: There are basically four types of audit tests that should be used in an automated environment. They are inquiry, observation, inspection and re-performance. Inquiry is the most efficient audit test but it also gives the least audit evidence. Hence, inquiry should always be used in combination with any one of the other audit testing methods. Inquiry alone is not sufficient. Applying inquiry in combination with inspection gives the most effective and efficient audit evidence.

Q30. MTP Apr 2021, 4 Marks

With respect to audit in an automated environment, explain the following:

- (i) Applications
- (ii) Control Deficiency
- (iii) Data Processing
- (iv) Enterprise Resource Planning
- (v) Software

Answer

(i) Applications: These are computer software programs that provide a medium for recording, storage and retrieval of business operations or transactions in electronic format.

(ii) Control Deficiency: It Exists when an internal control is either missing or not operating effectively to prevent or detect a misstatement in a timely manner by management.

(iii) Data Processing: It Refers to the systematic recording, storage, retrieval, modification and transformation of electronic data using information systems.

(iv) Enterprise Resource Planning: A type of business application software that provides an integrated platform to automate multiple interrelated business processes and operations.

(v) Software: A computer program or a collection of computer programs that provides an interface to a user for performing a specific activity, task, operation or transaction in electronic form through a computer or information system.

Q31. MTP Mar 2021, 4 Marks

With respect to audit in an automated environment, explain the following:

- (i) Data Processing
- (ii) ERP (Enterprise Resource Planning)
- (iii) General IT control
- (iv) Automated
- (v) Direct Data change

Answer

(i) Data Processing: Refers to the systematic recording, storage, retrieval, modification and transformation of electronic data using information systems.

(ii) ERP (Enterprise Resource Planning): A type of business application software that provides an integrated platform to automate multiple interrelated business processes and operations.

(iii) General IT Control: Are a type of internal controls that help in mitigating risks that arise due to use of information technology and information systems in a business.

(iv) Automated: A task or activity that is routinely performed by a computer system and does not require manual effort.

(v) Direct Data Change: A backend modification that is made directly to data that is stored in a database bypassing business rules built-in to a business application software.

Audit Sampling

Q1. Exam Nov 2022, 3 marks

What are the matters that the auditor shall consider while designing an audit sample?

Answer

Matters to be considered while designing an Audit Sample:

As per SA 530, "Audit Sampling",

(i) When designing an audit sample, the auditor shall consider the purpose of the audit procedures and the characteristics of the population from which the sample will be drawn.

(ii) When designing an audit sample, the auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

(iii) When designing an audit sample, the auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

(iv) When designing an audit sample, the auditor shall determine that sample selected must be representative of the population.

(v) When designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose.

(vi) When designing an audit sample, Consideration of the nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling.

(vii) In fulfilling the requirement of SA 500 "Audit Evidence", when performing audit sampling, the auditor performs audit procedures to obtain evidence that the population from which the audit sample is drawn is complete.

Q2. Exam May 2022, 3 marks

The approach to audit and extent of checking are undergoing a progressive change in favour of more attention towards the questions of principle and controls with a curtailment of non-consequential routine checking. Discuss the given statement.

Answer

Sampling: An Audit Procedure: No conscious effort in human society is divested of economic considerations and auditing is no exception. There is a growing realisation that the traditional approach to audit is economically wasteful because all the efforts are directed to check all transactions without any exception. This invariably leads to more emphasis on routine checking, which often is not necessary in view of the time and the cost involved. With the shift in favour of formal internal controls in the

management of affairs of organisations, the possibilities of routine errors and frauds have greatly diminished i.e The internal controls as designed by the management are for the very purpose of Prevention, Detection and Correction of Frauds and Errors. Thus, the auditors often find extensive routine checking as nothing more than a ritual because it seldom reveals anything material. Now the approach to audit and the extent of checking are undergoing a progressive change in favour of more attention towards the questions of principles and controls with a curtailment of non-consequential routine checking. By routine checking, we traditionally think of extensive checking and vouching of all the entries, disregarding the concept of materiality.

The extent of the checking to be undertaken is primarily a matter of judgment of the auditor. There is nothing statutorily stated anywhere which specifies what work is to be done, how it is to be done and to what extent it has to be done. It is also not obligatory that the auditor must adopt the sampling technique. What he is to do as an auditor is to express his opinion on the financial statements and become bound by that.

To ensure good and reasonable standard of work, he should adopt standards and techniques that can lead him to an informed professional opinion. On consideration of this fact, it can be said that it is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking (i.e., sampling), he should adopt standards and techniques which are widely followed and which have a recognised basis. Since statistical theory of sampling is based on a scientific law, it can be relied upon to a greater extent than any arbitrary technique which lacks in basis and acceptability. This enables the auditor to make conclusions and express fair opinion without having to check all of the items within the financial statements.

Q3. Exam Dec 2021, 2 Marks

Statistical sampling being more scientific and without personal bias bias will always be appropriate to use under all circumstances.

Answer

Incorrect: Statistical sampling is widely accepted way of sampling as it is more scientific, without personal bias and the result of sample can be evaluated and projected in more reliable way.

Under some audit circumstances, statistical sampling methods may not be appropriate. The auditor should not attempt to use statistical sampling when another approach is either necessary or will provide satisfactory information in less time or with less effort. For instance, when exact accuracy is required or in case of legal requirements etc.

Q4. Exam Dec 2021, 3 Marks

With reference to SA 530 "Audit Sampling", explain briefly the following factors that the auditor may consider when determining the sample size for the Test of Details –

- (i) The desired level of assurance
- (ii) Stratification of the population.

Answer

Examples of factors influencing Sample Size for Test of Details:

(i) Desired Level of Assurance: An increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population will increase the sample size. Hence, greater the level of assurance that the auditor requires that the results of the sample are in fact indicative of the actual amount of misstatement in the population, the larger the sample size needs to be.

(ii) Stratification of population: When stratification of the population is appropriate then sample size will decrease as when there is a wide range (variability) in the monetary size of items in the population, it may be useful to stratify the population. When a population can be appropriately stratified, the aggregate of the sample sizes from the strata generally will be less than the sample size that would have been required to attain a given level of sampling risk, had one sample been drawn from the whole population.

Q5. Exam Jul 2021, 2 Marks

In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population.

Answer

Incorrect: In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to derive conclusion only on the respective stratum from where they are drawn and not the whole population.

Q6. Exam Jan 2021, 4 marks | Exam May 2019, 4 Marks | RTP Nov 2020

In the context of SA 530 'Audit Sampling', explain the terms 'Sampling Risk' and 'Non- Sampling risk'.

Answer

Sampling Risk. The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. Sampling risk can lead to two types of erroneous conclusions:

(i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

(ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Non-Sampling Risk. The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

Example

Examples of non-sampling risk include use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognize a misstatement or deviation.

Sources of Non Sampling risk are :

(i) Human Mistakes

(ii) Applying audit procedures not appropriate to the objectives of audit

(iii) Relying on erroneous information e.g. erroneous confirmation

(iv) Misinterpreting the sample results

Non sampling risk can never be mathematically measured.

Q7. Exam Nov 2020, 3 Marks

It is imperative for the auditor to project misstatements for the population while performing audit procedures through sampling. Comment.

Answer

(i) The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded.

(ii) When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.

(iii) For tests of details, the auditor shall project misstatements found in the sample to the population whereas for tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.

Q8. Exam Nov 2019, 2 Marks

The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific.

Answer

Correct: The non-statistical sampling is criticized on the grounds that it is neither objective nor scientific. The expected degree of objectivity cannot be assured in non-statistical sampling because the risk of personal bias in selection of sample items cannot be eliminated. The closeness of the qualities projected

by the sample results with that of the whole population cannot be measured because the sample has not been selected in accordance with the mathematically based statistical techniques.

Q9. Exam Nov 2018, 5 Marks | RTP May 19 | RTP Nov 20

Factors that should be considered for deciding upon the extent of checking on a sampling plan.

Answer

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

- (i) Size of the organisation under audit.
- (ii) State of the internal control.
- (iii) Adequacy and reliability of books and records.
- (iv) Tolerable error range.
- (v) Degree of the desired confidence.

Q10. RTP Nov 2022 | MTP Oct 21,4 Marks

Explain the meaning of Audit Sampling as per the relevant standard on auditing. State the requirements relating to audit sampling, sample design, sample size and selection of items for testing.

Answer

Audit Sampling: As per SA 530 on "Audit Sampling", the meaning of the term Audit Sampling is – the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The requirements relating to sample design, sample size and selection of items for testing are explained below-

- **Sample design** - When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.
- **Sample Size** - The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.
- **Selection of Items for Testing** - The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

Q11. RTP Nov 2022

This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e. it is suitable for a homogeneous population having a similar range. Explain about that method.

Answer

Simple Random Sampling: Under this method each unit of the whole population e.g. purchase or sales invoice has an equal chance of being selected. It is considered that random number tables are simple and easy to use and also provide assurance that the auditors' bias does not affect the selection. Each item in a population is selected by use of random number table either with a help of computer or picking up a number in a random way (may be randomly from a drum). Today random numbers are also generated using various applications on the cellphones like the random number generator.

This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e. it is suitable for a homogeneous population having a similar range.

Q12. RTP May 2022

What are the advantages of Statistical sampling technique in auditing

Answer

Advantages of Statistical Sampling in Auditing: The advantages of statistical sampling may be summarized as follows -

- (i) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
- (ii) The sample selection is more objective and thereby more defensible.
- (iii) The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
- (iv) It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.
- (v) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.

Q13. RTP May 2022 | MTP Apr 21

Sampling risk can lead to two types of erroneous conclusions. Explain clearly stating the meaning of sampling risk

Answer

Sampling Risk. The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. This risk will always be in existence when auditor uses sampling technique in conducting his audit.

Sampling risk can lead to two types of erroneous conclusions:

(i) In the case of a **test of controls**, that controls are more effective than they actually are, or in the case of a **test of details**, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion. This is because of over reliance on the internal controls.

(ii) In the case of a **test of controls**, that controls are less effective than they actually are, or in the case of a **test of details**, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect. This is because of under reliance on the test of controls and detailed substantive procedures performed by the auditor. Here risk of giving wrong opinion is minimum but it will lead to more detailed checking which is time consuming.

Q14. RTP Nov 2021

When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn. Explain in detail.

Answer

Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can be applied using either non-statistical or statistical sampling approaches.

When designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose. Consideration of the nature of the audit evidence sought and possible deviation or misstatement conditions or other characteristics relating to that audit evidence will assist the auditor in defining what constitutes a deviation or misstatement and what population to use for sampling. In fulfilling the requirement of relevant portion (paragraph 8) of SA 500, when performing audit sampling, the auditor performs audit procedures to obtain evidence that the population from which the audit sample is drawn is complete.

The auditor's consideration of the purpose of the audit procedure includes a clear understanding of what constitutes a deviation or misstatement so that all, and only, those conditions that are relevant to the purpose of the audit procedure are included in the evaluation of deviations or projection of misstatements. For example, in a test of details relating to the existence of accounts receivable, such as confirmation, payments made by the customer before the confirmation date but received shortly after

that date by the client, are not considered a misstatement. Also, a misposting between customer accounts does not affect the total accounts receivable balance. Therefore, it may not be appropriate to consider this a misstatement in evaluating the sample results of this particular audit procedure, even though it may have an important effect on other areas of the audit, such as the assessment of the risk of fraud or the adequacy of the allowance for doubtful accounts.

In considering the characteristics of a population, for tests of controls, the auditor makes an assessment of the expected rate of deviation based on the auditor's understanding of the relevant controls or on the examination of a small number of items from the population. This assessment is made in order to design an audit sample and to determine sample size. For example, if the expected rate of deviation is unacceptably high, the auditor will normally decide not to perform tests of controls. Similarly, for tests of details, the auditor makes an assessment of the expected misstatement in the population. If the expected misstatement is high, 100% examination or use of a large sample size may be appropriate when performing tests of details.

In considering the characteristics of the population from which the sample will be drawn, the auditor may determine that stratification or value-weighted selection is appropriate.

The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

Q15. RTP Nov 2021

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.

Answer

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.

Dividing a population into discrete sub population which have identifying characteristics is called as Stratification. Each Sub population is called as Stratum and units under those sub population are referred to as Strata.

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.

The results of samples from the units drawn under each sub population are projected to that respective stratum. In order to draw an opinion on the overall population, the auditor needs to combine the results of all the stratum to check for possible deviation or risk of material misstatement.

Projected misstatements of each stratum will be combined together to consider the possible effect of misstatement in the account balances and class of transactions.

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).

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.

In value weighted selection, the sample size, its selection and evaluation will result in a conclusion in monetary amounts.

Q16. RTP May 2021

Explain the following terms with reference to Audit Sampling :

- (i) Stratification
- (ii) Tolerable misstatement
- (iii) Tolerable rate of deviation

Answer

(i) Stratification – The process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).

(ii) Tolerable misstatement – A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

(iii) Tolerable rate of deviation – A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

Q17. RTP May 2021

In most of the circumstances, the evidence available is not conclusive and the auditor always takes a calculated risk in giving his opinion. Even by undertaking hundred percent checking of the transactions, the auditor does not derive absolute satisfaction. This state of uneasiness led pragmatic auditors to adopt the statistical theory of sampling to derive the necessary satisfaction about the state of affairs by checking only a part of the total population of entries. Explain in detail.

Answer

In most of the circumstances, the evidence available is not conclusive and the auditor always takes a calculated risk in giving his opinion. Even by undertaking hundred percent checking of the transactions, the auditor does not derive absolute satisfaction. This state of uneasiness led pragmatic auditors to adopt the statistical theory of sampling to derive the necessary satisfaction about the state of affairs by checking only a part of the total population of entries.

Auditors realised that they can derive good satisfaction by undertaking a much lesser checking by adoption of this technique in the auditing process. It is a mathematical truth that the sample, if picked purely on a random basis would reveal the features and characteristics of the population.

By adopting the sampling technique, the auditor only checks a part of the whole mass of transactions. The satisfaction he used to derive earlier, by checking all the transactions, can be derived by a sample checking provided he can put reliance on the internal controls and checks within the client's organisation because they provide the reliability of the records. Sampling is used as a part of Test of controls. Auditor will check few internal controls and their operating effectiveness. Based on the conclusion derived, he can then design the sample size for test of details (i.e checking of transactions and balances)

If the internal control is satisfactory in its design and implementation, a much smaller sample can give the auditor the necessary reliability of the result he obtains.

On the other hand, if in certain areas controls are slack or not properly implemented, the auditor may have to take a much larger sample for getting satisfactory result.

Another truth about the sampling technique should be noted. It can never bring complete reliability; it cannot give precisely accurate results. It is a process of estimation. It may have some error. What error is tolerable for a particular matter under examination is a matter of the individual's judgment in that particular case.

Q18. RTP May 2020

The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded. Explain

Answer

The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded. When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.

For tests of details, the auditor shall project misstatements found in the sample to the population whereas for tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.

Q19. RTP May 2020

Explain the sampling method which involves selection of a block(s) of contiguous items from within the population. Also give example.

Answer

Block Sampling: This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

Example

Take the first 200 sales invoices from the sales day book in the month of September; alternatively take any four blocks of 50 sales invoices. Therefore, once the first item in the block is selected, the rest of the block follows items to the completion.

Q20. RTP Nov 2019

There is a growing realisation that the traditional approach to audit is economically wasteful because all efforts are directed to check all transactions without exception. Explain

Answer

No conscious effort in human society is divested of economic considerations and auditing is no exception. There is a growing realisation that the traditional approach to audit is economically wasteful because all efforts are directed to check all transactions without exception. This invariably leads to more emphasis on routine checking, which often is not necessary in view of the time and the cost involved. With the shift in favour of formal internal controls in the management of affairs of organisations, the possibilities of routine errors and frauds have greatly diminished and auditors often find extensive routine checking as nothing more than a ritual because it seldom reveals anything material. Now the approach to audit and the extent of checking are undergoing a progressive change in favour of more attention towards the questions of principles and controls with a curtailment of non-consequential routine checking. By routine checking we traditionally think of extensive checking and vouching of all entries.

Q21. RTP Nov 2019

The extent of the checking to be undertaken is primarily a matter of judgment of the auditor. It is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking, he should adopt standards and techniques which are widely followed Explain

Answer

The extent of the checking to be undertaken is primarily a matter of judgment of the auditor, there is nothing statutorily stated anywhere which specifies what work is to be done, how it is to be done and to what extent. It is also not obligatory that the auditor must adopt the sampling technique. What he is to do is to express his opinion and become bound by that.

To ensure good and reasonable standard of work, he should adopt standards and techniques that can lead him to an informed professional opinion. On a consideration of this fact, it can be said that it is in the interest of the auditor that if he decides to form his opinion on the basis of a part checking, he should adopt standards and techniques which are widely followed and which have a recognised basis. Since statistical theory of sampling is based on a scientific law, it can be relied upon to a greater extent than any arbitrary technique which lacks in basis and acceptability.

Q22. RTP May 2019

The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement. Explain

Answer

The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded. When a misstatement has been established as an anomaly, it may be excluded when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.

For tests of details, the auditor shall project misstatements found in the sample to the population whereas for tests of controls, no explicit projection of deviations is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.

Q23. RTP Nov 2018

While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind?

Answer

Risk Factors while applying Sampling Techniques: As per SA 530 "Audit Sampling", sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure.

Sampling risk can lead to two types of erroneous conclusions-

(i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.

(ii) In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

Q24. RTP Nov 2018

The auditor shall evaluate the results of the sample and whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. Explain

Answer

The auditor shall evaluate-

(a) The results of the sample; and

(b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

For tests of controls, an unexpectedly high sample deviation rate may lead to an increase in the assessed risk of material misstatement, unless further audit evidence substantiating the initial assessment is obtained. For tests of details, an unexpectedly high misstatement amount in a sample may cause the auditor to believe that a class of transactions or account balance is materially misstated, in the absence of further audit evidence that no material misstatement exists.

In the case of tests of details, the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population. When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested. The closer the projected misstatement plus anomalous misstatement is to tolerable misstatement, the more likely that actual misstatement in the population may exceed tolerable misstatement. Also, if the projected misstatement is greater than the auditor's expectations of misstatement used to determine the sample size, the auditor may conclude that there is an unacceptable sampling risk that the actual misstatement in the population exceeds the tolerable misstatement. Considering the results of other audit procedures helps the auditor to assess the risk that actual misstatement in the population exceeds tolerable misstatement, and the risk may be reduced if additional audit evidence is obtained.

In case the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

Q25. RTP May 2018

Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. Discuss explaining Statistical and Non Statistical sampling approaches.

Answer

Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn. Audit sampling can be applied using either non-statistical or statistical sampling approaches.

Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics. A sampling approach that does not have above characteristics is considered non-statistical sampling.

The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

Sample must be representative.

Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

Q26. RTP May 2018 | MTP Oct 19, 4 Marks

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.

Answer

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.

Q27. MTP Oct 2022, 2 Marks

The higher the auditor's assessment of the risk of material misstatement, the smaller the sample size needs to be.

Answer

Incorrect: The higher the auditor's assessment of the risk of material misstatement, the larger the sample size needs to be. The auditor's assessment of the risk of material misstatement is affected by inherent risk and control risk. Therefore, in order to reduce audit risk to an acceptably low level, the auditor needs a low detection risk and will rely more on substantive procedures. The more audit evidence that is obtained from tests of details (that is, the lower the detection risk), the larger the sample size will need to be.

Q28. MTP Oct 2022, 2 Marks

Systematic sampling means dividing a heterogeneous population into a homogeneous sub population, where samples are drawn from each sub population.

Answer

Incorrect: Stratification means dividing a heterogeneous population into a homogeneous sub population, where samples are drawn from each sub population. Systematic sampling 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, for example 50, and having determined a starting point within the first 50, each 50th sampling unit thereafter is selected.

Q29. MTP Sep 2022, 2 Marks

In case of stratified sampling, the conclusions are drawn on the stratum.

Answer

Correct: In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to derive conclusion only on the respective stratum from where they are drawn and not the whole population.

Q30. MTP Apr 2022, 2 Marks

The level of sampling risk that the auditor is willing to accept will not affect the sample size.

Answer

Incorrect: As per SA 530, "Audit Sampling" the level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

Q31. MTP March 2022, 3 Marks

ABC Ltd is a Large Company with huge purchase and sales transactions. Which sampling approach is recommended in such a company? Explain giving features of such sampling approach along with example

Answer

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

Features/Characteristics of Statistical Sampling:

(1) Audit testing done through this approach is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.

(2) Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.

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

For Example: An auditor while verifying the Purchases during the year realised that the purchase transactions in that year are more than 45000 in number, then in such case, statistical sampling will be highly recommended in the audit program. Random Sampling (discussed ahead in this topic) is the method you decide to choose sample in such a situation.

Q32. MTP Nov 2021, 3 Marks

CA X is not sure about the kind of Sampling method to be used for audit of a company. Advise him about the choice of methods (name of methods only) of Sampling to be used in various circumstances. Also explain briefly the advantages of the Sampling to be used by him in auditing.

Answer

Sample Selection:

CA. X should obtain the knowledge before using the sampling methods. The principal methods are as follows:

- (1) Random selection.
- (2) Systematic selection.
- (3) Monetary Unit sampling.
- (4) Haphazard selection.
- (5) Block selection.

Advantages of Statistical Sampling in Auditing:

(i) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.

- (ii) The sample selection is more objective and thereby more defensible.
- (iii) The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
- (iv) It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.
- (v) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.

Q33. MTP Oct 2020, 4 Marks

Audit testing done through Statistical sampling is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. Explain and also state advantages of Statistical sampling.

Answer

Audit testing done through this approach is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.

The advantages of statistical sampling may be summarized as follows -

- (1) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
- (2) The sample selection is more objective and thereby more defensible.
- (3) The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
- (4) It provides a means for deriving a "calculated risk" and corresponding precision (sampling error) i.e. the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.
- (5) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.

Q34. MTP May 2020, 3 Marks

The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen.

Explain stating the examples of factors (any four) that the auditor may consider when determining the sample size for tests of controls.

Answer

The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen.

Examples of Factors Influencing Sample Size for Tests of Controls: The following are factors that the auditor may consider when determining the sample size for tests of controls. These factors, which need to be considered together, assume the auditor does not modify the nature or timing of tests of controls or otherwise modify the approach to substantive procedures in response to assessed risks.

◆ When there is an increase in the extent to which the auditor's risk assessment takes into account relevant controls, The more assurance the auditor intends to obtain from the operating effectiveness of controls, the lower the auditor's assessment of the risk of material misstatement will be, and the larger

the sample size will need to be. When the auditor's assessment of the risk of material misstatement at the assertion level includes an expectation of the operating effectiveness of controls, the auditor is required to perform tests of controls. Other things being equal, the greater the reliance the auditor places on the operating effectiveness of controls in the risk assessment, the greater is the extent of the auditor's tests of controls (and therefore, the sample size is increased). Thus, sample size will increase.

◆ If there is an increase in the tolerable rate of deviation. Then sample size will decrease, as lower the tolerable rate of deviation, larger the sample size needs to be.

◆ When there is an increase in the expected rate of deviation of the population to be tested then sample size will increase, as higher the expected rate of deviation, larger the sample size needs to be so that the auditor is in a position to make a reasonable estimate of the actual rate of deviation. Factors relevant to the auditor's consideration of the expected rate of deviation include the auditor's understanding of the business (in particular, risk assessment procedures undertaken to obtain an understanding of internal control), changes in personnel or in internal control, the results of audit procedures applied in prior periods and the results of other audit procedures. High expected control deviation rates ordinarily warrant little, if any, reduction of the assessed risk of material misstatement.

◆ An increase in the auditor's desired level of assurance that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population will increase the sample size. Thus, the greater the level of assurance that the auditor desires that the results of the sample are in fact indicative of the actual incidence of deviation in the population, the larger the sample size needs to be.

◆ In case of large populations, the actual size of the population has little, if any, effect on sample size. For small populations however, audit sampling may not be as efficient as alternative means of obtaining sufficient appropriate audit evidence. Therefore, there will be negligible effect on sample size due to increase in the number of sampling units in the population.

Q35. MTP Oct 2019, 2 Marks

The method which involves dividing the population into groups of items is known as block sampling.

Answer

Incorrect. The method which involves dividing the population into groups of items is known as cluster sampling whereas block sampling involves the selection of a defined block of consecutive items.

Analytical Procedures

Q1. Exam Nov 2022, 2 marks

The term "Analytical Procedures" means evaluation of financial information through analysis of plausible relationships among financial data and non-financial data.

Answer

Correct: As per Standard on Auditing (SA) 520 "Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Q2. Exam Nov 2022, 3 marks

As per the Standard on Auditing (SA) 520 "Analytical Procedures", what are the examples of analytical procedures having consideration of relationships?

Answer

Examples of Analytical Procedure having consideration of relationship:

As per the Standard on Auditing (SA) 520 "Analytical Procedures", examples of Analytical Procedures having consideration of relationships are:

- i. Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
- ii. Between financial information and relevant non-financial information, such as payroll costs to number of employees.

Q3. Exam May 2022, 2 marks

SA 520 deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"), and as procedures near the end of the audit, that assist the auditor in preparation of the financial statements.

Answer

Incorrect: SA 520 deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"), and as procedures near the end of the audit that assist the auditor when forming an overall conclusion on the financial statements.

Q4. Exam May 2022, 4 marks

Tree Limited presented its financial statements for the F.Y. 2021-2022 to its auditor for expressing an opinion thereon. The auditor while carrying out the audit started comparing various items of profit and loss account of the year under audit with previous financial years. What is auditor trying to achieve by carrying out those comparisons?

Answer

Purpose of Applying Analytical Procedure: Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable.

The auditor of Tree Ltd. would achieve the following by carrying out the comparison stated in the question:

- (i) If balances included in the Statement of Profit and Loss of an entity are compared with those contained in the Statement of Profit and Loss with that of the previous period, it would be possible to find out the reasons for increase or decrease in the amount of profits of those years.
- (ii) By setting up certain expenses' ratios on the basis of balances included in the Statement of Profit and Loss, for the year under audit, comparing them with the same ratios for the previous year, it is possible to ascertain the extent of increase or decrease in various items of expenditure in relation to sales and that of trading profit in relation to sales.
- (iii) If differences are found to be material, the auditor would ascertain the reasons thereof and assess whether the accounts have been manipulated to inflate or suppress profits.

(iv) It would be possible to identify the existence of unusual transactions, amounts, ratios and trends that might indicate matters that have audit implications.

Q5. Exam Dec 2021, 2 Marks

When Profit before tax from continuing operations is non-volatile, other benchmarks will be appropriate.

Answer

Incorrect: Profit before tax from continuing operations is often used for profit-oriented entities. When profit before tax from continuing operations is volatile, other benchmarks may be more appropriate, such as gross profit or total revenues.

Q6. Exam Jul 2021, 2 Marks

Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur.

Answer

Incorrect: Assertions refer to representations by management, explicit or otherwise, that are embodied in the financial statements, as used by the auditor to consider the different types of potential misstatements that may occur.

Q7. Exam Jul 2021, 3 Marks

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?

Answer

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 non financial 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.

Q8. Exam Jan 2021, 3 marks

As a Statutory Auditor of the company list out audit procedure required to be undertaken for the recognition of following other income:

- i. Interest income from fixed deposit
- ii. Dividend income
- iii. Gain/(loss) on sale of investment in mutual funds.

Answer

Statutory auditor would perform the following audit procedure for recognition of different items given in the question:

(1) Interest income on fixed deposits is recognized on a time proportion basis taking into account the amount outstanding and the applicable interest rate.

(2) Dividends are recognised in the statement of profit and loss only when:

- (i) the entity's right to receive payment of the dividend is established;
- (ii) it is probable that the economic benefits associated with the dividend will flow to the entity; and
- (iii) the amount of the dividend can be measured reliably.

(3) Gain/(loss) on sale of investment in mutual funds is recorded as other income on transfer of title from the entity and is determined as the difference between the redemption price and carrying value of the investments.

Q9. Exam Nov 2020, 3 Marks

With respect to SA 520 "Analytical procedures", explain the following factors to be considered by the auditor for substantive audit procedures.

- (i) Account type (ii) Predictability (iii) Nature of Assertion.

Answer

The auditor should consider the following factors for Substantive Audit Procedures:

Account Type – Substantive analytical procedures are more useful for certain types of accounts than for others. Income statement accounts tend to be more predictable because they reflect accumulated transactions over a period, whereas balance sheet accounts represent the net effect of transactions at a point in time or are subject to greater management judgment.

Predictability – Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable (e.g., between sales and cost of sales or between trade receivables and cash receipts). A predictable relationship is one that may reasonably be expected to exist and continue over time.

Nature of Assertion – Substantive analytical procedures may be more effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations). Predictive analytical procedures using data analytics can be used to address completeness, valuation/ measurement and occurrence.

Q10. Exam Nov 2019, 2 Marks

The auditor's substantive procedure at the assertion level means substantive analytical procedures only.

Answer

Incorrect: The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedure, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.

Q11. Exam Nov 2019, 3 Marks

CA A, auditor of ABC Ltd. wants to design substantive analytical procedure and for that he wants to check whether the data is reliable or not. Mention the relevant points which he has to consider whether data is reliable for purpose of designing the substantive analytical procedures.

Answer

The following are the relevant points while determining whether data is reliable for purposes of designing substantive analytical procedures:

i. Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity.

ii. Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products.

iii. Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved.

iv. Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

Q12. Exam Nov 2019, 4 Marks

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures. Discuss the exceptions of the above statement when the prior period financial statements are audited.

Answer

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

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 auditor's report opinion on the current period's financial statements. In the basis for modification paragraph in the auditor's report the auditor shall either:

(i) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figure are material; or

(ii) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

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.

Q13. Exam May 2019, 4 Marks

While auditing purchases which types of analytical procedures will be performed by the auditor to obtain audit evidence as to overall reasonableness of purchase quantity and price.

Answer

Analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price may include:

(i) Consumption Analysis: Auditor should scrutinize raw material consumed as per manufacturing account and compare the same with previous years with closing stock and ask for the reasons from Management If any significant variations found.

(ii) Stock Composition Analysis: Auditor to collect the reports from management for composition of stock i.e. raw materials as a percentage of total stock and compare the same with previous year and ask for reasons from management in case of significant variations.

(iii) Ratios: Auditor should compare the creditors turnover ratios and stock turnover ratios of the current year with previous years.

(iv) Auditor should review quantitative reconciliation of closing stocks with opening stock, purchases and Consumption.

Q14. Exam Nov 2018, 3 Marks

Answer

Q15. Exam May 2018, 2 Marks

Answer

Q16. Exam May 2018, 5 Marks

Answer

Q17. RTP Nov 2022

Explain the aspects to be considered by an auditor when designing and performing substantive analytical procedures, either alone or in combination with test of details, as substantive procedures in accordance with SA 330.

Answer

Analytical procedures used as substantive tests: When designing and performing substantive analytical procedures, either alone or in combination with test of details as, substantive procedures in accordance with SA 330, the auditor shall:

- (i) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and test of details, if any, for these assertions.
- (ii) Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation.
- (iii) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.
- (iv) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

Q18. RTP Nov 2022

Discuss with examples the factors that are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures.

Answer

The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:

- (i) Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity;
- (ii) Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products;
- (iii) Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved; and
- (iv) Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

Q19. RTP May 2022

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, how would the auditor investigate such differences.

Answer

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.

Q20. RTP May 2022

Discuss the matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated.

Answer

Matters relevant to the auditor's evaluation of whether the expectation can be developed sufficiently precisely to identify a misstatement that, when aggregated with other misstatements, may cause the financial statements to be materially misstated, include:

(i) The accuracy with which the expected results of substantive analytical procedures can be predicted.

For example, the auditor may expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising.

(ii) The degree to which information can be disaggregated.

For example, substantive analytical procedures may be more effective when applied to financial information on individual sections of an operation or to financial statements of components of a diversified entity, than when applied to the financial statements of the entity as a whole.

(iii) The availability of the information, both financial and non-financial.

For example, the auditor may consider whether financial information, such as budgets or forecasts, and non-financial information, such as the number of units produced or sold, is available to design substantive analytical procedures. If the information is available, the auditor may also consider the reliability of the information.

Q21. RTP Nov 2021

For the purposes of the SAs, the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Explain giving examples of both.

Answer

Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:

- Comparable information for prior periods.
- Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
- Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.

Analytical procedures also include consideration of relationships, for example:

- Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
- Between financial information and relevant non-financial information, such as payroll costs to number of employees.

Q22. RTP Nov 2021

Analysis by computation of ratios includes the study of relationships between financial statement amounts. State Commonly used ratios.

Answer

Analysis by computation of ratios includes the study of relationships between financial statement amounts. Commonly used ratios include:

- Elements of income or loss as a percentage of sales
- Gross profit turnover
- Accounts receivable turnover

- Inventory turnover
- Profitability, leverage, and liquidity

Q23. RTP May 2021 | RTP May 19 | RTP May 18

The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. In this context, discuss the techniques available as Substantive Analytical Procedures.

Answer

Techniques available as Substantive Analytical Procedures : The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Substantive analytical procedures generally take one of the following forms:

Trend analysis — A commonly used technique 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.

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).

Q24. RTP May 2021

Mention the Analytical Review procedures that may be useful as a means of obtaining audit evidence regarding various assertions relating to Trade receivables, loans and advances.

Answer

Analytical Review Procedures: The following analytical review procedures may often be helpful as a means of obtaining audit evidence regarding the various assertions relating to trade receivables, loans and advances-

- (i) comparison of closing balances of trade receivables, loans and advances with the corresponding figures for the previous year;
- (ii) comparison of the relationship between current year trade receivable balances and the current year sales with the corresponding budgeted figures, if available;
- (iii) comparison of actual closing balances of trade receivables, loans and advances with the corresponding budgeted figures, if available;
- (iv) comparison of current year's ageing schedule with the corresponding figures for the previous year;
- (v) comparison of significant ratios relating to trade receivables, loans and advances with similar ratios for other firms in the same industry, if available;
- (vi) comparison of significant ratios relating to trade receivables, loans and advances with the industry norms, if available.

Q25. RTP Nov 2020

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

Answer

In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.

Q26. RTP Nov 2020

The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment. Explain

Answer

The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedures, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.

The auditor may inquire of management as to the availability and reliability of information needed to apply substantive analytical procedures, and the results of any such analytical procedures performed by the entity. It may be effective to use analytical data prepared by management, provided the auditor is satisfied that such data is properly prepared.

Q27. RTP May 2020

Explain the commonly used technique in the comparison of current data with the prior period balance or with a trend in two or more prior period balances.

Answer

Trend analysis – A commonly used technique 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.

Q28. RTP May 2020

When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions. Explain the other relevant points in this context.

Answer

When designing and performing substantive analytical procedures, either alone or in combination with tests of details, as substantive procedures in accordance with SA 330, the auditor shall:

- (i) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
- (ii) Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation;
- (iii) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
- (iv) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.

Q29. RTP Nov 2019

Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis. Analyse and Explain stating clearly the meaning of analytical procedures.

Answer

Since routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis in addition to reasonable tests. These collectively are known as overall tests. With the passage of tests, analytical procedures have acquired lot of significance as substantive audit procedure. SA-520 on Analytical Procedures discusses the application of analytical procedures during an audit.

Meaning of Analytical Procedures. As per the Standard on Auditing (SA) 520 "Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

Q30. RTP Nov 2019

Give examples of Analytical Procedures having consideration of comparisons of the entity's financial information

Answer

Examples of Analytical Procedures having consideration of comparisons of the entity's financial information with are:

- ❖ Comparable information for prior periods.
- ❖ Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
- ❖ Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry

Q31. RTP May 2019

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, explain how would the auditor investigate such differences.

Answer

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.

Q32. RTP Nov 2018 | MTP Apr 22, 4 Marks

Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. Explain

Answer

Substantive Analytical Procedure: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will

depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

Q33. RTP Nov 2018

The relationships between individual financial statements items traditionally considered in the audit of business entities may not always be relevant in the audit of governments or other non-business public sector entities. Analyse and Explain

Answer

The relationships between individual financial statements items traditionally considered in the audit of business entities may not always be relevant in the audit of governments or other non-business public sector entities; for example, in many public sector entities there may be little direct relationship between revenue and expenditure. In addition, because expenditure on the acquisition of assets may not be capitalized, there may be no relationship between expenditures on, for example, inventories and fixed assets and the amount of those assets reported in the financial statements. Also, industry data or statistics for comparative purposes may not be available in the public sector. However, other relationships may be relevant, for example, variations in the cost per kilometer of road construction or the number of vehicles acquired compared with vehicles retired.

Q34. RTP May 2018

Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Explain stating the purpose of analytical procedures with examples.

Answer

Purpose of Analytical Procedures

Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Analytical procedures are used for the following purposes:

- (i) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
- (ii) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

For instance, establishing the relationship that exists between certain balances included in the Balance Sheet and the Statement of Profit and Loss and comparing them with those that existed between the same set of balances in the previous year's reconciling the physical balances of assets with the relevant financial record; obtaining of account from the bankers, account receivables and account payables and reconciling with relevant balances in books of account; confirming amounts of outstanding income and expenses by preparing reconciliation statements, etc. These are helpful in the detection of unusual state of affairs and mistakes in accounts.

Example:

In XYZ Ltd., after applying analytical procedures as comparison of the gross profit ratio with that of the previous year, it is discovered that there has been fall in the ratio. Therefore, it became necessary for the auditor to make further enquiries as it may be due to pilferage of inventories/ misappropriation of a part of the sale proceeds/ a change in the cost of sales without a corresponding increase in the sales price.

Likewise, on verifying the balances of sundry account receivables and account payables by obtaining the confirmation of their statements of account, it will be possible for the auditor to find out whether the discrepancy in the balance of an account receivable is due to the failure to debit his account with the cost

of goods supplied to him or is the result of non-adjustment of a remittance received from him. Also whether in the case of account payable, the discrepancy is due to failure to afford him credit for one or more consignments of goods supplied by him or failure to debit him with an amount of remittance.

Similarly, by taking inventories of raw materials and stores at the end of the year any excesses or shortages therein shall be detected. The investigation of their causes might disclose that the shortages were the result of a misappropriation of inventory or that the excess were due to requisitions having been entered before the inventories were issued.

In the same way, by reconciling the amounts of interest and dividends collected with the amounts which had accrued due and that which are outstanding for payment, the mistake, if any, in the adjustment of such an income would be detected.

The overall tests can be extended for making inter-firm and intra-firm comparison of trading results.

For example, if balances included in the Statement of Profit and Loss of an entity are compared with those contained in the Statement of Profit and Loss for the same period of another entity engaged in the same trade and working under similar circumstances, it would be possible to find out the cause of the variation in the rate of profitability that exists.

Similarly, it would also be possible to compare the balances on the Statement of Profit and Loss with that of the previous period, it would be possible to find out the reasons for increase or decrease in the amount of profits of those years. By setting up certain expenses ratios on the basis of balances included in the Statement of Profit and Loss, for the year under audit, comparing them with the same ratios for the previous year, it is possible to ascertain the extent of increase or decrease in various items of expenditure in relation to sales and that of trading profit in relation to sales. If differences are found to be material, the auditor would ascertain the reasons thereof and assess whether the accounts have been manipulated to inflate or suppress profits.

An abnormal fall in the cost of manufacture or that in the administrative cost, apart from economy in expenses, there could be no provision or less provision for expenses incurred in the year. When it is suspected, the auditor should compare the entries in the outstanding book with those in the previous year. He must also check the vouchers for one month immediately before the close of the following years. To verify that none of the expenses in the accounts under audit have been charged to the accounts of the following years.

Often it is possible to independently verify the correctness of some of the items of expenses included in the Statement of Profit and Loss. For instance the cost of importing goods which are subjected to an ad valorem duty at uniform rate can be verified from the amount of duty paid. Similarly, a quantity of sugar sold by sugar mill can be verified independently from the amount of excise duty paid. Similarly, the amount of any income or expenses which has a direct relationship with the amount of profits or that of sales can be verified independently, e.g., commission paid to a manager calculated on the basis of net profits, commission paid to a selling agent as percentage of sales, etc. Such calculation of ratios, trends and comparisons is also termed as analytical review.

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

Q35. MTP Sep 2022

Answer

Understanding the Risk Management Process: Management develops controls and uses performance indicators to aid in managing key business and financial risks. An effective risk management system in a bank generally requires the following:

(i) Oversight and involvement in the control process by those charged with governance: Those charged with governance (Board of Directors/Managing Director) should approve written risk management policies. The policies should be consistent with the bank's business objectives and strategies,

capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable.

(ii) Identification, measurement and monitoring of risks: Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria.

(iii) Control activities: A bank should have appropriate controls to mitigate its risks including effective segregation of duties (particularly between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting up limits, reporting and approval of exceptions, physical security and contingency planning.

(iv) Monitoring activities: Risk management models, methodologies and assumptions used to measure and mitigate risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit.

(v) Reliable information systems: Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

Q36. MTP Apr 2022

In carrying out audit of income, the auditor is primarily concerned with obtaining reasonable assurance that the recorded income arose from transactions, which took place during the relevant period and pertained to the bank, there is no unrecorded income and the income is recorded at appropriate amount. Explain the Audit Approach and Procedures regarding following points in the above context :

- (i) RBI's Directions
- (ii) Materiality
- (iii) Revenue Certainty
- (iv) Revenue Uncertainty

Answer

Audit Approach and Procedures

- **Auditor's Concern:** In carrying out audit of income, the auditor is primarily concerned with obtaining reasonable assurance that the recorded income arose from transactions, which took place during the relevant period and pertained to the bank, there is no unrecorded income and the income is recorded at appropriate amount.
- **RBI's Directions:** RBI has advised that in respect of any income which exceeds one percent of the total income of the bank if the income is reckoned on a gross basis or one percent of the net profit before taxes if the income is reckoned net of costs, should be considered on accrual as per Accounting Standard 9.
- **Materiality:** If any item of income is not considered to be material as per the above norms, it may be recognised when received and the auditors need not qualify their report in that situation.
- **Revenue Certainty:** Banks recognise income (such as interest, fees and commission) on accrual basis, i.e., as it is earned. It is an essential condition for accrual of income that it should not be unreasonable to expect its ultimate collection. In modern day banking, the entries for interest income on advances are automatically generated through a batch process in the CBS system.
- **Revenue Uncertainty:** In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require that banks should not recognize income on non-performing assets until it is actually realised. When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for. This will apply to Government guaranteed accounts also.

Q37. MTP Nov 2021, 3 Marks

The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date

the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report. Explain the auditor's obligation in the above situation.

Answer

Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase.

Analytical Procedures in Planning the Audit

In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.

For example, analytical procedures may help the auditor during the planning stage to determine the nature, timing and extent of audit procedures that will be used to obtain audit evidence for specific account balances or classes of transactions.

Q38. MTP Oct 2021, 4 Marks

Mention the Analytical Review procedures that may be useful as a means of obtaining audit evidence regarding various assertions relating to Trade receivables, loans and advances.

Answer

Analytical Review Procedures: The following analytical review procedures may often be helpful as a means of obtaining audit evidence regarding the various assertions relating to trade receivables, loans and advances-

- (i) comparison of closing balances of trade receivables, loans and advances with the corresponding figures for the previous year;
- (ii) comparison of the relationship between current year trade receivable balances and the current year sales with the corresponding budgeted figures, if available;
- (iii) comparison of actual closing balances of trade receivables, loans and advances with the corresponding budgeted figures, if available;
- (iv) comparison of current year's ageing schedule with the corresponding figures for the previous year;
- (v) comparison of significant ratios relating to trade receivables, loans and advances with similar ratios for other firms in the same industry, if available;
- (vi) comparison of significant ratios relating to trade receivables, loans and advances with the industry norms, if available.

Q39. MTP Mar 2021, 4 Marks

TRM Ltd. is a company engaged in manufacture of beauty products. It has hair care segment, skin care segment and kids' beauty products. The auditor wants to obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework. Suggest the audit procedures in the given case.

Answer

The auditor shall obtain sufficient appropriate audit evidence regarding the presentation and disclosure of segment information in accordance with the applicable financial reporting framework by:

- (1) Obtaining an understanding of the methods used by management in determining segment information. Further,
 - (i) Evaluating whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework; and
 - (ii) Where appropriate, testing the application of such methods; and
- (2) Performing analytical procedures or other audit procedures appropriate in the circumstances.

Q40. MTP Oct 2020, 3 Marks

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

Explain with the help of examples.

Answer

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 organised 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.

Q41. MTP May 2020, 4 Marks

"P India" Ltd. is a manufacturer of various sports products. The company is having several cases of litigation pending in courts. The auditor wanted to identify litigation and claims, which may give rise to risk of material misstatements. Suggest the audit procedures in the given case.

Answer

The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

- (i) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
- (ii) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
- (iii) Reviewing legal expense accounts.

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

Audit Of Items of Financial Statements

Q1. Exam Nov 2022, 4 marks

S & Co., Chartered Accountants, are appointed as the auditors of ABC Ltd. CA S, the engagement partner, has come across the following while verifying equity share capital of the company:

(i) He noticed that some of the equity shares are held by promoters.

(ii) Some shares are issued as sweat equity shares to the employees.

What is the meaning of sweat equity shares?

What are the disclosure requirements of such promoter's shareholding?

Answer

Meaning of Sweat Equity & Disclosure of shares held by Promoters:

Meaning Sweat Equity Shares: According to Section 54 of the Companies Act, 2013, the employees may be compensated in the form of "Sweat Equity Shares".

"Sweat Equity Shares" mean equity shares issued by the company to **employees or directors** at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

Disclosure requirements of such promoter's shareholding: A company shall disclose Shareholding of Promoters* as below:

Shares held by promoters at the end of the year				% Change during the year***
S. No.	Promoter Name	No. of shares	% of total shares**	

* Promoter here means promoter as defined in the Companies Act, 2013.

** Details shall be given separately for each class of shares.

*** percentage change shall be computed with respect to the number at the beginning of the year or if issued during the year for the first time then with respect to the date of issue.]

Q2. Exam Nov 2022, 4 marks

M/s SS & Associates have been appointed as statutory auditors of Green Limited, a company engaged in the business of manufacturing of hardware products. They are analyzing the monthly trends for other expenses like rent, power and fuel, repairs, etc. and are also verifying attributes of such types of expenses. List down the attributes for verifying such expenses.

Answer

Attributes for verifying other expenses like Power and Fuel, Repair etc.:

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

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

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

Q3. Exam Nov 2022, 3 marks

While auditing books of accounts of SOLAR Ltd., you observed that an amount due from a debtor for invoice issued on 31.03.2022 has not been recognized in the books of accounts. As an auditor, you want to ensure that all trade receivable balances that are supposed to be recorded have been recognized in the financial statements. How will you achieve the stated objective?

Answer

Audit of Trade Receivable:

All Trade receivable balances that were supposed to be recorded have been recognized in the financial statements. (COMPLETENESS): The auditor needs to satisfy himself of the cut-offs. Without a cut-off, sales could be understated or overstated, hence there is a need to perform the following cut off procedure:

- (a) For the invoices issued during the last few days (last 5 days of the reporting year) i.e. cut-off date and which have been included in the debtors; check that the goods should have been dispatched and not lying with the Company;
- (b) Ensure that all goods dispatched prior to the period/ year-end have been invoiced and included in debtors on a test check basis;
- (c) Ensure that no goods dispatched after the year- end have been invoiced and included in debtors for the period under audit.

Q4. Exam Nov 2022, 3 marks

A Ltd. has traded for 50.00 Lacs in "TETRA", a virtual currency, during the F.Y. 2021-2022 and earned a profit of 20.00 Lacs on it. What disclosure requirements are prescribed for such type of transactions done by the company?

Answer

Disclosure of Crypto Currency or Virtual Currency:

Where the Company has traded or invested in Crypto currency or Virtual Currency during the financial year, the following shall be disclosed:

- (a) profit or loss on transactions involving Crypto currency or Virtual Currency
- (b) amount of currency held as at the reporting date,
- (c) deposits or advances from any person for the purpose of trading or investing in Crypto Currency/ virtual currency.

Q5. Exam May 2022, 4 marks

B Ltd. is covered u/s 135 of the Companies Act, 2013 i.e. Corporate Social Responsibility (CSR). What matters (other than the amount spent, amount not spent, amount required to be spent etc.) shall be disclosed by the company with regard to CSR activities done by the company?

Answer

Corporate Social Responsibility (CSR): Since B Ltd is covered under section 135 of the Companies Act, the following matters shall be disclosed by the B Ltd with regard to CSR activities:

- (a) total of previous years shortfall,
- (b) reason for shortfall,
- (c) nature of CSR activities,
- (d) 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,
- (e) 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.

Q6. Exam May 2022, 4 marks

Proceedings have been initiated against False Limited for holding benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, but such property is not recorded in books of accounts. As a consultant to the company, what will you advise to the company as far as disclosure requirements are concerned in relation to said proceedings?

Answer

Disclosure in case of Benami Properties held by the Company: Where any proceedings have been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, the company shall disclose the following:

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

Q7. Exam Dec 2021, 4 Marks

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

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

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

Answer

Audit procedure to establish Rights and Obligations of the entity over PPE:

- (i) In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, CA R, the statutory auditor of B Ltd, while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity. Verify whether the PPE additions have been approved by authorized personnel
- (ii) For all additions to land, building in particular, CA R, the statutory auditor of B Ltd, should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.

(iii) The auditor should insist and verify the original title deeds for all immovable properties held as at the balance sheet date.

(iv) In case the entity has given such immovable property as security for any borrowings and the original title deeds are not available with the entity, CA R, the statutory auditor of B Ltd should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immovable property as security.

(v) In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

Q8. Exam Dec 2021, 4 Marks

Statutory Auditors of TRB Ltd. observed various instances when either the TDS required to be deducted has not been deducted or deducted at lower than prescribed rates resulting in non-compliance of Income Tax provisions. Besides this, non-compliance under other acts like Labour Laws was also noticed by the auditor. What type of policies and procedures will you implement to assist in prevention and detection of non-compliance with laws and regulations?

Answer

Types of polices and procedures to assist prevention and detection of non-compliance with laws & regulation:

The following are examples of the types of policies and procedures, TRB Ltd may implement to assist in the prevention and detection of non-compliance with laws and regulations:

- (i) Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.
- (ii) Instituting and operating appropriate systems of internal control.
- (iii) Developing, publicizing and following a code of conduct.
- (iv) Ensuring employees are properly trained and understand the code of conduct.
- (v) Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.
- (vi) Engaging legal advisors to assist in monitoring legal requirements.
- (vi) Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

Q9. Exam Dec 2021, 3 Marks

Whether it is possible to independently verify the correctness of some of the items of expenses included in the statement of profit and loss? Explain with the help of some examples.

Answer

Often it is possible to independently verify the correctness of some of the items of expenses included in the Statement of Profit and Loss.

For instance, the cost of importing goods which are subjected to an ad-valorem duty at uniform rate can be verified from the amount of duty paid. Similarly, a quantity of sugar sold by sugar mill can be verified independently from the amount of excise duty/ GST paid.

Similarly, the amount of any income or expenses which has a direct relationship with the amount of profits or that of sales can be verified independently, e.g., commission paid to a manager calculated on the basis of net profits, commission paid to a selling agent as percentage of sales, etc. Such calculation of ratios, trends and comparisons is also termed as analytical review.

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

Q10. Exam Dec 2021, 3 Marks

CA K audited the books of accounts of E Ltd. for the financial year 2020-2021. The auditor used an audit procedure according to which all the documents and records maintained by the company were checked in detail to obtain audit evidence. Explain the audit procedure used by the auditor and its reliability.

Answer

Audit Procedure:

Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.

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

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

In view of above, it can be concluded that CA K used Inspection as an audit procedure.

Q11. Exam Jul 2021, 2 Marks

In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater.

Answer

Correct: In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

- ❖ Management may be unaware of the existence of all related party relationships.
- ❖ Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.

Q12. Exam Jul 2021, 4 Marks

CA B is appointed as an auditor of M/s. Divine Pharmacy, a wholesale medicine supplier. While auditing for the financial year 2020-21, CA B wants to use test checking technique. Advise CA B, what kind of precautions should be taken by him in this regard.

Answer

While auditing the accounts of Divine Pharmacy, CA B wanted to use Test Checking technique. The following Precautions should to be taken by CA B while applying test check techniques:

- ❖ Thorough study of accounting system should be done before adopting sampling
- ❖ Proper study of internal control systems.
- ❖ Areas which are not suitable for sampling should be carefully considered. eg: compliance with statutory provisions, transactions of unusual nature etc.
- ❖ Proper planning for Sampling methods to be used and explaining the staff,
- ❖ Transactions and balances have to be properly classified (stratified)
- ❖ Sample size should be appropriately determined.
- ❖ Sample should be chosen in unbiased way,
- ❖ Errors located in the sample should be analyzed properly.

Q13. Exam Jul 2021, 4 Marks

CA "X" while conducting an audit of Joyful Ltd. found a considerable increase in sales as compared to the previous year, he doubts that few fictitious sales have been recorded by the company to overstate its revenues. Discuss any four audit procedures to be undertaken by the auditor to ensure revenue from sales of goods and services performed during the period is not overstated?

Answer

CA X, having doubts about fictitious sales being recorded by Joyful Ltd would ensure that revenue is not overstated by performing following audit procedures:

- ❖ Check whether a single sales invoice is recorded twice or a cancelled sales invoice could also be recorded.
- ❖ Test check few invoices with their relevant entries in sales journal.
- ❖ Obtain confirmation from few customers to ensure genuineness of sales transaction
- ❖ Whether any fictitious customers and sales have been recorded.
- ❖ 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 actions (financing, resale etc.)

Q14. Exam Jul 2021, 3 Marks

The value of intangible assets may diminish due to efflux of time, use and/or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period. Discuss the audit procedures to be applied by the auditor to ensure that Intangible assets have been valued appropriately and as per generally accepted accounting policies and practices.

Answer

The value of intangible assets may diminish due to efflux of time, use and/ or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period. Unless this cost in the form of amortization is charged to the accounts, the profit or loss would not be correctly ascertained and the values of intangible asset would be shown at higher amounts. The auditor should:

- Verify that the entity has charged amortization on all intangible assets;
- Verify that the amortization method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

The auditor should also verify whether the management has done an impairment assessment to determine whether an intangible asset is impaired. For this purpose, the auditor needs to verify whether the entity has applied AS 28 - Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset, determining the recoverable amount of the asset to determine impairment loss, if any.

Q15. Exam Jan 2021, 2 marks

If the purpose of an audit procedure is to test for understatement in the existence or valuation of accounts payable then testing the recorded accounts payable may be relevant audit procedure.

Answer

Incorrect: If the purpose of an audit procedure is to test for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure.

On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.

Q16. Exam Jan 2021, 4 marks

Depreciation and amortisation expense generally constitute an entity's significant part of overall expenses and have direct impact on the profit/loss of the entity. What are the attributes, the Auditor needs to consider while verifying Depreciation and amortisation expense.

Answer

Depreciation and amortisation generally constitute an entity's significant part of overall expenses and have direct impact on the profit/ loss of the entity, hence auditors need to verify and ensure that such expenditure is appropriate, accurately calculated and has been accounted as per applicable provisions of Companies Act or other statutes, to the extent applicable on the respective industry and as per generally accepted accounting principles.

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

- Obtain the understanding of entity's accounting policy related to depreciation and amortisation.
- Ensure the Company policy for charging depreciation and amortisation is as per the relevant provisions of Companies Act/ applicable accounting standards.
- Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.
- Whether depreciation and amortisation charges are valid.
- Whether depreciation and amortisation charges are accurately calculated and recorded.
- Whether all depreciation and amortisation charges are recorded in the appropriate period.
- Ensure the parts (components) of each item of property, plant and equipment that are to be depreciated separately have been properly identified.
- Whether the most appropriate depreciation method for each separately depreciable component has been used.

Q17. Exam Jan 2021, 3 marks

ABC Limited has a closing balance of work in progress of inventories aggregating Rs.850 lakhs in their balance sheet as at March 31, 2020.

As Statutory Auditor of ABC Limited, explain various audit procedures which need to be performed to confirm Work-in-progress of inventories have been valued appropriately and as per generally accepted accounting policies and practices.

Answer

Audit procedure which needs to be performed to confirm work in progress worth Rs.850 lakhs has been valued appropriately and as per generally accepted accounting policies and practices is given hereunder :

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

Q18. Exam Jan 2021, 3 marks

As a Statutory Auditor of the company list out audit procedure required to be undertaken for the recognition of following other income:

- i. Interest income from fixed deposit
- ii. Dividend income

iii. Gain/(loss) on sale of investment in mutual funds.

Answer

Statutory auditor would perform the following audit procedure for recognition of different items given in the question:

(1) Interest income on fixed deposits is recognized on a time proportion basis taking into account the amount outstanding and the applicable interest rate.

(2) Dividends are recognised in the statement of profit and loss only when:

- (i) the entity's right to receive payment of the dividend is established;
- (ii) it is probable that the economic benefits associated with the dividend will flow to the entity; and
- (iii) the amount of the dividend can be measured reliably.

(3) Gain/(loss) on sale of investment in mutual funds is recorded as other income on transfer of title from the entity and is determined as the difference between the redemption price and carrying value of the investments.

Q19. Exam Jan 2021, 3 marks

XYZ Ltd. which is in the business of trading of automobile components is following Cash Basis of Accounting for sale of spare parts. As Statutory Auditor of XYZ Ltd. explain the reporting requirements, manner of qualification and disclosure, if any, to be made in the auditor's report in line with AS-1 'Disclosure of Accounting Policies'.

Answer

Reporting requirements, Manner of qualification and disclosure to be made in the auditor's report in line with AS 1, "Disclosure of Accounting Policies" are given hereunder :

In the case of a company, members should qualify their audit reports in case -

- (a) accounting policies required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013 have not been disclosed, or
- (b) accounts have not been prepared on accrual basis, or
- (c) the fundamental accounting assumption of going concern has not been followed and this fact has not been disclosed in the financial statements, or
- (d) proper disclosures regarding changes in the accounting policies have not been made.

Where a company has been given a specific exemption regarding any of the matters stated above but the fact of such exemption has not been adequately disclosed in the accounts, the member should mention the fact of exemption in his audit report without necessarily making it a subject matter of audit qualification.

In view of the above, the auditor will have to consider different circumstances whether the audit report has to be qualified or only disclosures have to be given.

In making a qualification / disclosure in the audit report, the auditor should consider the materiality of the relevant item. Thus, the auditor need not make qualification / disclosure in respect of items which, in his judgement, are not material.

A disclosure, which is not a subject matter of audit qualification, should be made in the auditor's report in a manner that it is clear to the reader that the disclosure does not constitute an audit qualification. The paragraph containing the auditor's opinion on true and fair view should not include a reference to the paragraph containing the aforesaid disclosure.

Q20. Exam Nov 2020, 2 Marks

Dividends are recognized in the statement of profit and loss only when the amount of dividend can be measured reliably.

Answer

Incorrect: Dividends are recognised in the statement of profit and loss only when:

- (i) the entity's right to receive payment of the dividend is established;
- (ii) it is probable that the economic benefits associated with the dividend will flow to the entity; and
- (iii) the amount of the dividend can be measured reliably.

Q21. Exam Nov 2020, 4 Marks

ABC limited appointed XYZ & Company, Chartered Accountants, as a Statutory Auditor of the Company for the year 2019-20. CA X, partner of XYZ & Company, was looking after the audit of other income of the company which consists of interest income on fixed deposits. As a Statutory Auditor how would CA X verify interest income on fixed deposits for the year 2019-20?

Answer

CA X, partner of XYZ & Company, would carry out the following audit procedure for verifying interest income on fixed deposits of ABC Limited:

1. Obtain a listing of fixed deposits opened during the period under audit along with the applicable interest rate and the number of days for which the deposit was outstanding during the period. Verify the arithmetical accuracy of the interest calculation made by the entity by recomputing i.e. multiplying the deposit amount with the applicable rate and number of days during the period under audit.
2. For deposits still outstanding as at the period- end, trace the same to the direct confirmations obtained from the respective bank/ financial institution.
3. Obtain a confirmation of interest income from the bank and verify that the interest income as per bank reconciles to the calculation shared by the entity.
4. Also, obtain a copy of Form 26AS (TDS withholding by the bank/ financial institution) and reconcile the interest reflected therein to the calculation shared by the client.

Q22. Exam Nov 2020, 3 Marks

Discuss the audit procedures generally required to be undertaken by the auditor while auditing Goods sent out on Sale or Return Basis.

Answer

The audit procedure generally required to be undertaken by the auditor while auditing Goods sent out on Sale or Return Basis is as under:

- (i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited **only** after the goods have been sold and the sales account is credited.
- (ii) Verify that the price of such goods is unloaded from the sales account and the trade receivables record. Check the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.
- (iii) Ensure that the goods in respect of which the period of approval has expired at the end of the year, have either been received back or customers' accounts have been debited.
- (iv) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the end of the year lying with the party, has been included in the closing inventory.

Q23. Exam Nov 2019, 2 Marks

All entities that are under common control by a state (i.e. national, regional or local government) are considered related party.

Answer

Incorrect: Entities that are under common control by a state (i.e., a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.

Q24. Exam Nov 2019, 4 Marks

Validity and consequence of issue of shares at discount, check with respect to the provisions of the Companies Act, 2013.

Answer

Shares issued at discount:

(i) As per section 53 of the Companies Act, 2013, a company shall not issue share at a discount, except in the case of an issue of sweat equity shares given under section 54 of the Companies Act, 2013. Any share issued by a company at a discounted price shall be void.

(ii) The auditor needs to 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 authorising issue of share capital and the issue price.

(iii) Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees: and

(iv) every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees, or with both.

Q25. Exam Nov 2019, 3 Marks

Explain the disclosure requirements of IND AS compliant Schedule III to Companies Act, 2013 for each component of "Other Equity."

Answer

For each component of other equity, whether the company has disclosed the following (to the extent applicable):

- (i) Balance at the beginning of the reporting period
- (ii) Changes in accounting policy or prior period error
- (iii) Restated balance at the beginning of the reporting period
- (iv) Total comprehensive income for the year end
- (v) Dividends
- (vi) Transfer to retained earnings
- (vii) Any other change (to be specified)
- (viii) Balance at the end of reporting period

Q26. Exam Nov 2019, 3 Marks

Discuss the audit procedure to be considered by an auditor while performing analytical procedure to obtain audit evidence as to overall reasonableness of purchase quantity and price.

Answer

Auditor needs to perform analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price which may include:

(i) Consumption Analysis: Auditor should scrutinize raw material consumed as per manufacturing account and compare the same with previous years with closing stock and ask for the reasons from management if any significant variations are found.

(ii) Stock Composition Analysis: Auditor to collect the reports from management for composition of stock i.e. raw materials as a percentage of total stock and compare the same with compare the same with previous years and ask for the reasons from management if any significant variations found.

(iii) Ratios: Auditor should compare the creditors turnover ratios and stock turnover ratios of the current year with previous years.

(iv) Auditor should review **quantitative reconciliation** of closing stocks with opening stock, purchases and consumption.

Q27. Exam May 2019, 4 Marks

"P India" Ltd. is a manufacturer of various sports products. The company is having several cases of litigation pending in courts. The auditor wanted to identify litigation and claims, which may give rise to risk of material misstatements. Suggest the audit procedures in the given case.

Answer

The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

- (i) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
- (ii) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
- (iii) Reviewing legal expense accounts.

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

Q28. Exam May 2019, 4 Marks

You are an auditor of PQR Ltd. which has spent ₹ 10 lakhs on Research activities of the product during period under audit. Board of Directors want to recognize it as an internally generated intangible assets. Advise and discuss the conditions necessary to be fulfilled to recognize the intangible assets in the financial statements.

Answer

No Intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research shall be recognised as an expense when it is incurred since in the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Thus, board of directors of PQR Ltd cannot recognize the expense as internally generated intangible asset.

An intangible asset shall be recognised if, and only if:

- (i) the said asset is identifiable;
- (ii) the entity controls the asset i.e. the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits;
- (iii) it is probable that future economic benefits associated with the asset will flow to the entity;
- (iv) the cost of the item can be measured reliably.

Q29. Exam May 2019, 3 Marks

While reviewing Employee benefits expenses of a company, how you as an auditor you will evaluate its hiring, appraisal and retirement process?

Answer

While reviewing Employee Benefits expenses auditor needs to obtain a clear understanding about the organisation and its hiring, appraisal and retirement process in the following manner:

- (i) The auditor first tests the controls the company has set around the employee benefit payment process to determine how strong and reliable they are. If they are strong, the auditor can minimize the amount of transaction testing he must do. Common internal controls over the employee benefit payment cycle includes maintaining of attendance records, authorisation and approval of monthly payroll processing and disbursement.
- (ii) The auditor selects a random sample of transactions and examines the related appointment letters, appraisal letters, attendance records, HR policies, employee master etc.
- (iii) The auditor performs Substantive analytical procedure consisting of monthly expense reasonability, comparison with previous accounting period, any analysis auditor may find relevant and most important

of all setting an expectation in relation to the expense incurred during the period under audit and compare that with the client's business operations and overall trend in the industry.

Q30. Exam May 2019, 3 Marks

The securities premium account may only be applied by the company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares. Comment.

Answer

It is not correct to say that the securities premium account may only be applied by the Company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares, other purposes for which securities premium account can be applied are-

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

Q31. Exam May 2019, 4 Marks

Mr. Piyush, the Bank Manager develops controls to aid in managing key business and financial risks. Discuss the various requirements for an effective risk management system in a bank.

Answer

An effective risk management system in a bank generally requires the following:

(i) Oversight and involvement in the control process by those charged with governance: Those charged with governance (BOD/Chief Executive Officer) should approve written risk management policies. The policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable.

(ii) Identification, measurement and monitoring of risks: Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria.

(iii) Control activities: A bank should have appropriate controls to manage its risks, including effective segregation of duties (particularly, between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting of limits, reporting and approval of exceptions, physical security and contingency planning.

(iv) Monitoring activities: Risk management models, methodologies and assumptions used to measure and manage risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit.

(v) Reliable information systems: Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

Q32. Exam Nov 2018, 5 Marks

M/s Pankaj & Associates, Chartered Accountants, have been appointed as an auditor of ABC Limited. CA Pankaj did not apply any audit procedures regarding opening balances. He argued that since financial statements were audited by the predecessor auditor therefore he is not required to verify them. Is CA Pankaj correct in his approach?

Answer

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.

Q33. Exam May 2018, 5 Marks

Expenses which are essentially of a revenue nature if incurred for creating an asset or adding to its value for achieving higher productivity are regarded as expenses of a capital nature. Describe any five such expenses.

Answer

Depreciation and Amortisation Expenses: Auditor needs to consider the following attributes while verifying for depreciation and amortisation expenses:

- Obtain the understanding of entity's accounting policy related to depreciation and amortisation.
- Ensure that the Company's policy for charging depreciation and amortisation is as per the relevant provisions of Companies Act and applicable accounting standards.
- Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.
- Whether depreciation and amortisation charges are valid.
- Whether depreciation and amortisation charges are accurately calculated and recorded.
- Whether all depreciation and amortisation charges are recorded in the appropriate period.
- Ensure the parts (components) of each item of property, plant and equipment that are to be depreciated separately has been properly identified.
- Whether the most appropriate depreciation method for each separately depreciable component has been used.

Q34. Exam, May 2018, 8 Marks

As statutory auditor of the company, list out audit procedures required to be undertaken for the following:

- (i) Interest income from fixed deposits.
- (ii) Dividend income.
- (iii) Gain/(loss) on sale of investment in Mutual funds.

Also indicate disclosure requirements of above as per Companies Act, 2013.

Answer

(i) For verifying interest income on fixed deposits:

- Obtain a listing of fixed deposits opened during the period under audit along with the applicable interest rate and the number of days for which the deposit was outstanding during the period. Verify the arithmetical accuracy of the interest calculation made by the entity by multiplying the deposit amount with the applicable rate and number of days during the period under audit.
- For deposits still outstanding as at the period- end, trace the same to the direct confirmation obtained from the respective bank/ financial institution.
- Obtain a confirmation of interest income from the bank and verify that the interest income as per bank reconciles to the calculation shared by the entity.
- Also, obtain a copy of Form 26AS (TDS withholding by the bank/ financial institution) and reconcile the interest reflected therein to the calculation shared by client.

(ii) Dividend Income: For Dividends, verify that the same are recognised in the statement of profit and loss only when the entity's right to receive payment of the dividend is established, provided it is probable that the economic benefits associated with the dividend will flow to the entity and the amount of the dividend can be measured reliably.

(iii) Gain/(loss) on sale of investment in mutual funds: Verify that Gain/(loss) on sale of investment in mutual funds is recorded as other income only on transfer of title from the entity and is determined as the difference between the redemption price and carrying value of the investments. For the purpose, obtain the mutual fund statement and trace the gain / loss as recorded in the books of account to the gain/ loss as reflected in the statement.

Disclosure Requirements: Ensure whether the following disclosures as required under Ind AS compliant Schedule III to Companies Act, 2013 have been made:

Whether 'other income' has been classified as:

- o Interest income
- o Dividend income
- o Other non-operating income (net of expenses directly attributable to such income)

Q35. RTP Nov 2022 | Exam May 18, 4 Marks

Name the assertions for the following audit procedures:

- Year end inventory verification.
- Depreciation has been properly charged on all assets.
- The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company.
- All liabilities are properly recorded in the financial statements.
- Related party transactions are shown properly.

Answer

- Year-end inventory verification: Existence Assertion.
- Depreciation has been properly charged on all assets: Valuation Assertion.
- Title deed of lands disclosed in the Balance Sheet are held in the name of the Company: Rights & Obligations Assertion.
- All liabilities are properly recorded in the financial statements: Completeness.
- Related party transactions are shown properly: Presentation & Disclosure.

Q36. RTP Nov 2022

PK Pvt Ltd, based in Moradabad, is engaged in export of brassware goods. The company has huge export receivables as on 31st March 2022. It is also analysed from Export Sales account of the company that large number of small shipments were almost despatched daily during month of March 2022. List out few audit procedures you would adopt as an auditor to verify completeness assertion of export trade receivables.

Answer

Completeness assertion in respect of account balances means that all balances which should have been recorded have been recorded. The auditor needs to satisfy himself about cut off so that there is no understatement or overstatement in account balances of export receivables.

In this context, while verifying completeness assertion of export trade receivables, following audit procedures are required: -

- (1) Check that in respect of invoices raised in last few days nearing the cut off date, goods have been actually despatched and not lying with the company.
- (2) Check stock records, e-way bill, and transporter receipt regarding actual movement of goods. It would provide assurance that export invoices in respect of which revenue was booked have been actually moved out of company's premises.
- (3) Ensure that all goods invoiced prior to cut off date/year end have been included in export receivables on test check basis.
- (4) Ensure that no goods despatched after year end have been included in export receivables by tracing entries in export sales, stock records of next year. The same can be verified from e-way bills also.
- (5) Match invoices to dispatch/shipping details. Further match invoices dates to dispatch dates to see if sales are being recorded in correct accounting period.
- (6) Test invoices in receivable report. Select invoices from ageing report of export receivables and compare them with supporting documentation to ensure that these are billed with correct names, dates and amounts.

Q37. RTP May 2022 | RTP Nov 21

Explain how you will verify the items given while conducting an audit of an entity:

- (a) Recovery of Bad debts written off
- (b) Receipt of Insurance claims
- (c) Payment of Taxes
- (d) Sale proceeds of scrap material

Answer

(a) Recovery of Bad Debts written off: Recovery of bad debts written off is verified with reference to relevant correspondence and proper authorisation.

- (i) Ascertain the total amount lying as bad debts and verify the relevant correspondence with the trade receivables whose accounts were written off as bad debt.
- (ii) Ensure that all recoveries of bad debts have been properly recorded in the books of account.
- (iii) Examine notification from the Court or from bankruptcy trustee. Letters from collecting agencies or from account receivables should also be seen.
- (iv) Check Credit Manager's file for the amount received and see that the said amount has been deposited into the bank promptly.
- (v) Vouch acknowledgement receipts issued to account receivables or trustees.
- (vi) Review the internal control system regarding writing off and recovery of bad debts

(b) Receipt of Insurance Claims: Insurance claims may be in respect of fixed assets or current assets. While vouching the receipts of insurance claims-

- (i) The auditor should examine a copy of the insurance claim lodged with the insurance company correspondence with the insurance company and with the insurance agent should also be seen. Counterfoils of the receipts issued to the insurance company should also be seen.
- (ii) The auditor should also determine the adjustment of the amount received in excess or short of the value of the actual loss as per the insurance policy.
- (iii) The copy of certificate/report containing full particulars of the amount of loss should also be verified.
- (iv) The accounting treatment of the amount received should be seen particularly to ensure that revenue is credited with the appropriate amount and that in respect of claim against asset, the Statement of Profit and Loss is debited with the short fall of the claim admitted against book value, if the claim was lodged in the previous year but no entries were passed, entries in the Statement of Profit and Loss should be appropriately described.

(c) Payment of Taxes:

- (i) Obtain the computation of taxes prepared by the auditee and verify whether it is as per the Income Tax Act/GST Act/ Rules/ Notifications/ Circulars etc.
- (ii) Examine relevant records and documents pertaining to payment of advance income tax and self assessment tax.
- (iii) Payment on account of income-tax and other taxes like GST consequent upon a regular assessment should be verified by reference to the copy of the assessment order, notice of demand and the receipted challan acknowledging the amount paid.
- (iv) The penal interest charged for non-payment should be debited to the interest account.
- (v) Nowadays, electronic payment of taxes is also in trend. Such electronic payment of taxes by way of internet banking facility or credit or debit cards shall also be verified.
- (vi) The assessee can make electronic payment of taxes also from the account of any other person. Therefore, it should be verified that the challan for making such payment is clearly indicating the PAN No./TAN No./TIN No./GSTIN etc. of the assessee on whose behalf the payment is made.

(d) Sale Proceeds of Scrap Material:

- (i) Review the internal control on scrap materials, as regards its generation, storage and disposal and see whether it was properly followed at every stage.
- (ii) Ascertain whether the organisation is maintaining reasonable records for the sale and disposal of scrap materials.
- (iii) Review the production and cost records for determination of the extent of scrap materials that may arise in a given period.
- (iv) Compare the income from the sale of scrap materials with the corresponding figures of the preceding three years.
- (v) Check the rates at which different types of scrap materials have been sold and compare the same with the rates that prevailed in the preceding year.
- (vi) See that scrap materials sold have been billed and check the calculations on the invoices.
- (vii) Ensure that there exists a proper procedure to identify the scrap material and good quality material is not mixed up with it and sold as scrap
- (viii) Make an overall assessment of the value of the realisation from the sale of scrap materials as to its reasonableness.

Q38. RTP May 2022

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.

Answer

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.

Q39. RTP Nov 2021

APQ Ltd. deals in real estate and classifies all of its land holding under current assets as inventory. The same is, therefore, valued at cost or market value whichever is less. How would you verify profit or loss arising on sale of plots of land by such a dealer?

Answer

Verification of Profit & Loss Arising on sale of Plots by real estate dealer:

The land holding in the case of real estate dealer will be a current asset and not a fixed asset. The same should, therefore, be valued at cost or market value whichever is less. The amount of profit or loss arising on sale of plots of land by such a dealer should be verified as follows:

(i) Each property account should be examined from the beginning of the development with special reference to the nature of charges so as to find out that only the appropriate cost and charges have been debited to the account and the total cost of the property has been set off against the price realised for it.

(ii) This basis of distribution of the common charges between different plots of land developed during the period, and basis for allocation of cost to individual properties comprised in a particular piece of land should be scrutinised.

(iii) If land price lists are available, these should be compared with actual selling prices obtained. And it should be verified that contracts entered into in respect of sale have been duly sanctioned by appropriate authorities.

(iv) Where part of the sale price is intended to reimburse taxes or expenses, suitable provisions should be maintained for the purpose.

(v) The prices obtained for various plots of land sold should be checked with the plan map of the entire tract and any discrepancy or unreasonable price variations should be inquired into. The sale price of different plots of land should be verified on a reference to certified copies of sale deeds executed.

(vi) Out of the sale proceeds, provision should be made for the expenditure incurred on improvement of land, which so far has been accounted for.

Q40. RTP May 2021

List out the steps to be taken by auditor while vouching/ verifying the 'Refund of General Insurance premium paid'.

Answer

Refund of General Insurance Premium paid: The refund of insurance premium may be because of earlier provisional payment of premium or may be a policy might have been cancelled at a later date. The auditor should take following steps while vouching such refunds:

(i) Ascertain the reasons for refund of insurance premium.

(ii) Examine insurance policy or cover note to find out the amount of premium.

(iii) Verify advice of refund received from the insurance company. When refund is admitted, the insurance company sends the advice. This will be evidence as a covering letter to the cheque for the refund. Sometimes, a cheque is issued after a receipt is sent in advance to the insurance company.

(iv) Scrutinise correspondence between the insurance company and the client.

(v) Check entries in the bank book or the bank statement. If necessary, the counterfoil of the pay-in-slips can also be verified.

Q41. RTP May 2021

Newton Ltd. has made loans and advances on the basis of following securities to various borrowers. As an auditor what type of documents can be verified to ensure that the company holds a legally enforceable security?

(i) Shares and Debentures

(ii) Life Insurance Policy

(iii) Hypothecation of goods.

Answer

Types of Security	Documents etc. to be seen
(i) Shares and debentures	The scrip and the endorsement thereon of the name of the transferee, in the case of transfer.
(ii) Life Insurance Policy.	Assignment of policy in favour of the lender, duly registered with the insurer
(iii) Hypothecation of goods	Deed of hypothecation or other document creating the charge, together with a statement of inventories held at the Balance Sheet date

Q42. RTP Nov 2020

How will you vouch/verify the following?

- (a) Trademarks and copyrights
- (b) Investments income in the case of charitable institutions
- (c) Contingent liabilities
- (d) Leasehold rights

Answer

(a) Trademarks and Copyrights:

- (i) Obtain schedule of Trade Marks and Copyrights duly signed by the responsible officer and scrutinise the same and confirm that all of them are shown in the Balance Sheet.
- (ii) Examine the written agreement in case of assignment of Copyrights and Assignment Deed in case of transfer of trade marks. Also ensure that trademarks and copyrights have been duly registered.
- (iii) Verify existence of copyright by reference to contract between the author & the entity and note down the terms of payment of royalty.
- (iv) See that the value has been determined properly and the costs incurred for the purpose of obtaining the trademarks and copyrights have been capitalised.
- (v) Ascertain that the legal life of the trademarks and copyrights has not expired.
- (vi) Ensure that amount paid for both the intangible assets is properly amortised having regard to appropriate legal and commercial considerations, as per the principles enunciated under AS 26 on Intangible Assets.

(b) Investment Income in the case of Charitable Institution:

- (i) Vouching the amounts received with the dividend and interest counterfoils.
- (ii) Checking the calculations of interest received on securities bearing fixed rates of interest.
- (iii) Checking that the appropriate dividend has been received where any investment has been sold ex-dividend or purchased cum-dividend.
- (iv) Comparing the amounts of dividend received with schedule of investments making special enquiries into any investments held for which no dividend has been received.

(c) Contingent liabilities:

- (i) Inspect the minute books of the company to ascertain all contingent liabilities known to the company.
- (ii) Examine the contracts entered into by the company and the likelihood of contingent liabilities emanating therefrom.
- (iii) Scrutinise the lawyer's bills to track unreported contingent liabilities.
- (iv) Examine bank letters in respect of bills discounted and not matured.
- (v) Examine bank letters to ascertain guarantees on behalf of other companies or individuals.
- (vi) Discuss with various functional officers of the company about the possibility of contingent liability existing in their respective field.
- (vii) Obtain a certificate from the management that all known contingent liabilities have been included in the accounts and they have been properly disclosed.
- (viii) Ensure that proper disclosure has been made as per Schedule III to the Companies Act, 2013 and AS 29, "Provisions, Contingent Liabilities and Contingent Assets".

(d) Leasehold Rights:

- (i) Inspect the lease or assignment thereof to ascertain the amount of premium, if any, for securing the lease, and its terms and conditions; and that the lease has been duly registered. A lease exceeding one year is not valid unless it has been granted by a registered instrument.
- (ii) Ascertain that all the conditions, the failure to comply with which might result in the forfeiture or cancellation of the lease, e.g., payment of ground rent on the due dates, insurance of property, its maintenance in a satisfactory state of repairs, etc. prescribed by the lease, are being duly complied with.
- (iii) Examine the counterpart of the tenants' agreements, if part of the leasehold property has been sublet.
- (iv) Make certain that due provisions for any claim that might arise under the dilapidation clause on the expiry of the lease has been made, and, if no such provision has been made, draw the client's attention to the matter.

(v) Ensure that the outlay as well as any legal expenses incurred to acquire the leases which are shown as an asset in the Balance Sheet is being written off at a rate which could completely wipe off the asset over the unexpired term of the lease.

Q43. RTP Nov 2020

A significant and important audit activity is to contact banks/ financial institutions directly and ask them to confirm the amounts held in current accounts, deposit accounts, EEFC account, cash credit accounts, etc. as at the end of the reporting period under audit. Explain the audit procedure in this context.

Answer

Direct confirmation procedure

- A significant and important audit activity is to contact banks/ financial institutions directly and ask them to confirm the amounts held in current accounts, deposit accounts, EEFC account, cash credit accounts, restrictive use accounts like dividend, escrow accounts as of the end of the reporting period under audit. This should necessarily be done for all account balances as at the period-end.
- The Company should be asked to investigate and reconcile the discrepancies, if any, including seeking written explanations/ clarifications from the banks/ financial institutions on any unresolved queries.
- The auditor should emphasize for confirmation of 100% of bank account balances. In remote situations, where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include:
 - Agreeing the balance to bank statement received by the Company or internet/ online login to account in auditor's personal presence;
 - Sending the audit team member to the bank branch along with the entity's personal to obtain balance confirmation from the bank directly.

Q44. RTP May 2020

Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS). In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards. Explain with example stating the relevant assertions involved in this regard. Also explain financial statement audit.

Answer

Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS).

A financial statement audit comprises the examination of an entity's financial statements and accompanying disclosures by an independent auditor. The result of this examination is a report by the auditor, attesting to the truth and fairness of presentation of the financial statements and related disclosures.

In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding:

- completeness;
- cut-off;
- existence/ occurrence;
- valuation/ measurement;
- rights and obligations; and
- presentation and disclosure of assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards.

Example

If Company X's balance sheet shows building with carrying amount of ₹ 50 lakh, the auditor shall assume that the management has claimed/ asserted that:

- The building recognized in the balance sheet exists as at the period- end (existence assertion);
- Company X owns and controls such building (Rights and obligations assertion);
- The building has been valued accurately in accordance with the measurement principles (Valuation assertion);
- All buildings owned and controlled by Company X are included within the carrying amount of ₹50 lakh (Completeness assertion).

Q45. RTP May 2020

What does the Valuation assertion mean in respect of Assets, liabilities and equity balances? Explain with the help of example in respect of Inventory.

Answer

Meaning of Valuation Assertion- Assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

Example of Inventory explaining the valuation assertion is given hereunder:

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

Q46. RTP Nov 2019

The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Plant and Equipment) purchase invoices are in the name of the entity he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor.

Answer

In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity. For all additions to land, building in particular, the auditor should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.

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

Q47. RTP Nov 2019

Explain with examples the audit procedure to establish the existence of intangible fixed assets as at the period- end.

Answer

Since an Intangible Asset is an identifiable non-monetary asset, without physical substance, for establishing the existence of such assets, the auditor should verify whether such intangible asset is in active use in the production or supply of goods or services, for rental to others, or for administrative purposes.

Example- for verifying the existence of software, the auditor should verify whether such software is in active use by the entity and for the purpose, the auditor should verify the sale of related services/ goods during the period under audit, in which such software has been used.

Example- For verifying the existence of design/ drawings, the auditor should verify the production data to establish if such products for which the design/ drawings were purchased, are being produced and sold by the entity.

In case any intangible asset is not in active use, deletion should have been recorded in the books of account post approvals by the entity's management and amortization charge should have ceased to be charged beyond the date of deletion.

Q48. RTP May 2019

Explain the audit procedure to vouch/verify :

- (i) Rent expenses
- (ii) Power and Fuel expenses

Answer

(i) Rent expense- Obtain a month wise expense schedule along with the rent agreements. Verify if expense has been recorded for all 12 months and whether the rent amount is as per the underlying agreement. Specific consideration should be given to the escalation clause in the agreement to verify if the rent was to be increased/ adjusted during the period under audit. Also, verify if the agreement is in the name of the entity and whether the expense pertains to premises used for running business operations of the entity

(ii) Power and fuel expense- Obtain a month wise expense schedule along with the power bills. Verify if expense has been recorded for all 12 months. Also, compile a month wise summary of power units consumed and the applicable rate and check the arithmetical accuracy of the bill raised on a monthly basis. In relation to the units consumed, analyse the monthly power units consumed by linking it to units of finished goods produced and investigate reasons for variance in monthly trends

Q49. RTP May 2019

Reserves are amounts appropriated out of profits whereas on the contrary, provisions are amounts charged against revenue. Discuss explaining the difference between the two and also explain clearly revenue reserve and capital reserve.

Answer

Reserves are amounts appropriated out of profits that are not intended to meet any liability, contingency, commitment or diminution in the value of assets known to exist as at the date of the Balance Sheet.

On the contrary, provisions are amounts charged against revenue to provide for:

- (i) Renewal or diminution in the value of assets; or
- (ii) a known liability, the amount whereof could only be estimated and cannot be determined with accuracy; or
- (iii) a claim which is disputed.

Amounts contributed or transferred from profits to make good the diminution in value of assets due to the fact that some of them have been lost or destroyed as a result of some natural calamity or debts have proved to be irrecoverable are also described as provisions.

Provisions are normally charged to the Statement of Profit and Loss before arriving at the amount of profit. Reserves are appropriations out of profits.

Difference between Reserves and Provisions

The difference between the two is that provisions are amounts set aside to meet specific/ identified liabilities or diminution in recoverable value of assets. These must be provided for regardless of the fact whether the Company has earned profit or not.

Reserves on the other hand, represent amounts appropriated out of profits, held for equalising the dividends of the company from one period to another or for financing the expansion of the company or for generally strengthening the company financially.

If we examine the Balance Sheet of a company, at a given time, and deduct the total liabilities to outside trade payables from the value of assets shown therein, the difference between the two figures will represent the net worth of the company based on the book values of assets as on that date. The same shall include the capital contributed by the shareholders as well as total undistributed profit held either to the credit of the Statement of Profit and Loss or to reserves; the reserves again will be segregated as revenue or capital reserves.

Revenue reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose

Examples- to supplement divisible profits in lean years, to finance an extension of business, to augment the working capital of the business or to generally strengthen the company's financial position.

Capital Reserve, on the other hand represents a reserve which does not include any amount regarded as free for distribution through the Statement of Profit and Loss

Examples- share premium, capital redemption reserve.

It may be noted that if a company appropriates revenue profit for being credited to the asset replacement reserve with the objective that these are to be used for a capital purpose, such a reserve shall also be in the nature of a capital reserve.

A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised. But the amount of share premium or capital redemption reserve account can be utilised only for the purpose specified in Sections 52 and 55 respectively of the Companies Act, 2013.

Q50. RTP Nov 2018

Explain with examples the audit procedure to establish the existence of intangible fixed assets as at the period- end.

Answer

Since an Intangible Asset is an identifiable non-monetary asset, without physical substance, for establishing the existence of such assets, the auditor should verify whether such intangible asset is in active use in the production or supply of goods or services, for rental to others, or for administrative purposes.

Example- for verifying the existence of software, the auditor should verify whether such software is in active use by the entity and for the purpose, the auditor should verify the sale of related services/ goods during the period under audit, in which such software has been used.

Example- For verifying the existence of design/ drawings, the auditor should verify the production data to establish if such products for which the design/ drawings were purchased, are being produced and sold by the entity.

In case any intangible asset is not in active use, deletion should have been recorded in the books of account post approvals by the entity's management and amortization charge should have ceased to be charged beyond the date of deletion.

Q51. RTP Nov 2018

Verification of liabilities is as important as that of assets, considering if any liability is omitted (or understated) or overstated, the Balance Sheet would not show a true and fair view of the state of affairs of the entity. Explain stating also criteria for a liability to be classified as current liability.

Answer

Liabilities in addition to borrowings (discussed above), include trade payables and other current liabilities, deferred payment credits and provisions. Verification of liabilities is as important as that of assets, considering if any liability is omitted (or understated) or overstated, the Balance Sheet would not show a true and fair view of the state of affairs of the entity.

Further, a liability is classified as current if it satisfies any of the following criteria:

- It is expected to be settled in the entity's normal operating cycle
- It is held primarily for the purpose of being traded
- It is due to be settled within twelve months after the reporting period
- The entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments does not affect its classification.

Q52. RTP May 2018 | MTP Oct 22

ABC Ltd. has issued shares for cash at a premium of Rs 450, that is, at amount in excess of the nominal value of the shares which is Rs 10 for cash. Section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account. Advise the means in which the amount in the account can be applied.

Answer

Shares Issued at Premium: In case a company has issued shares at a premium, that is, at amount in excess of the nominal value of the shares, whether for cash or otherwise, section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account and state the means in which the amount in the account can be applied. As per the section, where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and the provisions of this Act relating to reduction of share capital of a company shall apply as if the securities premium account were the paid-up share capital of the company.

Application of securities premium account: The securities premium account may be applied by the Company:

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

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

Q53. RTP May 2018

The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Plant and Equipment) purchase invoices are in the

name of the entity he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor.

Answer

In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity. For all additions to land, building in particular, the auditor should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.

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

Q54. MTP Oct 2022, 4 Marks

The securities premium account may only be applied by the Company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares. Is the statement correct? Explain.

Answer

The statement is not correct.

The securities premium account may be applied by the Company for the following purposes:

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

Q55. MTP Sep 2022

No entry is passed for cheques received by the auditee on the last day of the year and not yet deposited with the Bank.

Answer

Incorrect: The person who is controlling the trade receivables should ensure that proper accounting entries have been passed by crediting respective trade receivables account. The balance of cheque in hand should be disclosed along with the cash and bank balances in the financial statements.

Q56. MTP Sep 2022, 6 Marks | MTP Mar 22

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.

Answer

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 an 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 the 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 items 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.

Q57. MTP Mar 2022, 3 Marks

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.

Answer

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.

Q58. MTP Apr 2022, 4 Marks

Proceedings have been initiated against the company ABC Ltd for holding one of its property as benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder. State the disclosure requirements to be complied with by ABC Ltd as per Schedule III to the Companies Act, 2013.

Answer

Details of Benami Property held

Where any proceedings have been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, the company shall disclose the following:-

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

Q59. MTP Nov 2021, 4 Marks

The auditor may choose to analyse the monthly trend for Power & Fuel expense. Explain how this analysis will be performed by the auditor

Answer

Power and fuel expense -

- Obtain a month wise expense schedule along with the power bills.
- Verify if expense has been recorded for all 12 months.
- Also, compile a month wise summary of power units consumed and the applicable rate and check the arithmetical accuracy of the bill raised on monthly basis.
- In relation to the units consumed, analyse the monthly power units consumed by linking it to units of finished goods produced and investigate reasons for variance in monthly trends.

Q60. MTP Nov 2021, 6 Marks

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

Answer

For Verification of Existence of Trade Receivables, the auditor should check the following :

- i. Check whether there are controls in place to ensure that invoices cannot be recorded more than once and receivable balances are automatically recorded in the general ledger from the original invoice.

Ask for a period-end accounts receivable aging report and trace the balance as per the report to the general ledger.

- ii. Check whether realization is recorded invoice-wise or not. If not, check that money received from debtors is adjusted chronologically invoice-wise and on FIFO basis i.e. previous bill is adjusted first.
- iii. If any large balance is due for a long time, auditor should ask for reasons and justification for the same.
- iv. A list of trade receivables selected for confirmation should be given to the entity for preparing request letters for confirmation which should be properly addressed.
- v. The auditor should maintain strict control to ensure the correctness and proper despatch of request letters. It should be ensured that confirmations as well as any undelivered letters are returned to the auditor and not to the client.
- vi. Any discrepancies revealed by the confirmations received or by the additional tests carried out by the auditor may have a bearing on other accounts not included in the original sample.
- vii. Where no reply is received, the auditor should perform alternate procedures regarding the balances. This could include:
 - viii. Agreeing the balance to cash received subsequently;
 - ix. Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred. (examination in depth for those balances)
 - x. If there are any related party receivables, review them for collectability as well as whether they were properly authorized and the value of such transactions were reasonable and at arm's length.
 - xi. Check that receivables for other than sales or services are not included in the list.
 - xii. Review a trend line of sales and accounts receivable, or a comparison of the two over time, to check if there are any unusual trends i.e. perform Analytical procedures. Make inquiries about reasons for changes in trends with the management and document the same in audit work papers.

Q61. MTP Oct 2020, 6 Marks

BNP Ltd has reduced its Share Capital to a greater extent in the year for which you are conducting the audit. State how will you proceed for verifying the reduction of Capital.

Answer

Reduction of Capital

For verifying reduction of capital, the auditor needs to undertake the following procedures:

- (i) Verify that the meeting of the shareholders held to pass the special resolution was properly convened and that the proposal was circularized in advance to all the shareholders;
- (ii) Verify that the Articles of Association authorises reduction of capital;
- (iii) Examine the order of the Tribunal confirming the reduction and verify that a copy of the order and the minutes have been registered and filed with the Registrar of Companies;
- (iv) Check the Registrar's Certificate as regards to reduction of capital;
- (v) Vouch the accounting entries recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also check whether the requirements of Schedule III, Part I, have been complied with in relation to presentation;
- (vi) Confirm whether the revaluation of assets has been properly disclosed in the Balance Sheet;
- (vii) Verify the adjustment made in the members' accounts in the Register of Members and confirm that either the paid up amount shown on the old share certificates has been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled;
- (viii) Confirm that the words "and reduced", if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.
- (ix) Verify that the Memorandum of Association of the company has been suitably amended.

Q62. MTP Oct 2019, 3 Marks

What audit points are to be borne in mind in case of issue of "Sweat Equity Shares" by a limited company?

Answer

Issue of Sweat Equity Shares: As per section 54 of the Companies Act, 2013, the employees may be compensated in the form of 'Sweat Equity Shares'.

"Sweat Equity Shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

The auditor may see that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions are fulfilled-

- (a) The issue is authorized by a special resolution passed by the company;
- (b) The resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
- (c) Not less than one year has, at the date of such issue, elapsed since the date on which the company had commenced business; and
- (d) Where the equity shares of the company are listed on a recognized stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.

The rights, limitations, restrictions and provisions as are for the time being applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank pari passu with other equity shareholders.

Q63. MTP Oct 2019, 3 Marks

The auditor A of ABC & Co.- firm of auditors is conducting the audit of XYZ Ltd and while performing testing of additions wanted to verify that all PPE (Property Plant and Equipment) purchase invoices are in the name of the entity he is auditing. For all additions to land, building in particular, the auditor desires to have concrete evidence about ownership. The auditor is worried about whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements. Advise the auditor.

Answer

In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity. For all additions to land, building in particular, the auditor should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.

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

The Company Audit

Q1. Nov 2022 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

A company should disclose in its Annual Report, the shares in the company held by each shareholder holding more than 10 percent shares specifying the number of shares held.

Answer

Incorrect: Schedule III to the Companies Act, 2013 requires the company to disclose- "shares in the company held by each shareholder holding more than 5 per cent shares specifying the number of shares held" in notes to accounts.

Q2. Nov 2022 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

Schedule III to the Companies Act, 2013 requires the company to disclose- "shares in the company held by each shareholder holding more than 5 per cent shares specifying the number of shares held" in notes to accounts.

Answer

Incorrect: The auditor is required to report the same as per clause (xv) of Paragraph 3 of CARO, 2020, "whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with".

Q3. Nov 2022 Exam, 4 marks

M/s RAP & Co., a firm of Chartered Accountants, has three partners, namely Mr. R, Mr. A and Mr. P. Mr. R is also in whole time employment elsewhere and Mr. A & Mr. P do not hold any audits in their personal capacity or as partners of other firms. The Firm, currently, has statutory audit of 40 public companies. They are offered the statutory audit of a public company XYZ Ltd. Whether M/s. RAP & Co. can accept the audit of XYZ Ltd.?

Answer

Eligibility to be appointed as an auditor of a company: Section 141(3)(g) of Companies Act, 2013 states that a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies shall be disqualified from being appointed as auditor of the company. In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere. The above said ceiling applies per partner of the firm. In the given case, M/s. RAP & Co., a firm of Chartered Accountants, having 3 partners CA. R, CA. A and CA. P, is offered appointment of statutory audit of a public company XYZ Limited. CA. R is in whole time employment elsewhere, therefore, for computation of ceiling limit only CA. A and CA. P (two partners) will be considered. Therefore, entitlement of firm is 40 company audits(20X2) only. Since, M/s. RAP & Co. is already having statutory audit of 40 public companies, therefore, RAP & Co. cannot accept audit of XYZ Limited.

Q4. Nov 2022 Exam, 4 marks

TS Ltd. has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. However, the company utilised these funds for repayment of long-term loans and advances. What are the reporting requirements under CARO 2020 in this case?

Answer

Reporting Requirements under CARO 2020 for raising funds: As per clause (x)(b) of Para 3 of CARO, 2020, the auditor of a company has to report whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have

been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of non-compliance.

In the present case, TS Ltd. has raised funds by issuing fully convertible debentures for expansion and diversification of the business. However, the company used the funds for repayment of long-term loans and advances instead of utilisation of the same for the purpose for which the funds were raised i.e., expansion and diversification of business. Here, the auditor should report the fact in his report that the funds were used for the purpose other than the purpose for which the funds were raised, as per clause (x)(b) of Para 3 of CARO, 2020.

Q5. May 2022 Exam, 2 marks

According to CARO 2020, the company auditor is required to state that whether the title deeds of all immovable properties held in the name of the company are disclosed in its financial statements.

Answer

Incorrect: According to CARO, 2020, the company auditor is required to state 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.

Q6. May 2022 Exam, 4 marks

G Pvt. Ltd. had fully paid-up Capital and Reserves of Rs. 1.20 crore as at the end of F.Y. 2020-2021. During the F.Y 2021-2022, business was interrupted due to Covid restrictions and therefore the company incurred losses to the tune of Rs. 25 lacs. During the year, the company also borrowed `Rs. 55 lakh each from a bank and a financial institution independently. It had a turnover of Rs. 850 lakhs (other than revenue of Rs. 250 lakhs from discontinuing operations). Ascertain whether CARO, 2020 is applicable to the company.

Answer

Applicability of CARO, 2020 in case of Private Ltd. Company: CARO, 2020 shall apply to every company including a foreign company **except**- a private limited company, not being a subsidiary or holding company of a public company,

- i. having a paid-up capital and reserves and surplus not more than one crore rupees as on the balance sheet date; and
- ii. which does not have total borrowings exceeding one crore rupees from any bank or financial institution at any point of time during the financial year; and
- iii. which does not have a total revenue as disclosed in Scheduled III to the Companies Act (including revenue from discontinuing operations) exceeding ten crore rupees during the financial year as per the financial statements.

Applying the above to the given case, G Pvt. Ltd., its paid-up capital and reserves are Rs. 95 Lakh (Rs 120 Lakh - Rs 25 Lakh), borrowings from a Bank and financial institution are (Rs 55 Lakh + Rs 55 Lakh) i.e., Rs. 1.10 Crore, turnover {including discontinuing operations (Rs 850 lakh + Rs 250 Lakh)} Rs 1100 Lakh i.e., Rs 11 Crore.

Since its borrowings and turnover are exceeding the specified limit and therefore it is not exempt from the applicability of CARO, 2020.

Q7. May 2022 Exam, 4 marks | MTP Apr 2022, 4 marks

CAB, an auditor of DBF Limited engaged in the manufacturing and trading of hardware products, while auditing got aware of some secrets of the company. The auditor acted in an unlawful way in order to deceive or gain an advantage over others and also, he encouraged and assisted directors to do something wrong, in particular to commit crime. Now company has requested you to guide it as to how such acts are covered under Companies Act, 2013 and what consequences auditor may face?

Answer

Punishment for Non - Compliance/Contravention: Section 147 of the Companies Act, 2013 prescribes punishments:

Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in an fraud by,

or in relation to or by, the company or its directors or officers, the liability, whether civil or criminal as provided in this Act or in any other law for the time being in force, for such act shall be of the partner or partners concerned of the audit firm and of the firm jointly and severally.

However, in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable. In view of the above, CA. B would be liable for fine and imprisonment as per Companies Act, 2013.

Alternative Solution:

Direction by Tribunal in case Auditor acted in a Fraudulent Manner:

As per sub-section (5) of the section 140, the Tribunal either suo motu or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government and the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor and the Central Government may appoint another auditor in his place. It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order and the auditor shall also be liable for action under section 447.

Q8. May 2022 Exam, 4 marks

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.

Answer

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:

- i. The auditor would not be required to modify the opinion in accordance with SA 705 as a result of the matter; and
- ii. 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:

- i. (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".

Q9. Nov 2021 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

As per section 139(5) of the Companies Act, 2013, in the case of a government company, board of directors shall appoint the subsequent auditor within a period of 60 days from the commencement of the financial year.

Answer

Incorrect : As per section 139(5), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

Q10. Nov 2021 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

Auditor has to disclose the impact, if any, of the pending litigations on the financial position of the auditee in his audit report.

Answer

Incorrect: 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 - whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

Q11. Nov 2021 Exam, 3 marks

How is "Cash and cash equivalents" disclosed in the Financial Statements as required under Schedule III (part I) to Companies Act, 2013?

Answer

Disclosure of Cash & Cash Equivalent in the Financial Statements:

Regarding Cash and cash equivalents- Ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:

- i. Cash and cash equivalents shall be classified as:
- Balances with banks;
 - Cheques, drafts on hand;
 - Cash on hand;

- d) Others (specify nature)
- ii. Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.
- iii. Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
- iv. Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.
- v. Bank deposits with more than 12 months' maturity shall be disclosed separately.

Q12. Nov 2021 Exam, 4 marks

CA G was appointed as the auditor of RJ Ltd. at the remuneration of INR 35000. He resigned after 7 months on health grounds but failed to file the required statement with the Registrar of Companies. What are the responsibilities of CA G as per section 140(2) of the Companies Act, 2013? As per section 140(3) of the Companies Act, 2013, how much fine will be levied on CA G for non-compliance of Sec 140(2) of the Companies Act 2013?

Answer

Casual Vacancy by Resignation:

As per section 140(2) of the Act, the auditor CA G who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form ADT-3 (as per Rule 8 of CAAR) with the company and the Registrar. The auditor shall indicate the reasons and other facts as may be relevant with regard to his resignation.

In the given case, CA G, auditor of RJ Ltd resigned after 7 months on health grounds and also, he did not file ADT-3 with the Registrar. So, he did not fulfil his responsibilities as stated under Section 140(2). So, the auditor CA G shall be liable to a penalty of fifty thousand rupees or the remuneration of the auditor Rs 35000, whichever is less i.e., ` 35000, and in case of continuing failure, with further penalty of five hundred rupees for each day after the first during which such failure continues, subject to a maximum of Two lakh rupees as per section 140(3).

Q13. Nov 2021 Exam, 4 marks

State the auditor's reporting responsibilities under CARO 2020 when –

- i. The company has raised money by public issue.
- ii. The company has made private placement of shares.

Answer

Auditor's reporting responsibilities under CARO 2020:

- i. **Clause (ix) para 3 of CARO, 2020 states** - whether moneys raised by way of initial public offer or further public offer (including debt instruments) and term loans were applied for the purposes for which those are raised. If not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported.
- ii. **Clause (xiv) para 3 of CARO, 2020 states** - whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance.

Q14. July 2021 Exam, 3 marks | MTP Oct 2021, 3 marks

Care Ltd. is an unlisted public limited company, During the financial year 2019-20, the paid-up share capital of Care Ltd. was INR 50 crore and the turnover was INR 80 crore. During the financial year 2020-21, the Board of Directors of the company appointed an internal auditor. Whether Care Ltd. is required to appoint an internal auditor according to the provisions of the Companies act, 2013?

Answer

As per section 138 of the Companies Act, 2013: following class of companies (prescribed in rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely-

- a) every listed company;

- b) every unlisted public company having-
- i. paid up share capital of fifty crore rupees or more during the preceding financial year; or
 - ii. turnover of two hundred crore rupees or more during the preceding financial year; or
 - iii. outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
 - iv. outstanding deposits of twenty-five crore rupees or more at any point of time during the preceding financial year.

Conclusion: Applying the above to the given problem, since Care Ltd is an unlisted public company and having paid up share capital of Rs. 50 crores during the preceding F.Y. 2019-20, therefore, Care Ltd is required to appoint an Internal Auditor.

Q15. July 2021 Exam, 4 marks

Shine Industries is an electricity generating company engaged in generation of electricity for captive consumption. Its gross turnover was INR 68 crores during the immediately preceding financial year. Management of shine industries has not maintained any cost records as they felt that there is no requirement for them to maintain any cost records or conduct any cost audit.

Comment.

Answer

Applicability for Maintenance of Cost Records: Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover from all its products and services of Rs. 35 crore or more during the immediately preceding financial year, required to include cost records in their books of account. These companies include Foreign Companies defined in sub-section (42) of section 2 of the Act, but exclude a company classified as a Micro enterprise or a Small enterprise including as per the turnover criteria provided under Micro, Small and Medium Enterprises Development Act, 2006. The said rule has divided the list of companies into (A) Regulated sectors and (B) Non-regulated sectors.

Cost Audit Rules Not to Apply in Certain Cases: The requirement for cost audit under these rules shall not be applicable to a company which is covered under Rule 3, and,

- i. whose revenue from exports, in foreign exchange, exceeds 75% of its total revenue; or
- ii. which is operating from a special economic zone.
- iii. which is engaged in generation of electricity for captive consumption through Captive Generating Plant.

Conclusion: Since Shine Industries is having an overall turnover of ` exceeding 35 crore during the immediately preceding financial year, therefore, it is required to include cost records in its books of account but is not required to get its accounts audited because Cost Audit Rules are not applicable on Companies engaged in generation of electricity for captive consumption.

Q16. July 2021 Exam, 4 marks

The recommendation for appointment of auditors is only one of the several functions performed by audit committee. Discuss atleast four other key responsibilities of Audit Committee in accordance with Section 177 of the Companies Act, 2013.

Answer

Audit committee performs wide functions. The recommendation for appointment of auditors is only one of the several functions performed by audit committee. Under section 177 of Companies Act, 2013, audit committee is responsible for following actions: -

- i. the recommendation for appointment, remuneration and terms of appointment of auditors of the company;
- ii. review and monitor the auditor's independence and performance, and effectiveness of audit process;
- iii. examination of the financial statement and the auditors' report thereon;
- iv. approval or any subsequent modification of transactions of the company with related parties;
- v. scrutiny of inter-corporate loans and investments;

- vi. valuation of undertakings or assets of the company, wherever it is necessary;
- vii. evaluation of internal financial controls and risk management systems;
- viii. monitoring the end use of funds raised through public offers and related matters.

Hence, audit committee oversees range of matters including those related to making recommendation for appointment of auditors.

Q17. Jan 2021 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

As per Section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall in case of a company other than a company whose accounts are subject to audit by an auditor appointed by Comptroller and Auditor General of India, be filled by the Shareholders at an Annual General Meeting within 60 days.

Answer

Incorrect: As per Section 139(8), any casual vacancy in the office of an auditor shall in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days.

Q18. Jan 2021 Exam, 4 marks

CA Raj, an auditor was removed by PQR Ltd. before the expiry of his term. Discuss the procedure to be taken by PQR Ltd to appoint an auditor other than retiring auditor under Sec. 140(4) of the Companies Act, 2013.

Answer

In the given question, CA Raj was removed by PQR Ltd. before the expiry of his term and PQR Ltd wants to appoint an auditor other than retiring auditor i.e. CA Raj who was removed.

Section 140(4) lays down procedure to appoint an auditor other than retiring auditor who was removed-

- 1) Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or as the case may be, ten years, as provided **under sub-section (2) of section 139.**
- 2) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
- 3) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so,-
 - a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and
 - b) send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company. and if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting.

Q19. Jan 2021 Exam, 3 marks

What are the prohibited services for auditor as per Companies Act, 2013?

Answer

Prohibited services for an auditor as per Companies Act, 2013 are stated in Section 144.

Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of

the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:

- i. accounting and book keeping services;
- ii. internal audit;
- iii. design and implementation of any financial information system;
- iv. actuarial services;
- v. investment advisory services;
- vi. investment banking services;
- vii. rendering of outsourced financial services;
- viii. management services; and
- ix. any other kind of services as may be prescribed.

Q20. Nov 2020 Exam, 3 marks

The auditor's requirement to report under clause (X) of paragraph 3 of the Companies (Auditor's Report) Order, 2020 is restricted to frauds noticed or reported during the year. Explain what auditors may consider for reporting under this clause?

Answer

The auditor is required to report under clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016,

Where the auditor notices that any fraud by the company or on the company by its officers or employees has been noticed by or reported during the year, the auditor should, apart from reporting the existence of fraud, also required to report, the nature of fraud and amount involved. For reporting under this clause, the auditor may consider the following:

- i. This clause requires all frauds noticed or reported during the year shall be reported indicating the nature and amount involved. As specified, the fraud by the company or on the company by its officers or employees are only covered.
- ii. Of the frauds covered under section 143(12) of the Act, only noticed frauds shall be included here and not the suspected frauds.
- iii. While reporting under this clause with regard to the nature and the amount involved of the frauds notice do reported, the auditor may also consider the principles of materiality outlined in Standards on Auditing.

Q21. Nov 2020 Exam, 4 marks

Clue Ltd. is a Public unlisted company having paid-up share capital of ` 9 crores and public borrowings from the financial institutions of ` 51 crores. They appointed M/s Pray and Co., A Chartered Accountant firm as the statutory auditor in its annual general meeting for 11 years.

- i. Is the manner of rotation of auditor applicable in case of Clue Ltd.?
- ii. Whether the appointment of M/s Pray and Co. is valid?

Answer

- I. As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the class of companies shall mean the following classes of companies excluding one person companies and small companies-
 - i. all unlisted public companies having paid up share capital of rupees ten crore or more;
 - ii. all private limited companies having paid up share capital of rupees fifty crore or more;
 - iii. all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

In the given case, Clue Ltd is an Unlisted Public company, any having paid up share capital of Rs. 9 crores and public borrowings from financial institutions of Rs. 51 crores. So, applying the above provisions to the given problem, although paid up share capital of Clue Ltd is below threshold limit of Rs. 10 crores yet the Company is having public borrowings from financial institutions worth Rs. 51 crores i.e. above Rs. 50 crores.

Therefore, manner of rotation of auditors is applicable in case of Clue Ltd.

- II. Clue Ltd., an unlisted public company is covered by the rotational provisions, appointed M/s Pray and Co., a Chartered Accountant firm, as the statutory auditor in its AGM for 11 years. Here, the appointment of M/s Pray & Co. is not valid as the appointment can be made only for one term of five consecutive years and then another one more term of five consecutive years. It can't be appointed for two terms in one AGM only. Further, a cooling period of five years from the completion of term is required i.e. the firm can't be re-appointed for further 5 years after completion of two terms of five consecutive years. Keeping in view above, the appointment of M/s Pray and Co. is not valid.

Q22. Nov 2019 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

The auditor's reporting on internal financial control will be applicable with respect to interim financial statements.

Answer

Incorrect: Clause (i) of Sub-section 3 of Section 143 of the Act requires the auditors' report to state whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls. It may be noted that auditor's reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in case of reporting on financial statements prepared under the Act and reported under Section 143. Accordingly, reporting on internal financial controls will not be applicable with respect to interim financial statements, such as quarterly or half-yearly financial statements, unless such reporting is required under any other law or regulation.

Q23. Nov 2019 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

Provision of CARO, 2020 is not applicable to ABC Pvt. Ltd., a subsidiary of XYZ Ltd. (a public company) having fully paid-up Capital and Reserves & Surplus of Rs 50 lakhs, Secured loan from bank of Rs 90 Lakhs and Turnover of Rs 5 Crore, for the financial year 2018-19.

Answer

Incorrect: The CARO specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees 1 crore as on the balance sheet date and which does not have total borrowings exceeding rupees 1 crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees 10 crore during the financial year as per the financial statements. From the above, it is clear that ABC Pvt. Ltd. is a subsidiary of XYZ Ltd. and hence not exempt from CARO, 2020 although it is satisfying the conditions that allow exemption to private limited company which is not a subsidiary or holding company of a public company.

Q24. Nov 2019 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

CA K has resigned as an auditor after 2 months of his appointment in NML Ltd. He needs to file ADT-3 with the Registrar within 60 days from the date of resignation.

Answer

Incorrect: As per section 140(2) of the Companies Act, 2013, the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form ADT-3 (as per Rule 8 of CAAR) with the company and the Registrar.

Q25. Nov 2019 Exam, 4 marks

Board of Directors of MN Ltd. wants to appoint CA B, a practicing Chartered Accountant, as an internal auditor of the company as they believe that they could not appoint any other person as an internal auditor other than practicing chartered accountant. Examine the correctness of the statement of Board of Directors of MN Ltd. with respect to provisions of Companies Act, 2013.

Answer

- 1) As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not).
- 2) Or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies.
- 3) The internal auditor may or may not be an employee of the company.

Hence, the belief of Company is not correct.

Q26. Nov 2019 Exam, 3 marks

"Before the commencement of audit, the joint auditors should discuss and develop a joint audit plan." Discuss the points to be considered in developing the joint audit plan by the joint auditors.

Answer

Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan.

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

- i. Identify division of audit areas and common audit areas;
- ii. Ascertain the reporting objectives of the engagement;
- iii. Consider and communicate among all joint auditors the factors that are significant in directing the engagement team's efforts;
- iv. Consider the results of preliminary engagement activities, or similar engagements performed earlier.
- v. Ascertain the nature, timing and extent of resources necessary to accomplish the engagement.

Q27. May 2019 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

Bhartiya Gas Ltd. a Government Company, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the end of the financial year, who shall hold office till the end of the next financial year.

Answer

Incorrect- As per section 139(5), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

Q28. May 2019 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

Joint auditor is always bound by the views of majority of the joint auditors regarding matters to be covered in report.

Answer

Incorrect- Where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit report(s). Therefore, joint auditor is not bound by the views of the majority of the joint auditors regarding the matters to be covered in the audit report.

Q29. May 2019 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

Auditor of a Nationalised bank is to be appointed at the annual general meeting of the shareholders.

Answer

Incorrect- Auditor of a nationalized bank is to be appointed by the bank concerned acting through its Boards of Directors and approval of the Reserve bank is required before the appointment is made.

Q30. May 2019 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

Rule 3 of the Companies (Cost Records and Audit) Rule, 2014 provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover of Rs 25 crore or more during the immediately preceding financial year, required to include cost records in their books of account.

Answer

Incorrect- Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover from all its products and services of ` 35 crore or more during the immediately preceding financial year, required to include cost records in their books of account.

Q31. May 2019 Exam, 4 marks

Auditors have right to attend only those general meetings at which the accounts audited by them are to be discussed. Comment.

Answer

The auditors of a company are entitled to attend any general meeting of the company and the right is not only restricted to those at which the accounts audited by them are to be discussed, he is also entitled to receive all the notices and other communications relating to the general meetings, which members are entitled to receive and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors. According to the section 146 of the Companies Act 2013, "all notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, unless otherwise exempted by the company, attend either by himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor." Thus, it is right of the auditor to receive notices and other communications relating to any general meeting and to be heard at such meeting, relating to the matter of his concern, however, it is duty of the auditor to attend the same or through his authorised representative unless otherwise exempted.

Q32. May 2019 Exam, 3 marks

Though legally auditor may exercise right of Lien in case of companies, it is mostly impracticable for legal and practicable constraints. Do you agree?

Answer

Right of Lien means any person having the lawful possession of somebody else's property, on which he has worked, may retain the property for non-payment of his dues on account of the work done on the property. On this premise, auditor can exercise lien on books and documents placed at his possession by the client for non-payment of fees, for work done on the books and documents. Under section 128 of the Companies Act 2013, In case of company, books of accounts must be kept at the registered office. These provisions ordinarily make it impracticable for the auditor to have possession of the books and documents. The company provides reasonable facility to auditor for inspection of the books of account by directors and others authorised to inspect under the Companies Act 2013. Taking an overall view of the matter, it seems to be correct that though legally, auditor may exercise right of lien in cases of companies, it is mostly impracticable for legal and practicable constraints.

Q33. May 2019 Exam, 3 marks | MTP May 2020, 2 marks

Explain the Reporting requirements the auditor should ensure under CARO 2020 related to fixed assets.

Answer

Reporting for Fixed Assets- Clause (i) of Para 3 of CARO ,2016, requires the auditor to include a statement in the auditor's report on the following matters, namely-

- i. whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

- ii. whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
- iii. whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

Q34. Nov 2018 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

The Board of Director of ABC Ltd., a listed company at Bombay Stock Exchange, is required to fill the casual vacancy of an auditor only after taking into account the recommendations of the audit committee.

Answer

Correct: Where a company is required to constitute an Audit Committee under section 177, all appointments, including the filling of a casual vacancy of an auditor under this section shall be made after taking into account the recommendations of such committee.

Q35. Nov 2018 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

Any partner of an LLP, who is appointed as an auditor of a company, can sign the audit report.

Answer

Incorrect: Section 141(2) of the Companies Act, 2013 states that where a firm including a limited liability partnership is appointed as an auditor of a company, only the partner who are chartered accountants shall be authorised to act and sign on behalf of the firm.

Q36. Nov 2018 Exam, 4 marks

"The company has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. However, the company utilized these funds for repayment of long-term loans and advances." Advise the auditor regarding reporting requirements under CARO, 2016.

Answer

The auditor is required to report as per clause xiv of paragraph 3 of CARO 2016, whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance; In view of the above clause, the auditor would report that funds raised by the company for expansion and diversification of business have not been used for the said purpose rather the company has utilised these funds for repayment of long-term loans and advance.

Q37. Nov 2018 Exam, 5 marks | MTP Apr 2021, 4 marks

"Mr. A is offered by ABC Ltd. for appointment as cost auditor and asked to certify certain requirements before such appointment." Discuss those requirements with reference to the provisions of the Companies Act, 2013.

Answer

Cost Auditor: Rule 6 of the Companies (Cost Records and audit) rules, 2014 required the companies prescribed under the said rules to appoint an auditor within 180days of the commencement of every financial year. However, before such appointment is made, the written consent of the cost auditor to such appointment and a certificate from him or it shall be obtained.

The certificate to be obtained from the cost auditor shall certify that the-

- 1) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Companies Act, 2013, the Cost and Works Accountants Act, 1959 and the rules or regulations made thereunder;
- 2) the individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Companies Act, 2013 so far as may be applicable;

- 3) the proposed appointment is within the limits laid down by or under the authority of the Companies Act, 2013; and
- 4) the list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

Q38. May 2018 Exam, 2 marks | MTP Apr 2021, 2 marks

State with reasons whether the following statements is correct or incorrect:

Few members of the Board of Directors oppose the appointment of Mr. N, an employee of the company, as an Internal Auditor, stating that Mr. N is not a chartered accountant and further he is an employee of the company.

Answer

Incorrect: As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not), or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies. The internal auditor may or may not be an employee of the company.

Q39. May 2018 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

PQR & Co., Chartered Accountants, resigned from the audit of a Government Company and filed the resignation with the company and the registrar within 30 days. Comment, whether PQR & Co. has complied with the provisions of the Companies Act, 2013.

Answer

Incorrect: As per section 140(2) the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form with the company and the Registrar, and in case of the companies referred to in section 139(5) i.e. Government company, the auditor shall also file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other facts as may be relevant with regard to his resignation. In this case, the PQR & Co., was also required to file prescribed Form with C & AG of India but it did not file the same. Therefore, it did not comply with the provisions of the Companies Act, 2013.

Q40. May 2018 Exam, 2 marks | RTP May 2019 | MTP Oct 2021, 2 marks

State with reasons whether the following statements is correct or incorrect:

K Ltd., a non-government company, was incorporated on 01-10-2017. Mr. B, Managing Director of K Ltd., himself appointed the first auditor of the company on 31-12-2017.

Answer

Incorrect: Section 139(6) of the Companies Act, 2013 lays down that the first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company. In view of the above, the appointment of first auditor made by the managing director is in violation of the provisions of the Companies Act, 2013.

Q41. May 2018 Exam, 5 marks

At the AGM of HDB Pvt. Ltd., Mr. R was appointed as the statutory auditor. He, however, resigned after 3 months since he wanted to pursue his career in banking sector. The Board of Director has appointed Mr. L as the statutory auditor in board meeting within 30 days. Comment on the matter with reference to the provisions of Companies Act, 2013.

Answer

Casual Vacancy by Resignation: As per Section 139(8), any casual vacancy in the office of an auditor shall in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days. If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting. Further, as per section 140(2) the auditor who has resigned from the company shall file within a period of 30 days

from the date of resignation, a statement in the prescribed Form with the company and the Registrar. In the instant case, R resigned after three months of his appointment as statutory auditor as he wanted to pursue his career in banking sector. Therefore, the board of director has appointed Mr. L as the statutory auditor within 30 days is in order subject to such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board. Further, it is also the duty of the auditor to file, within a period of 30 days from the date of resignation, a statement in the prescribed Form with the company and the Registrar in compliance with section 140(2) of the Companies Act, 2013.

Q42. May 2018 Exam, 5 marks | RTP May 2018 | MTP May 2020, 3 marks

M/s. ABC & Co. is an Audit firm, having partners CA. A, CA. B and CA. C. The firm has been offered the appointment as an Auditor of XYZ Ltd. for the Financial Year 2017-18. Mr. D, the relative of CA. A, is holding 25,000 shares (face value of Rs 10 each) in XYZ Ltd. having market value of Rs 90,000. Are M/s. ABC & Co. qualified to be appointed as Auditors of XYZ Ltd.?

Answer

As per section 141(3)(d)(i), a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. However, as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of Rs 1,00,000. In the instant case, M/s ABC & Co. is an audit firm having partners CA. A, CA. B and CA. C. Mr. D is a relative of CA. A and he is holding shares in XYZ Ltd. of face value of Rs 2,50,000 (25,000 shares x rupees 10 per share). Market value of Rs 90,000 would not be relevant. Therefore, M/s ABC & Co. is disqualified for appointment as an auditors of XYZ Ltd. as the relative of CA. A (i.e. partner of M/s ABC & Co.) is holding the securities in XYZ Ltd. which is exceeding the limit mentioned in proviso to section 141(3)(d)(i) of the Companies Act, 2013.

Q43. RTP May 2023 | MTP Oct 2022, 4 marks

XYZ Ltd. removed its statutory auditor by passing a resolution in the meeting of Board of Directors for his removal without obtaining prior approval of the Central Government. Such removal of the auditor was made before the expiry of term of the auditors. Give your comments in this regard.

Answer

According to **Section 140(1)**, the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per **Rule 7 of CAAR, 2014-**

- 1) The application to the Central Government for removal of auditor shall be made in **Form ADT-2** and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.
- 2) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.
- 3) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution.

It is important to note that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard. In view of above, the procedure followed by the company for removal of its auditors is not correct.

Q44. RTP May 2023 | RTP Nov 2022 | RTP May 2018

S Private Limited has a paid-up share capital of Rs 49 Crores and borrowings from bank of Rs 99 Crores. The audit firm P & Company was appointed as statutory auditors of the Company for one term of six consecutive years. Is the provision of rotation of auditors applicable to the company? Comment.

Answer

As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the **class of companies** shall mean the following classes of companies excluding one person companies and small companies-

- i. all unlisted public companies having paid up share capital of rupees ten crore or more;
- ii. all private limited companies having paid up share capital of rupees fifty crore or more;
- iii. all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

In the given case, S Private Limited is a private limited Company, having paid up share capital of Rs 49 crore but having borrowing from banks of Rs 99 crore, provision of rotation of auditor will be applicable on S Private Limited as borrowings from bank are exceeding the prescribed limit of 50 crore rupees. Further, as per **section 139(2)**, appointment of audit firm can be made only for one term of five consecutive years and then another one more term of five consecutive years. It can't be appointed for two terms in one AGM only. S Private Limited, appointed M/s P & Company, a Chartered Accountant firm, as the statutory auditor in its AGM for one term of six years. Here, the appointment of M/s P & Company is not valid in accordance with section 139 (2) of the Companies Act, 2013.

Q45. RTP May 2023

The recommendation for appointment of auditors is one of the several functions performed by the Audit Committee. Discuss other key responsibilities of the Audit Committee in accordance with section 177 of the Companies Act, 2013.

Answer

Audit committee performs wide functions. The recommendation for appointment of auditors is only one of the several functions performed by audit committee. Under section 177 of companies Act, 2013, audit committee is responsible for following actions: -

- i. the recommendation for appointment, remuneration and terms of appointment of auditors of the company;
- ii. review and monitor the auditor's independence and performance, and effectiveness of audit process;
- iii. examination of the financial statement and the auditors' report thereon;
- iv. approval or any subsequent modification of transactions of the company with related parties;
- v. scrutiny of inter-corporate loans and investments;
- vi. valuation of undertakings or assets of the company, wherever it is necessary;
- vii. evaluation of internal financial controls and risk management systems;
- viii. monitoring the end use of funds raised through public offers and related matters.

Hence, audit committee oversees range of matters including those related to making recommendation for appointment of auditors etc.

Q46. RTP Nov 2022 | MTP Apr 2022, 4 marks

XYZ Limited is engaged in the business of Shoes having geographical presence across India. Following details are available from the last audited financial statements of XYZ Limited for the financial year 2020-21:

Particulars	₹
Paid-up capital as on 31 st March, 2021	9.8 Crores
Turnover for Financial Year 2020-21	98 Crores
Outstanding Loan from Bank as on 31 st March, 2021	25 Crores
Liability on Outstanding Debentures as on 31 st March, 2021	26 Crores

Comment on the applicability of constitution of Audit Committee for XYZ Limited for the financial year 2021-22 based on the above information.

Answer

Applicability of Constitution of Audit Committee: According to Section 177 of the Companies Act, 2013, in addition to listed public companies, following classes of companies shall constitute and Audit Committee

-

- i. All public companies with a paid-up capital of ten crore rupees or more;
- ii. All public companies having turnover of one hundred crore rupees or more;
- iii. All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation – The paid-up share capital or turnover or outstanding loans or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

Therefore, provisions of constitution of audit committee are applicable only to listed companies and public companies satisfying criteria as stated above. In the given case, XYZ Limited, engaged in the business of Shoes, is a public company and it's having paid-up capital of 9.8 crore rupees and turnover of 98 crore which is less than prescribed limit (i.e., 10 crores for paid-up capital and 100 crores for turnover). However, aggregate of its outstanding loan from bank (25 crores) and liability on outstanding debentures (26 crore) is exceeding the prescribed limit i.e., 50 crore rupees.

Therefore, provisions relating to constitution of Audit Committee will be applicable for XYZ Limited.

Q47. RTP Nov 2022

Enumerate the circumstances under which the retiring auditor can be re-appointed.

Answer

Re-appointment of auditor: A retiring auditor may be re-appointed at an annual general meeting, if-

- i. he is not disqualified for re-appointment.
- ii. he has not given the company a notice in writing of his unwillingness to be re-appointed; and
- iii. a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.
- iv. Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

Q48. RTP May 2022

State with reason (in short) whether the following statements are true or false:

According to Para 3(1)(d) of CARO, 2020, an auditor needs to report whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 5% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets.

Answer

Incorrect: According to Para 3(1)(d) of CARO, 2020, an auditor needs to report whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets.

Q49. RTP May 2022

Before appointment is made under Section 139(1) of the Companies Act, 2013, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor. Explain stating clearly provisions of Section 139(1) along with Rule 4 of The Companies (Audit and Auditors) Rules, 2014.

Answer

Section 139(1) of the Companies Act, 2013 provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

The following points need to be noted in this regard-

- i. Before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.
- ii. **Under Rule 4** of The Companies (Audit and Auditors) Rules, 2014, the said certificate shall state the following: -
 - a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;
 - b) the proposed appointment is as per the term provided under the Act;
 - c) the proposed appointment is within the limits laid down by or under the authority of the Act;
 - d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.
- iii. The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

Q50. RTP May 2022 | RTP May 2018

Harry Limited appointed CA Lakshman as an auditor of the company for a term of 5 years. Further, the company offered him the services of actuarial which were also approved by the board of directors. As an auditor, how would you deal with such situation?

Answer

Section 141(3)(i) of the Companies Act, 2013 disqualifies a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144. **Section 144 of the Companies Act, 2013** prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:

- i. accounting and book keeping services;
- ii. internal audit;
- iii. design and implementation of any financial information system;
- iv. actuarial services*;
- v. investment advisory services;
- vi. investment banking services;
- vii. rendering of outsourced financial services;
- viii. management services; and
- ix. any other kind of services as may be prescribed.

*Actuarial services broadly pertain to services relating to evaluation of financial impact of risks using range of mathematical and statistical methods

In the given situation, CA. Lakshman was appointed as an auditor of Harry Ltd for a term of 5 years. He was offered additional services of actuarial which was also approved by the Board of Directors. CA. Lakshman is advised not to accept the services as these services are specifically notified in the services not to be rendered by him as an auditor as per section 144 of the Act.

Q51. RTP May 2022 | RTP Nov 2021 | MTP Oct 2022, 6 marks

Explain the Reporting requirements the auditor should ensure under CARO 2020 related to PPE and Intangible assets.

Answer

Reporting for PPE and Intangible assets – Clause (i) of Para 3 of CARO ,2020, requires the auditor to include a statement in the auditor’s report on the following matters, namely –

(i) (a) (A) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;
 (B) whether the company is maintaining proper records showing full particulars of intangible assets;
 (b) whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;
 I 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

(d) whether the company has revalued its Property, Plant and Equipment (including Right of Use assets) or intangible assets or both during the year and, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment or intangible assets;

I whether any proceedings have been initiated or are pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and rules made thereunder, if so, whether the company has appropriately disclosed the details in its financial statements.

Q52. RTP Nov 2021 | RTP Nov 2020

State with reason (in short) whether the following statements are true or false:

The auditor appointed under section 139 may be removed from his office before the expiry of his term by Board resolution only.

Answer

Incorrect: According to Section 140(1), the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per Rule 7 of CAAR, 2014.

Q53. RTP Nov 2021

Under the provisions of Section 141(3) of Companies Act, 2013 along with relevant rules, a person or a firm who has "business relationship" with a company is not eligible to be appointed as an auditor of that company. In this context, discuss meaning of term "business relationship".

Answer

Under provisions of section 141(3) of Companies Act, 2013, a person or a firm who, whether directly or indirectly has business relationship with the Company, or its Subsidiary, or its Holding or Associate Company or Subsidiary of such holding company or associate company, of such nature as may be prescribed is not eligible to be appointed as auditor of the company.

The term "business relationship" shall be construed as any transaction entered into for a commercial purpose, except -

- i. commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
- ii. commercial transactions which are in the ordinary course of business of the company at arm's length price - like sale of products or services to the auditor, as customer, in the ordinary course

of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

Q54. RTP Nov 2021

Discuss significance of a company auditor's right/power to obtain information and explanation from officers of the company.

Answer

The right of the auditor to obtain from the officers of the company such information and explanations as he may think necessary for the performance of his duties as auditor is a wide and important power. In the absence of such power, the auditor would not be able to obtain details of amount collected by the directors, etc. from any other company, firm or person as well as of any benefits in kind derived by the directors from the company, which may not be known from an examination of the books. It is for the auditor to decide the matters in respect of which information and explanations are required by him. Therefore, such a right/power is quite significant for discharge of duty of an auditor of a company to report to the members of the company on accounts examined by him.

Q55. RTP May 2021

During the audit of PQR Ltd. you as an auditor requested officers of the company to have access to secretarial records and correspondence which they refused to provide. Comment.

Answer

Right of Access to secretarial records and correspondence:

- 1) Section 143(1) of the Companies Act, 2013 grants powers to the auditor that every auditor has a right of access, at all times, to the books of account and vouchers of the company kept at Registered or Head Office, branches and subsidiaries in the case of a Holding Company for conducting the audit.
- 2) Further, he is also entitled to require from the officers of the company such information and explanations which he considers necessary for the proper performance of his duties as Auditor. Therefore, he has a statutory right to inspect the secretarial records and correspondence.
- 3) In order to verify actions of the company and to vouch and verify some of the transactions of the company, it is necessary for the auditor to refer to the decisions of the shareholders and/or the directors of the company. It is, therefore, essential for the auditor to refer to the secretarial records and correspondence which also includes Minute book. In the absence of the same, the auditor may not be able to vouch/verify certain transactions of the company.
- 4) The refusal to provide access to secretarial records and correspondence shall constitute limitation of scope as far as the auditor's duties are concerned.
- 5) The auditor may examine whether by performing alternative procedures, the auditor can substantiate the assertions or else he shall have to either qualify the report or give a disclaimer of opinion.

Q56. RTP May 2021

In exercise of the powers conferred by the Chartered Accountants Act, 1949, the Council of the Institute of Chartered Accountants of India specifies that a member of the Institute in practice shall be deemed to be guilty of professional misconduct, if he holds at any time appointment of more than the "specified number of audit assignments of the companies under Section 141(3)(g) of the Companies Act, 2013). Explain the provisions prescribed under Companies Act, 2013 in respect of ceiling on number of audits in a company to be accepted by an auditor.

Answer

Ceiling on number of Audits:

- 1) Before appointment is given to any auditor, the company must obtain a certificate from him to the effect that the appointment, if made, will not result in an excess holding of company audit by the auditor concerned over the limit laid down in section 141(3)(g) of the Companies Act, 2013 which prescribes that a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one

person companies, dormant companies, small companies and private companies having paid-up share capital less than Rs 100 crore, shall not be eligible for appointment as an Auditor of a Company.

- 2) In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere. This limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits.
- 3) Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Subject to the overall ceiling of company audits, how they allocate the 20 audits between themselves is their affairs.

Q57. RTP May 2021 | RTP May 2018 | MTP Mar 2022, 4 marks | MTP Oct 2021, 6 marks

Discuss the Provisions regarding appointment of Auditors –

- i. First auditor of a Government company and a Non-Government company.
- ii. Subsequent auditor of a government company and a Non- Government company.

Answer

- i. **Appointment of First Auditor of a Government Company:** Section 139(7) of the Companies Act, 2013 provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.

Appointment of First Auditor of a Non-Government Company: As per Section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company. In the case of failure of the Board to appoint the auditor, it shall inform the members of the company. The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

- ii. **Appointment of Subsequent Auditor of a Government Company:** As per Section 139(5) of the Companies Act, 2013, in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

Appointment of Subsequent Auditor of a Non-Government Company: As per section 139(1) of the Companies Act, 2013, every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

Q58. RTP Nov 2020 | RTP May 2019

Rule 3 of CAAR, 2014 prescribes the manner and procedure of selection and appointment of auditors. Explain that procedure in detail.

Answer

Rule 3 of CAAR, 2014 prescribes the following manner and procedure of selection and appointment of auditors-

- 1) In case of a company that is required to constitute an Audit Committee under section 177, the committee, and, in cases where such a committee is not required to be constituted, the Board, shall take into consideration the qualifications and experience of the individual or the firm proposed to be considered for appointment as auditor and whether such qualifications and experience are commensurate with the size and requirements of the company. It may be noted that while considering the appointment, the Audit Committee or the Board, as the case may be, shall have regard to any order or pending proceeding relating to professional matters of conduct against the proposed auditor before the Institute of Chartered Accountants of India or any competent authority or any Court.
- 2) The Audit Committee or the Board, as the case may be, may call for such other information from the proposed auditor as it may deem fit.
- 3) Subject to the provisions of sub-rule (1), where a company is required to constitute the Audit Committee, the committee shall recommend the name of an individual or a firm as auditor to the Board for consideration and in other cases, the Board shall consider and recommend an individual or a firm as auditor to the members in the annual general meeting for appointment.
- 4) If the Board agrees with the recommendation of the Audit Committee, it shall further recommend the appointment of an individual or a firm as auditor to the members in the annual general meeting.
- 5) If the Board disagrees with the recommendation of the Audit Committee, it shall refer back the recommendation to the committee for reconsideration citing reasons for such disagreement.
- 6) If the Audit Committee, after considering the reasons given by the Board, decides not to reconsider its original recommendation, the Board shall record reasons for its disagreement with the committee and send its own recommendation for consideration of the members in the annual general meeting; and if the Board agrees with the recommendations of the Audit Committee, it shall place the matter for consideration by members in the annual general meeting.
- 7) The auditor appointed in the annual general meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting.

Q59. RTP Nov 2020

At the AGM of HDB Pvt. Ltd., Mr. R was appointed as the statutory auditor. He, however, resigned after 3 months since he wanted to pursue his career in banking sector. The Board of Director has appointed Mr. L as the statutory auditor in board meeting within 30 days. Comment on the matter with reference to the provisions of Companies Act, 2013.

Answer

As per Section 139(8), any casual vacancy in the office of an auditor shall in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days. If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting. Further, as per section 140(2) the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form with the company and the Registrar. In the instant case, R resigned after three months of

his appointment as statutory auditor as he wanted to pursue his career in banking sector. Therefore, the board of director has appointed Mr. L as the statutory auditor within 30 days is in order subject to such appointment shall also be approved by the company at a general meeting convened within three months

of the recommendation of the Board. Further, it is also the duty of the auditor to file, within a period of 30 days from the date of resignation, a statement in the prescribed Form with the company and the Registrar in compliance with section 140(2) of the Companies Act, 2013.

Q60. RTP Nov 2020 | RTP May 2018

M/s. ABC & Co. is an Audit firm, having partners CA. A, CA. B and CA. C. The firm has been offered the appointment as an Auditor of XYZ Ltd. for the Financial Year 2019-20. Mr. D, the relative of CA. A, is holding 25,000 shares (face value of Rs 10 each) in XYZ Ltd. having market value of Rs 90,000. Are M/s. ABC & Co. qualified to be appointed as Auditors of XYZ Ltd.?

Answer

As per section 141(3)(d)(i), a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. However, as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of Rs 1,00,000. In the instant case, M/s ABC & Co. is an audit firm having partners CA. A, CA. B and CA. C. Mr. D is a relative of CA. A and he is holding shares in XYZ Ltd. of face value of Rs 2,50,000 (25,000 shares x rupees 10 per share). Market value of Rs 90,000 would not be relevant. Therefore, M/s ABC & Co. is disqualified for appointment as an auditor of XYZ Ltd. as the relative of CA. A (i.e., partner of M/s ABC & Co.) is holding the securities in XYZ Ltd. which is exceeding the limit mentioned in proviso to section 141(3)(d)(i) of the Companies Act, 2013.

Q61. RTP May 2020

State with reason (in short) whether the following statements are true or false:

According to Section 140(1), the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a general resolution of the company.

Answer

Incorrect: According to Section 140(1), the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per Rule 7 of CAAR, 2014.

Q62. RTP May 2020

State with reason (in short) whether the following statements are true or false:

As per sub-section (5) of the section 140, the Tribunal cannot direct the company to change its auditors.

Answer

Incorrect: As per sub-section (5) of the section 140, the Tribunal either suo motu or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

Q63. RTP May 2020

ABC Ltd is a company incorporated in India. It has branches within and outside India. Explain who can be appointed as an auditor of these branches within and outside India. Also explain to whom branch auditor is required to report.

Answer

Sub-section (8) of section 143 of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch

auditor, if any, shall be such as may be prescribed: It may be noted that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary. Further as per rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

Q64. RTP May 2020

Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should identify division of audit areas and common audit areas. Explain stating the other relevant considerations in this regard.

Answer

Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:

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

Q65. RTP May 2020

The head accountant of a company entered fake invoices of credit purchases in the books of account aggregate of Rs 50 lakh and cleared all the payments to such bogus creditor. How will you deal as an auditor?

Answer

Here, the auditor of the company is required to report the fraudulent activity to the Board or Audit Committee (as the case may be) within 2 days of his knowledge of fraud. Further, the company is also required to disclose the same in Board's Report. It may be noted that the auditor need not to report the central government as the amount of fraud involved is less than Rs 1 crore, however, reporting under CARO, 2020 is required.

Q66. RTP Nov 2019

State with reason (in short) whether the following statements are true or false:

As per Section 139(6), the first auditor of a company, including a Government company, shall be appointed by the Board of Directors within 60 days from the date of registration of the company.

Answer

Incorrect: As per Section 139(6), the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

Q67. RTP Nov 2019

State with reason (in short) whether the following statements are true or false:

As per section 140(2) of the Act, the auditor who has resigned from the company need not inform the Registrar of Companies.

Answer

Incorrect: As per section 140(2) of the Act, the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form ADT-3 (as per Rule 8 of CAAR) with the company and the Registrar.

Q68. RTP Nov 2019 | MTP Apr 2023, 4 marks

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

Answer

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.

Q69. RTP Nov 2019

According to Companies Act, 2013, the person appointed as an auditor of the company shall sign the auditor's report in accordance with the relevant provisions of the Act. Explain clearly the relevant provisions relating to signing of report.

Answer

Duty to Sign the Audit Report: As per section 145 of the Companies Act, 2013, the person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company, in accordance with the provisions of section 141(2).

Section 141(2) of the Companies Act, 2013 states that where a firm including a limited liability partnership is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm. The qualifications, observations or comments on financial transactions or matters, which have any adverse effect on the functioning of the company mentioned in the auditor's report shall be read before the company in general meeting.

Q70. RTP Nov 2019

The auditor shall make a report to the members of the company on the accounts examined by him. Explain with reference to relevant provisions of the Companies Act, 2013.

Answer

Right to report to the members of the company on the accounts examined by him – The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under this section and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

Q71. RTP May 2019

Under sub-section (3) of section 141 of the Companies Act, 2013 along with Rule 10 of the Companies (Audit and Auditors) Rules, 2014, state the persons who shall not be eligible for appointment as an auditor of a company.

Answer

Under sub-section (3) of section 141 along with Rule 10 of the Companies (Audit and Auditors) Rules, 2014 (hereinafter referred as CAAR), the following persons shall not be eligible for appointment as an auditor of a company, namely-

(a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008;

(b) an officer or employee of the company;

l a person who is a partner, or who is in the employment, of an officer or employee of the company;

(d) a person who, or his relative or partner –

(i) is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company;

It may be noted that the relative may hold security or interest in the company of face value not exceeding Rs 1,00,000.

It may also be noted that the condition of Rs 1,00,000 shall, wherever relevant, be also applicable in the case of a company not having share capital or other securities. It may also be noted that in the event of acquiring any security or interest by a relative, above the threshold prescribed, the corrective action to maintain the limits as specified above shall be taken by the auditor within 60 days of such acquisition or interest.

(ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of Rs 5,00,000;

or

(iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the Company or its Subsidiary, or its Holding or Associate Company or a Subsidiary of such Holding Company, in excess of Rs 1,00,000.

l a person or a firm who, whether directly or indirectly has business relationship with the Company, or its Subsidiary, or its Holding or Associate Company or Subsidiary of such holding company or associate company, of such nature as may be prescribed;

(f) a person whose relative is a Director or is in the employment of the Company as a director or key Managerial Personnel.

(g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than Rs 100 crore.

(h) a person who has been convicted by a Court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction.

(i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialized services as provided in section 144.

Q72. RTP May 2019

Mr. A, a chartered accountant, has been appointed as an auditor of Laxman Ltd. in the Annual General Meeting of the company held in September, 2016, which assignment he accepted. Subsequently in January, 2017 he joined Mr. B, another chartered accountant, who is the Manager Finance of Laxman Ltd., as partner. Analyse and explain.

Answer

Provisions and Explanation: Section 141(3)l of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, he shall be deemed to have vacated his office as an auditor.

Conclusion: In the present case, Mr. A, an auditor of Laxman Ltd., joined as partner with Mr. B, who is Manager Finance of Laxman Limited. The given situation has attracted sub-section (3)l of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of Laxman Limited in accordance with sub-section (4) of section 141.

Q73. RTP May 2019 | MTP Oct 2019, 3 marks

CA. Donald was appointed as the auditor of PS Ltd. at the remuneration of Rs 30,000. However, after 4 months of continuing his services, he could not continue to hold his office of the auditor as his wife got a government job at a distant place and he needs to shift along with her to the new place. Thus, he resigned from the company and did not perform his responsibilities relating to filing of statement to the company and the registrar indicating the reasons and other facts as may be relevant with regard to his resignation. How much fine may he be punishable with under section 140(3) for non-compliance of section 140(2) of the Companies Act, 2013?

Answer

Provisions and Explanation: For non-compliance of sub-section (2) of section 140 of the Companies Act, 2013, the auditor shall be punishable with fine, which shall not be less than fifty thousand rupees or the remuneration of the auditor, whichever is less but which may extend to five lakh rupees, under section 140(3) of the said Act.

Conclusion: Thus, the fine under section 140(3) of the Companies Act, 2013 shall not be less than Rs 30,000 but which may extend to Rs 5,00,000.

Q74. RTP Nov 2018 | MTP Oct 2020, 6 marks

Explain the duties of Auditor to inquire under Section 143(1) of the Companies Act, 2013.

Answer

Duty of Auditor to Inquire on certain matters: It is the duty of auditor to inquire into the following matters-

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

Q75. RTP Nov 2018

Explain Auditor's right to-

- (a) Report to the members of the company on the accounts examined by him
- (b) Obtain information and explanation from officers

Answer

- a) **Right to report to the members of the company on the accounts examined by him** - The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under this section and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.
- b) **Right to obtain information and explanation from officers** - This right of the auditor to obtain from the officers of the company such information and explanations as he may think necessary for

the performance of his duties as auditor is a wide and important power. In the absence of such power, the auditor would not be able to obtain details of amount collected by the directors, etc. from any other company, firm or person as well as of any benefits in kind derived by the directors from the company, which may not be known from an examination of the books. It is for the auditor to decide the matters in respect of which information and explanations are required by him. When the auditor is not provided the information required by him or is denied access to books, etc., his only remedy would be to report to the members that he could not obtain all the information and explanations he had required or considered necessary for the performance of his duties as auditors.

Q76. RTP Nov 2018

Why Central Government permission is required, when the auditors are to be removed before expiry of their term, but the same is not needed when the auditors are changed after expiry of their term?

Answer

Permission of Central Government for Removal of Auditor Under Section 140(1) of the Companies Act, 2013: Removal of auditor before expiry of his term i.e., before he has submitted his report is a serious matter and may adversely affect his independence. Further, in case of conflict of interest the shareholders may remove the auditors in their own interest. Therefore, law has provided this safeguard so that central government may know the reasons for such an action and if not satisfied, may not accord approval. On the other hand, if auditor has completed his term i.e., has submitted his report and thereafter he is not re-appointed then the matter is not serious enough for central government to call for its intervention. In view of the above, the permission of the Central Government is required when auditors are removed before expiry of their term and the same is not needed when they are not re-appointed after expiry of their term.

Q77. RTP Nov 2018

When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole. Explain.

Answer

Using the Work of another Auditor: When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in SA 600, "Using the Work of another Auditor". It makes clear that in certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the

component and/or to examine the books of account and other records of the said component. Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

- i. advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and
- ii. advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them. The principal auditor might discuss with the other auditor

the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor.

Q78. RTP May 2018

Discuss the matters to be included in the auditor's report regarding statutory dues and repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders as per CARO, 2020.

Answer

Matters to be included in the auditor's report- statutory dues and repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders (CARO, 2020) –

Clause (vii) (a) whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not constitute a dispute).

Clause (viii) whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).

Q79. RTP May 2018

State with reasons whether the following statements is correct or incorrect:

As per section 138 of the Companies Act, 2013 private companies are not required to appoint internal auditor.

Answer

Incorrect: Section 138 of the Companies Act, 2013 requires every private company to appoint an internal auditor having turnover of Rs 200 crore or more during the preceding financial year; or outstanding loans or borrowings from banks or public financial institutions exceeding Rs 100 crore or more at any point of time during the preceding financial year.

Q80. RTP May 2018

State with reasons whether the following statements is correct or incorrect:

Manner of rotation of auditor will not be applicable to company A, which is having paid up share capital of Rs 15 crores and having public borrowing from nationalized bank of Rs 50 crore because it is a Private Limited Company.

Answer

Incorrect: According to section 139 of the Companies Act, 2013, the provisions related to rotation of auditor are applicable to all private limited companies having paid up share capital of Rs 50 crore or more; and all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of Rs 50 crore or more.

Q81. RTP May 2018

State with reasons whether the following statements is correct or incorrect:

If LLP (Limited Liability Partnership Firm) is appointed as an auditor of a company, every partner of a firm shall be authorized to act as an auditor.

Answer

Incorrect: As per section 141(2) of the Companies Act, 2013, where a firm including a limited liability partnership (LLP) is appointed as an auditor of a company, only the partners who are Chartered Accountants shall be authorised to act and sign on behalf of the firm.

Q82. RTP May 2018

State with reasons whether the following statements is correct or incorrect:

A Chartered Accountant holding securities of S Ltd. having face value of Rs 950 is qualified for appointment as an auditor of S Ltd.

Answer

Incorrect: As per the provisions of the Companies Act, 2013, a person is disqualified to be appointed as an auditor of a company if he is holding any security of or interest in the company.

Q83. MTP Apr 2023, 3 marks

Why Central Government permission is required, when the auditors are to be removed before expiry of their term, but the same is not needed when the auditors are changed after expiry of their term?

Answer

Permission of Central Government for Removal of Auditor Under Section 140(1) of the Companies Act, 2013:

Removal of auditor before expiry of his term i.e. before he has submitted his report is a serious matter and may adversely affect his independence. Further, in case of conflict of interest the shareholders may remove the auditors in their own interest. Therefore, law has provided this safeguard so that central government may know the reasons for such an action and if not satisfied, may not accord approval. On the other hand if auditor has completed his term i.e. has submitted his report and thereafter he is not re-appointed then the matter is not serious enough for central government to call for its intervention. In view of the above, the permission of the Central Government is required when auditors are removed before expiry of their term and the same is not needed when they are not re-appointed after expiry of their term. The provisions of removal of auditor before expiry of his term are also meant to safeguard auditor's independence by imposing strict conditions like prior approval of Central government.

Q84. MTP Apr 2023, 4 marks

CA Amrit, an auditor was removed by Kritika Ltd. before the expiry of his term. Discuss the procedure to be taken by Kritika Ltd to appoint an auditor other than retiring auditor under Sec. 140(4) of the Companies Act, 2013.

Answer

In the given question, CA Amrit was removed by Kritika Ltd. before the expiry of his term and Kritika Ltd wants to appoint an auditor other than retiring auditor i.e CA Amrit who was removed. Section 140(4) lays down procedure to appoint an auditor other than retiring auditor who was removed-

- 1) Special notice shall be required for a resolution at an annual general meeting appointing as auditor a person other than a retiring auditor, or providing expressly that a retiring auditor shall not be re-appointed, except where the retiring auditor has completed a consecutive tenure of five years or as the case may be, ten years, as provided under sub-section (2) of section 139.
- 2) On receipt of notice of such a resolution, the company shall forthwith send a copy thereof to the retiring auditor.
- 3) Where notice is given of such a resolution and the retiring auditor makes with respect thereto representation in writing to the company (not exceeding a reasonable length) and requests its notification to members of the company, the company shall, unless the representation is received by it too late for it to do so, -
 - a) in any notice of the resolution given to members of the company, state the fact of the representation having been made; and
 - b) send a copy of the representation to every member of the company to whom notice of the meeting is sent, whether before or after the receipt of the representation by the company. And if a copy of the representation is not sent as aforesaid because it was received too late or because of the company's default, the auditor may (without prejudice to his right to be heard orally) require that the representation shall be read out at the meeting. Provided further that if a copy of representation is

not sent as aforesaid, a copy thereof shall be filed with the Registrar. Curtailing right of the auditor regarding circulation of copy of representation in the case of appointment of auditor other than retiring auditor under section 140(4) of the Companies Act, 2013:

If the Tribunal is satisfied on an application either of the company or of any other aggrieved person that the rights conferred by section 140(4) of the Companies Act, 2013 are being abused by the auditor, then, the copy of the representation may not be sent and the representation need not be read out at the meeting.

Q85. MTP Mar 2023, 4 marks

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

- i. disputed and undisputed statutory dues and
- ii. internal audit system of the company

Answer

(a) Matters to be included as per CARO, 2020:

Undisputed and Disputed Statutory dues

Clause (vii)

(a) whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

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

Internal audit system

Clause (xiv)

(a) whether the company has an internal audit system commensurate with the size and nature of its business;

(b) whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor.

Q86. MTP Oct 2022, 4 marks

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

- i. Inventory and
- ii. Deposits accepted by company or amounts which are deemed to be deposits

Answer

Matters to be included as per CARO, 2020:

Inventory

Clause (ii)

(a) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account;

(b) whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

Deposits accepted by company or amounts which are deemed to be deposits

Clause (v)

In respect of deposits accepted by the company or amounts which are deemed to be deposits, whether the directives issued by the Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act and the rules made thereunder, where applicable, have been complied with, if not, the nature of such contraventions be stated; 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.

Q87. MTP Oct 2022, 3 marks

Explain how the casual vacancy in the office of an auditor will be filled in case of a company.

Answer

As per Section 139(8), any casual vacancy in the office of an auditor shall-

- i. In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor General of India, be filled by the Board of Directors within 30 days. If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.
- i. In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within 30 days. It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period the Board of Directors shall fill the vacancy within next 30 days.

Q88. MTP Sep 2022, 4 marks

"Section 139(1) of the Companies Act, 2013 provides that every company shall, at the first annual general meeting appoints an auditor". Explain in detail.

Answer

Section 139(1) of the Companies Act, 2013 provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

The following points need to be noted in this regard-

- i. Before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.
- ii. **Under Rule 4** of The Companies (Audit and Auditors) Rules, 2014, the said certificate shall state the following: -
 - a) the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Act, the Chartered Accountants Act, 1949 and the rules or regulations made thereunder;
 - b) the proposed appointment is as per the term provided under the Act;
 - c) the proposed appointment is within the limits laid down by or under the authority of the Act;
 - d) the list of proceedings against the auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.
- iii. The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

Q89. MTP Sep 2022, 4 marks | MTP May 2020, 2 marks

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

Answer

Matters to be included as per CARO, 2020:

Statutory dues

Clause (vii) (a) whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales -tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

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

Internal Audit

Clause (xiv) (a) whether the company has an internal audit system commensurate with the size and nature of its business.

(b) whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor;

Q90. MTP Sep 2022, 3 marks

Under the provisions of Section 141(3) of Companies Act, 2013 along with relevant rules, a person or a firm who has "business relationship" with a company is not eligible to be appointed as an auditor of that company. In this context, discuss meaning of term "business relationship".

Answer

Under provisions of section 141(3) of Companies Act, 2013, a person or a firm who, whether directly or indirectly has business relationship with the Company, or its Subsidiary, or its Holding or Associate Company or Subsidiary of such holding company or associate company, of such nature as may be prescribed is not eligible to be appointed as auditor of the company. **The term "business relationship" shall be construed as any transaction entered into for a commercial purpose, except-**

- i. commercial transactions which are in the nature of professional services permitted to be rendered by an auditor or audit firm under the Act and the Chartered Accountants Act, 1949 and the rules or the regulations made under those Acts;
- ii. commercial transactions which are in the ordinary course of business of the company at arm's length price – like sale of products or services to the auditor, as customer, in the ordinary course of business, by companies engaged in the business of telecommunications, airlines, hospitals, hotels and such other similar businesses.

Q91. MTP Mar 2022, 2 marks

Examine with reasons (in short) whether the following statements are correct or incorrect.

An auditor has to report on the matters specified in section 143(1) of the Companies Act, 2013.

Answer

Incorrect: The auditor is not required to report on the matters specified in section 143(1) of the Companies Act, 2013 unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. However, the auditor should make a report to the members in case he finds answer to any of these matters in adverse.

Q92. MTP Mar 2022, 3 marks | MTP Nov 2021, 3 marks

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."

Answer

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				

- b) whether the company is a declared wilful defaulter by any bank or financial institution or other lender;
- c) 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;
- d) whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated;
- e) 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;
- f) 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;

Q93. MTP Apr 2022, 3 marks

State the matters to be included in auditor's report as per CARO, 2020 regarding – Verification of inventory and working capital limits.

Answer

Matters to be included in Auditor's report as per CARO 2020:

- i. Clause (ii) of Para 3 of CARO, 2020, requires the auditor to report
 - a) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account;
 - b) whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

Q94. MTP Nov 2021, 4 marks

Enumerate the circumstances under which the retiring auditor can be re-appointed.

Answer

Re-appointment of auditor: A retiring auditor may be re-appointed at an annual general meeting, if-

- i. he is not disqualified for re-appointment.
- ii. he has not given the company a notice in writing of his unwillingness to be re-appointed; and
- iii. a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.
- iv. Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.

Q95. MTP Oct 2021, 2 marks

CA K has resigned as an auditor after 2 months of his appointment in NML Ltd. He needs to file ADT-4 with the Registrar within 60 days from the date of resignation.

Answer

Incorrect: As per section 140(2) of the Companies Act, 2013, the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form ADT-3 (as per Rule 8 of CAAR) with the company and the Registrar.

Q96. MTP Oct 2021, 3 marks

"The company has raised funds by issuing fully convertible debentures. These funds were raised for the expansion and diversification of the business. However, the company utilized these funds for repayment of long-term loans and advances." Advise the auditor regarding reporting requirements under CARO, 2020.

Answer

The auditor is required to report as per clause xiv of paragraph 3 of CARO 2020, whether the company has made any preferential allotment or private placement of shares or fully or partly convertible debentures during the year under review and if so, as to whether the requirement of section 42 of the Companies Act, 2013 have been complied with and the amount raised have been used for the purposes for which the funds were raised. If not, provide the details in respect of the amount involved and nature of non-compliance; In view of the above clause, the auditor would report that funds raised by the company for expansion and diversification of business have not been used for the said purpose rather the company has utilised these funds for repayment of long term loans and advance.

Q97. MTP Apr 2021, 3 marks

"CA. NM who is rendering management consultancy service to LA Ltd. wants to accept offer letter for appointment as an auditor of the LA Ltd. for the next financial year." Discuss with reference to the provision of the Companies Act, 2013.

Answer

Section 141(3)(i) of the Companies Act, 2013 disqualifies a person for appointment as an auditor of a company who is engaged as on the date of appointment in management consultancy service as provided in section 144. Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor which are as under:

- i. Accounting and book keeping services
- ii. Internal audit.
- iii. Design and implementation of any financial information system.
- iv. Actuarial services
- v. Investment advisory services.
- vi. Investment banking services.
- vii. Rendering of outsourced financial services
- viii. Management services and
- ix. Any other kind of services as may be prescribed

Therefore, CA. NM is advised not to accept the assignment of auditing as the management consultancy service is specifically notified in the list of services not to be rendered by him as per section 141(3)(i) read with section 144 of the Companies Act, 2013.

Q98. MTP Apr 2021, 3 marks

Provision of CARO, 2020 is not applicable to ABC Pvt. Ltd., a subsidiary of XYZ Ltd. (a public company) having fully paid-up Capital and Reserves & Surplus of Rs. 50 lakhs, Secured loan from bank of Rs. 90 Lakhs and Turnover of Rs. 5 Crore, for the financial year 2018-19.

Answer

The CARO specifically exempts a private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees 1 crore as on the balance sheet date and which does not have total borrowings exceeding

rupees 1 crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees 10 crore during the financial year as per the financial statements. From the above, it is clear that ABC Pvt. Ltd. is a subsidiary of XYZ Ltd. and hence not exempt from CARO, 2020 although it is satisfying the conditions that allow exemption to private limited company which is not a subsidiary or holding company of a public company.

Q99. MTP Mar 2021, 2 marks

The auditor appointed by a company under section 139 of the Companies Act, 2013, can be appointed for conducting the audit of cost records of the same company.

Answer

Incorrect: The cost audit shall be conducted by a Cost Accountant who shall be appointed by the Board of such remuneration as may be determined by the members in such manner as may be prescribed. It may be noted that no person appointed under section 139 as an auditor of the company shall be appointed for conducting the audit of cost records.

Q100. MTP Mar 2021, 3 marks

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?

Answer

Further, Clause (v) of paragraph 3 of CARO, 2016 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, 2016

Q101. MTP Mar 2021, 3 marks

You have been approached by HK Ltd. to be appointed as Cost Auditor for the F.Y. 2019 -20. Company has requested you to provide a certificate confirming your eligibility as per the provisions of Companies Act, 2013. List down the matters to be included in the certificate.

Answer

Appointment of Cost Auditor: The Companies (Cost Records and Audit) Rules, 2014 requires the companies prescribed under the said Rules to appoint an Auditor within 180 days of the commencement of every financial year. However, before such appointment is made, the written consent of the cost auditor to such appointment and a certificate from him or it shall be obtained.

The certificate to be obtained from the cost auditor shall certify that the-

- i. the individual or the firm, as the case may be, is eligible for appointment and is not disqualified for appointment under the Companies Act, 2013, the Cost and Works Accountants Act, 1959 and the rules or regulations made thereunder;
- ii. the individual or the firm, as the case may be, satisfies the criteria provided in section 141 of the Companies Act, 2013 so far as may be applicable;
- iii. the proposed appointment is within the limits laid down by or under the authority of the Companies Act, 2013; and
- iv. the list of proceedings against the cost auditor or audit firm or any partner of the audit firm pending with respect to professional matters of conduct, as disclosed in the certificate, is true and correct.

Q102. MTP Mar 2021, 4 marks

Mr. A is appointed as statutory auditor of a company for the Financial Year ended 31st March, 2020. During the course of audit, it was found that few doubtful transactions had been committed by finance manager

who retired in March, 2020. The fraud was going on since last 2 -3 years and the total amount misappropriated exceeding Rs. 100 lakhs. As a statutory auditor, what would be reporting responsibilities of Mr. A?

Answer

Reporting to the Central Government- As per section 143(12) of the Companies Act, 2013 read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of Rs. 1 crore or above, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as prescribed.

The manner of reporting the matter to the Central Government is as follows:

(1) the auditor shall 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;

(2) 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;

(3) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;

(4) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

(5) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and

(6) the report shall be in the form of a statement as specified in Form ADT-4. The auditor is also required to report under clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016 [CARO, 2020], whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.

Q103. MTP Oct 2020, 2 marks

Audit committee is to be constituted by every public company to ensure better standards of corporate governance.

Answer

Incorrect: Under Section 177 of Companies Act, 2013 read together with Rule 4 of Companies (Appointment and qualification of Directors) Rules, 2014 prescribe that audit committee is to be constituted by every listed public company and following classes of public companies only:-

- i. the Public Companies having paid up share capital of ten crore rupees or more; or
- ii. the Public Companies having turnover of one hundred crore rupees or more; or
- iii. the Public Companies which have, in aggregate, outstanding loans, debentures and deposits, exceeding fifty crore rupees:

Hence, the statement that all public companies are required to constitute audit committee is incorrect.

Q104. MTP Oct 2020, 2 marks

One of the directors of Very Fresh Fruits Limited was of the opinion that internal auditor to be appointed must be an employee of Very Fresh Fruits Limited.

Answer

Incorrect: As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not), or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies. The internal auditor may or may not be an employee of the company.

Q105. MTP Oct 2020, 4 marks

When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole. Explain.

Answer

Using the Work of another Auditor: When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in SA 600, "Using the Work of another Auditor". It makes clear that in certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component.

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

(a) advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as are as requiring special consideration, procedures for the identification of inter -component transactions that may require disclosure and the time-table for completion of audit; and

(b) advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

Q106. MTP Oct 2020, 6 marks

"ABC & Co." is an Audit Firm having partners "Mr. A", "Mr. B" and "Mr. C", Chartered Accountants. "Mr. A", "Mr. B" and "Mr. C" are holding appointment as an Auditor in 4, 6 and 10 Companies respectively.

- i. Provide the maximum number of Audits remaining in the name of "ABC & Co."
- ii. Provide the maximum number of Audits remaining in the name of individual partner i.e., Mr. A, Mr. B and Mr. C.
- iii. Can ABC & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than Rs 100 crore, 2 small companies and 1 dormant company?
- iv. Would your answer be different, if out of those 60 private companies, 45 companies are having paid-up share capital of Rs 110 crore each?

Answer

Fact of the Case: In the instant case, Mr. A is holding appointment in 4 companies, whereas Mr. B is having appointment in 6 Companies and Mr. C is having appointment in 10 Companies. In aggregate all three partners are having 20 audits.

Provisions and Explanations: Section 141(3)(g) of the Companies Act, 2013 states that the following persons shall not be eligible for appointment as an auditor of a company i.e., a person who is in full time employment elsewhere; or a person, or a partner of a firm holding appointment as its auditor, if such

person, or partner is at the date of such appointment, or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than Rs 100 crore.

As per section 141(3)(g), this limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account.

Conclusion:

- i. Therefore, ABC & Co. can hold appointment as an auditor of 40 more companies: Total Number of Audits available to the Firm Number = $20 \times 3 = 60$ of Audits already taken by all the partners
In their individual capacity = $4+6+10 = 20$
Remaining number of Audits available to the Firm = 40
- ii. With reference to above provisions an auditor can hold more appointment as auditor = ceiling limit as per section 141(3)(g)- already holding appointments as an auditor. Hence (1) Mr. A can hold: $20 - 4 = 16$ more audits. (2) Mr. B can hold $20-6 = 14$ more audits and (3) Mr. C can hold $20-10 = 10$ more audits.
- iii. In view of above discussed provisions, ABC & Co. can hold appointment as an auditor in all the 60 private companies having paid-up share capital less than Rs 100 crore, 2 small companies and 1 dormant company as these are excluded from the ceiling limit of company audits given under section 141(3)(g) of the Companies Act, 2013.
- iv. As per fact of the case, ABC & Co. is already having 20 company audits and they can also accept 40 more company audits. In addition they can also conduct the audit of one person companies, small companies, dormant companies and private companies having paid up share capital less than Rs 100 crores. In the given case, out of the 60 private companies, ABC & Co. is offered 45 companies having paid-up share capital of ` 110 crore each. Therefore, ABC & Co. can also accept the appointment as an auditor for 2 small companies, 1 dormant company, 15 private companies having paid-up share capital less than Rs100 crore and 40 private companies having paid-up share capital of Rs 110 crore each in addition to above 20 company audits already holding.

Q107. MTP Oct 2020, 2 marks

The auditor has to report under section 143 of companies act, 2013 whether company has adequate internal controls in place and overall effectiveness of such internal controls.

Answer

Incorrect: Under provisions of Section 143 of the companies Act, 2013, auditor has to report whether the company has adequate internal financial controls with reference to financial statements in place and operating effectiveness of such controls. The auditor has to report on adequacy and effectiveness of internal financial controls only and not internal controls.

Q108. MTP May 2020, 2 marks

Examine with reasons (in short) whether the following statements are correct or incorrect.

Managing Director of Pigeon Ltd. himself wants to appoint CA. Champ, a practicing Chartered Accountant, as first auditor of the company.

Answer

Incorrect: Section 139(6) of the Companies Act, 2013 lays down that the first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company. In the instant case, the proposed appointment of CA. Champ, a practicing Chartered Accountant, as first auditor by the Managing Director of Pigeon Ltd. by himself is in violation of Section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company. In view of the above, the Managing Director of Pigeon Ltd. should be advised not to appoint the first auditor of the company.

Q109. MTP May 2020, 3 marks

Companies Act, 2013 prescribes that a person shall not be eligible for appointment as an auditor of a company if such person is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies. Explain stating the relevant provisions.

Answer

Ceiling on number of Audits:

1. Section 141(3)(g) of the Companies Act, 2013 prescribes that a person shall not be eligible for appointment as an auditor of a company namely – a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than Rs. 100 crores.
2. In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere. This limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits.
3. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Subject to the overall ceiling of company audits, how they allocate the 20 audits between themselves is their affairs.

Q110. MTP Oct 2019, 3 marks

"The remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein." Explain with reference to provisions of the Companies Act, 2013.

Answer

As per section 142 of the Act, the remuneration of the auditor of a company shall be fixed in its general meeting or in such manner as may be determined therein. However, board may fix remuneration of the first auditor appointed by it. Further, the remuneration, in addition to the fee payable to an auditor, includes the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company. Therefore, it has been clarified that the remuneration to Auditor shall also include any facility provided to him.

Q111. MTP Oct 2019, 3 marks

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

Answer

CARO 2020 specifically exempts the following class of companies:

- i. A banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949;
- ii. An insurance company as defined under the Insurance Act, 1938;
- iii. A company licensed to operate under section 8 of the Companies Act;
- iv. A One Person Company as defined under clause (62) of section 2 of the Companies Act;
- v. A small company as defined under clause (85) of section 2 of the Companies Act; and
- vi. A private limited company, not being a subsidiary or holding company of a public company, having a paid up capital and reserves and surplus not more than rupees one crore as on the balance sheet date and which does not have total borrowings exceeding rupees one crore from any bank or financial institution at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding rupees ten crores during the financial year as per the financial statements.

The Audit Report

Q112. Nov 2022 Exam, 2 marks

State with reasons whether the following statements is correct or incorrect:

Where a firm is appointed as the auditor of a company, the report is signed only in the personal name of the partner signing the report.

Answer

Incorrect: Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm. The partner/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India. They also include the registration number of the firm, wherever applicable, as allotted by ICAI, in the audit reports signed by them.

Alternative Solution:

As per section 145 of the Companies Act, 2013, the person appointed as an auditor of the company shall sign the auditor's report or sign or certify any other document of the company. Whereas if a firm is appointed as an auditor of a company, only the partners who are chartered accountants shall be authorised to act and sign on behalf of the firm. The partner signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India. They also include the registration number of the firm, wherever applicable, as allotted by ICAI, in the audit reports signed by them.

Q113. Nov 2022 Exam, 4 marks | MTP Sep 2022, 3 marks

NG Ltd. appointed CA N as the statutory auditor for the F.Y. 2021-2022. Previous year's auditor gave a qualified opinion on the Comparative Financial Statements for the year ended 31.03.2021. What will be the reporting responsibility casted on CA N when he forms an opinion and prepares audit report on the Comparative Financial Statements for the F.Y. 2021-2022?

Answer

Prior Period Financial Statements Audited by a Predecessor Auditor: As per SA 710, if the financial statements of the prior period were audited by a predecessor auditor, in addition to expressing an opinion on the current period's financial statements, CA. N, the auditor of NG Limited shall state in an Other Matter paragraph:

- That the financial statements of the prior period were audited by a predecessor auditor;
- The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefor; and
- The date of that report, unless the predecessor auditor's report on the prior period's financial statements is revised with the financial statements.

Q114. May 2022 Exam, 2 marks

State with reasons whether the following statements are correct or incorrect.

Pervasive is a term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are detected by obtaining sufficient appropriate audit evidence.

Answer

Incorrect: Pervasive is a term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are undetected due to an inability to obtain sufficient appropriate audit evidence.

Q115. Nov 2021 Exam, 3 marks | MTP Mar 2022, 4 marks

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.

Answer

Others Matters prescribed by Rule 11 to include in Auditor's Report:

As per **section 143(3)(j)**- the auditor's report shall also state such other matters as may be prescribed. 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.
- 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 (i) and (ii) contain any material mis-statement.
- iv. Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.

Q116. July 2021 Exam, 2 marks

State with reasons whether the following statements are correct or incorrect.

The Location of the description of the auditor's responsibilities for the audit of the financial statements is always within the body of the auditor's report.

Answer

Incorrect: The description of the auditor's responsibilities for the audit of the financial statement shall be always shown as below -

- Within the body of the auditor's report
- Within an appendix to the auditor's report, in which case the auditor's report shall

include a reference to the location of the appendix or By a specific reference within the auditor's report to the location of such a description on a website of an appropriate authority, where law, regulation or national auditing standards expressly permit the auditor to do so

Q117. July 2021 Exam, 3 marks

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)?

Answer

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

- (a) 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;
- (b) 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
- (c) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised)

Q118. Jan 2021 Exam, 2 marks | RTP May 2022

State with reasons whether the following statements are correct or incorrect.

Communicating Key Audit Matters is a substitute for the auditor expressing a modified audit opinion when required by the circumstances of a specific audit engagement in accordance with SA 705.

Answer

Incorrect: Communicating key audit matters in the auditor's report is not a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised)

Q119. Jan 2021 Exam, 4 marks | RTP Nov 2020 | RTP Nov 2019

What an auditor should state in "Basis for opinion" section of auditor's report and when the auditor modifies the opinion on the financial statements, what amendments he should make in this section?

Answer

An auditor should state in "Basis for Opinion" section of Auditor's Report as under:

Basis for Opinion:

The auditor's report shall include a section, directly following the Opinion section, with the heading "**Basis for Opinion**", that:

- i. States that the audit was conducted in accordance with Standards on Auditing;
- ii. Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- iii. Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- iv. 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.

Amendments an Auditor should make:

When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

- i. Amend the heading "Basis for Opinion" required by para of SA 700 (Revised) to "Basis for Qualified Opinion," "Basis for Adverse Opinion," or "Basis for Disclaimer of Opinion," as appropriate; and
- ii. Within this section, include a description of the matter giving rise to the modification.

Q120. Nov 2020 Exam, 3 marks | RTP Nov 2021 | MTP Oct2021, 3 marks

How would an auditor determine Key Audit Matters as per SA - 701, "Communicating Key Audit Matters in the Independent Auditor's Report"?

Answer

The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit.

In making this determination, the auditor shall take into account the following:

- a) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA315.

- b) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- c) The effect on the audit of significant events or transactions that occurred during the period.
- The auditor shall determine which of the matters determined in accordance with above stated para were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

Q121. Nov 2018 Exam, 2 marks

State with reasons whether the following statements are correct or incorrect.

An auditor should issue disclaimer of opinion when there is difference of opinion between him and the management on a particular point.

Answer

Incorrect: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. In case of difference of opinion, either the auditor will issue qualified report or adverse report and not disclaimer of opinion.

Q122. Nov 2018 Exam, 5 marks | RTP May 2022 | MTP Mar 2023, 4 marks | MTP Oct 2021, 3 marks | MTP Apr 2021, 4 marks

"An auditor is required to make specific evaluations while forming an opinion in an audit report." State them.

Answer

Specific Evaluations by the auditor: In particular, the auditor shall evaluate whether:

The financial statements adequately disclose the significant accounting policies selected and applied;

- i. The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- ii. The accounting estimates made by management are reasonable;
- iii. The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- iv. The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
- v. The terminology used in the financial statements, including the title of each financial statement, is appropriate.

Q123. May 2018 Exam, 2 marks

State with reasons whether the following statements are correct or incorrect.

The statutory auditor of ABC Ltd. is of the opinion that communicating key audit matters in the auditor's report constitutes a substitute for disclosure in the financial statements.

Answer

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

Q124. May 2018 Exam, 5 marks | RTP Nov 2020

Define Emphasis of Matter Paragraph and how it should be disclosed in the Independent Auditor's Report?

Answer

Emphasis of Matter paragraph: A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

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

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

Q125. RTP May 2023 | MTP Apr 2021, 4 marks | MTP May 2020, 4 marks

The description of management's responsibilities in the auditor's report includes reference to management's responsibilities as it helps to explain to users the premise on which an audit is conducted. Explain.

Answer

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

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

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

- a) **Preparing the financial statements** in accordance with the applicable financial reporting framework, and for **such internal control** as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; [because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and
- b) **Assessing the entity's ability to continue as a going concern** and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

Q126. RTP May 2023 | RTP May 2020

In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgements. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Explain and analyse the indicators of lack of neutrality with examples, wherever required.

Answer

In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgements. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:

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

Example

- Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.
- The combination of several deficiencies affecting the same significant account or disclosure (or the same internal control component) could amount to a significant deficiency (or material weakness if

required to be communicated in the jurisdiction). This evaluation requires judgement and involvement of audit executives.

- ii. Possible management bias in the making of accounting estimates.

Q127. RTP Nov 2022 | RTP May 2020

While drafting auditor's report of LK Ltd., what are the matter to be included by auditor in Opinion Section paragraph?

Answer

The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion".

Opinion Section of the Auditor's report shall also:

- i. Identify the entity whose financial statements have been audited;
- ii. State that the financial statements have been audited;
- iii. Identify the title of each statement that comprises the financial statements;
- iv. Refer to the summary of significant accounting policies and other explanatory information; and
- v. Specify the date or per period covered by each financial statement comprising the financial statement.

Q128. RTP Nov 2022 | MTP Oct 2022, 4 marks | MTP Nov 2021, 3 marks

Mention the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph.

Answer

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

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

Q129. RTP May 2022

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.

Answer

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 (Revised) to include only the following:

- a) 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;
- b) 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
- c) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised).

Q130. RTP Nov 2021

Delightful Ltd. is a company engaged in the production of smiley balls. During the FY 2020- 21 the company transferred its accounts to computerised system (SAP) from manual system of accounts. Since the employees of the company were not well versed with the SAP system, there were many errors in the

accounting during the transition period. As such the statutory auditors of the company were not able to extract correct data and reports from the system. Such data was not available manually also. Further, the employees and the management of the company were not supportive in providing the requisite information to the audit team. The auditor believes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive. Explain the kind of audit report that the statutory auditor of the company should issue in this case.

Answer

The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements. In the present case Delightful Ltd, the statutory auditor of the company is unable to extract correct data and reports from the SAP system for conduct of audit. Also, such data and reports are not available manually. Moreover, the auditor believes that the possible effects on the financial statements of undetected misstatements could be both material and pervasive. As such, the statutory auditor of Delightful Ltd. should give a disclaimer of opinion.

Q131. RTP May 2021

The Auditor is fully satisfied with the audit of an entity in respect of its systems and procedures and wants to issue a report without any hesitation. Discuss the type of opinion that can be given and state giving reasoning.

Answer

Unqualified Opinion:

- 1) An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements.
- 2) An unqualified opinion indicates, implicitly, that any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.
- 3) An unqualified opinion also indicates that:
 - i. the financial statements have been prepared using the generally accepted accounting principles, which have been consistently applied;
 - ii. the financial statements comply with relevant statutory requirements and regulations; and
 - iii. there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

Q132. RTP May 2021

The requirements of SA 700 are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally. Explain.

Answer

The requirements of SA 700 are aimed at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally and the need to increase the value of auditor reporting by making the information provided in the auditor's report more relevant to users. This SA promotes consistency in the auditor's report but recognizes the need for flexibility to accommodate particular circumstances of individual jurisdictions. Consistency in the auditor's report, when the audit has been conducted in accordance with SAs, promotes credibility in the global marketplace by making more readily identifiable those audits that have been conducted in accordance with globally recognized standards. It also helps to promote the user's understanding and to identify unusual circumstances when they occur.

Q133. RTP May 2020

An Audit report is an opinion drawn on the entity's financial statements to make sure that the records are true and correct representation of the transactions they claim to represent.

Answer

Incorrect: The purpose of an audit is to enhance the degree of confidence of intended users of the financial statements. The aforesaid purpose is achieved by the expression of an independent reporting by the auditor as to whether the financial statements exhibit a true and fair view of the affairs of the entity. Thus, an Audit report is an opinion drawn on the entity's financial statements to make sure that the records are true and fair representation of the transactions they claim to represent.

Q134. RTP Nov 2019 | RTP May 2018 | MTP Apr 2022, 3 marks

Communicating Key Audit Matter is not a substitute for disclosure in the Financial Statements rather 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. Analyse.

Answer

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 (Revised);
- 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.

Q135. RTP May 2019

The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. Explain clearly stating the essential audit reporting differences between the approaches. Also define comparative information and audit procedures regarding comparative information.

Answer

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

The essential audit reporting differences between the approaches are:

- a) For corresponding figures, the auditor's opinion on the financial statements refers to the current period only; whereas
- b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

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

Audit Procedures regarding comparative information

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

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

Q136. RTP May 2019

Define Emphasis of Matter paragraph. When the auditor shall include an Emphasis of Matter paragraph in the auditor's report? Also explain how the auditor would include an Emphasis of Matter in the auditor's report?

Answer

Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

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 judgment, 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:

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

Separate section for Emphasis of Matter paragraph

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

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

Q137. RTP Nov 2018

Explain clearly the purpose of communicating key audit matters.

Answer

Purpose of communicating key audit matters

As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", the purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

Q138. RTP Nov 2018

The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Explain.

Answer

Responsibilities for the Financial Statements: The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements." SA 200 explains the premise,

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

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

- a) **Preparing the financial statements** in accordance with the applicable financial reporting framework, **and for such internal control** as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; [because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and
- b) **Assessing the entity's ability to continue as a going concern** and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.

Q139. RTP May 2018 | MTP Oct 2019, 4 marks

The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments. Advise about qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

Answer

Evaluations by the Auditor

The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework. This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

Qualitative Aspects of the Entity's Accounting Practices

- 1) Management makes a number of judgments about the amounts and disclosures in the financial statements.
- 2) SA 260 (Revised) contains a discussion of the qualitative aspects of accounting practices.
- 3) In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following:
 - i. The selective correction of misstatements brought to management's attention during the audit

Example

Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.

The combination of several deficiencies affecting the same significant account or disclosure (or the same internal control component) could amount to a significant deficiency (or material weakness if required to be communicated in the jurisdiction). This evaluation requires judgment and involvement of audit executives.

- ii. Possible management bias in the making of accounting estimates.
 - 4) SA 540 addresses possible management bias in making accounting estimates. Indicators of possible management bias do not constitute misstatements for purposes of drawing conclusions on the

reasonableness of individual accounting estimates. They may, however, affect the auditor's evaluation of whether the financial statements as a whole are free from material misstatement.

Q140. MTP Apr 2023, 2 marks

Examine with reasons (in short) whether the following statements are correct or incorrect.

The auditor's reporting on internal financial control will be applicable with respect to interim financial statements.

Answer

Incorrect: Clause (i) of Sub-section 3 of Section 143 of the Act requires the auditors' report to state whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls. It may be noted that auditor's reporting on internal financial controls is a requirement specified in the Act and, therefore, will apply only in case of reporting on financial statements prepared under the Act and reported under Section 143. Accordingly, reporting on internal financial controls will not be applicable with respect to interim financial statements, such as quarterly or half-yearly financial statements, unless such reporting is required under any other law or regulation.

Q141. MTP Mar 2023, 3 marks

The auditor shall make a report to the members of the company on the accounts examined by him. Explain with reference to relevant provisions of the Companies Act, 2013

Answer

Right to report to the members of the company on the accounts examined by him – The auditor shall make a report to the members of the company on the accounts examined by him on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under this section and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

Q142. MTP Oct 2022, 3 marks

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?

Answer

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:

- 1) Evaluate the competence, capabilities and objectivity of that expert;
- 2) Obtain an understanding of the work of that expert; and
- 3) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.
- 4) CA Amar should consider the above before using the work of the management's expert.

Q143. MTP Sep 2022, 4 marks

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

Answer

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.

Q144. MTP Mar 2022, 2 marks

Examine with reasons (in short) whether the following statements are correct or incorrect.

An auditor has to report on the matters specified in section 143(1) of the Companies Act, 2013.

Answer

Incorrect: The auditor is not required to report on the matters specified in section 143(1) of the Companies Act, 2013 unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. However, the auditor should make a report to the members in case he finds answer to any of these matters in adverse.

Q145. MTP Mar 2022, 4 marks

While conducting audit of VED Ltd., you as an auditor are not only prevented in completing **certain** audit procedures but also are not able to obtain audit evidence even by performing alternative procedures. How you will deal with this situation.

Answer

As per SA 705, "Modifications to the Opinion in the Independent Auditor's Report", if, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation. If management refuses to remove the limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (1) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (2) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
 - (i) Withdraw from the audit, where practicable and possible under applicable law or regulation; or
 - (ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

If the auditor withdraws, before withdrawing, the auditor shall communicate to those charged

with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

Q146. MTP Mar 2021, 2 marks

Examine with reasons (in short) whether the following statements are correct or incorrect.

The inclusion of an Emphasis of Matter paragraph in the Auditor's Report affects the auditor's opinion.

Answer

Incorrect: When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall indicate that the auditor's opinion is not modified in respect of the matter emphasized. Such a paragraph shall refer only to information presented or disclosed in the financial statements. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion.

Q147. MTP Oct 2020, 2 marks

Examine with reasons (in short) whether the following statements are correct or incorrect.

The auditor has to report under section 143 of companies act, 2013 whether company has adequate internal controls in place and overall effectiveness of such internal controls.

Answer

Incorrect: Under provisions of Section 143 of the companies Act, 2013, auditor has to report whether the company has adequate internal financial controls with reference to financial statements in place and operating effectiveness of such controls. The auditor has to report on adequacy and effectiveness of internal financial controls only and not internal controls.

Q148. MTP Oct 2020, 4 marks

State clearly the objective of the Auditor as per SA 706. Also define emphasis of matter paragraph and other matter paragraph.

Answer

As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report", the objective of the auditor, having formed an opinion on the financial statements, is to draw users' attention, when in the auditor's judgment it is necessary to do so, by way of clear additional communication in the auditor's report, to:

- a) A matter, although appropriately presented or disclosed in the financial statements, that is of such importance that it is fundamental to users' understanding of the financial statements; or
- b) As appropriate, any other matter that is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.

Other Matter paragraph – A paragraph included in the auditor's report that refers to a matter other than those presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report.

Q149. MTP May 2020, 2 marks

Examine with reasons (in short) whether the following statements are correct or incorrect.

If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall include an Emphasis of Matter paragraph in the auditor's report.

Answer

Incorrect: If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate, in accordance with SA 705.

Audit of Banks

Q150. Nov 2022 Exam, 4 marks | Nov 2019 Exam, 4 marks | RTP May 2022 | MTP Oct 2021, 4 marks

CARD Ltd. is into the banking business and handles large amount of loans and advances of different kinds. Non-performing assets are on the rise since last two quarters. The management is concerned with correct provisioning for the same. CA R is appointed to check whether correct provisioning of NPA's is being made by the bank or not. What are the aspects that will be verified by CA R for this purpose?

Answer

Provisioning of Non-performing Assets: CA R should verify that the classification of NPAs into sub-standard assets, doubtful assets and loss assets is done depending upon prudential norms as per the RBI Guidelines. Further he should also ensure that provision is being made for the same in accordance with the given table:

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	(Secured+ Unsecured)
Sub- categories <ul style="list-style-type: none"> Doubtful up to 1 Year (D1) Doubtful 1 to 3 Years (D2) Doubtful more than 3 Years (D3) 	25% + 100%
Loss Assets Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.	40% + 100%
	100% + 100%
	100%

Alternative Answer 1:

Aspects to be verified by CA R to check correct provisioning of NPAs: CA R should verify following aspects while checking whether correct provisioning of NPAs is being made by bank: -

- 1) It should be verified whether classification of NPAs is in accordance with RBI guidelines. Such guidelines require classification of NPAs into sub-standard assets, doubtful assets and loss assets depending upon different criteria. Each classification requires different percentage of provisions. Therefore, proper classification of NPAs would ensure that provisioning is correct.
- 2) It should be verified that doubtful assets have been further properly classified in D1, D2 and D3 categories. These three different categories require provision of 25%, 40% and 100% respectively of secured portions of outstanding amount.
- 3) It should be verified that secured and unsecured portion in doubtful assets have been arrived at properly. Unsecured portion of liability entails provision of 100%. Therefore, it is important to verify that break-up of doubtful assets into secured and unsecured portions is proper.
- 4) As different kinds of loans and advances are handled by the bank; it should be ensured that loan classification according to its purpose is properly made in the system. NPA norms vary for cash credit accounts, term loans, bills purchased an agricultural loans. Any wrong classification can lead to

incorrect provisioning. For example, if an agricultural loan is wrongly classified, it would lead to incorrect provisions.

Alternative Answer 2:

Aspects to be verified by CA R to check correct provisioning of NPAs:

- 1) For audit of Provisions, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled.
- 2) The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets.
- 3) The auditor may verify the loan classification on a sample basis.
- 4) The auditor should obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger.

Q151. May 2022 Exam, 3 marks | RTP Nov 2019

After becoming Chartered Accountant, you have got your first assignment as an auditor of a bank branch dealing in various types of advances. What are the areas which you will be looking for obtaining sufficient appropriate evidence (for advances) besides studying and evaluating internal controls?

Answer

Audit Procedure in Audit of Advances in case of Bank Audit: The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of internal controls relating to advances, and by:

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

Q152. Nov 2021 Exam, 4 marks | MTP Apr 2023, 4 marks

In a bank, all accounts should be kept within the drawing power and the sanctioned limit. The accounts which exceed the sanctioned limit or drawing power should be brought to the notice of the management regularly. Analyse the following points to be considered in the computation of drawing power in case of bank audit.

- i. Bank's Duties
- ii. Auditor's concern
- iii. Computation of DP
- iv. Stock audit

Answer

Computation of Drawing Power:

- i. **Bank's Duties:** Banks should ensure that drawings in the working capital account are covered by the adequacy of the current assets. Drawing power is required to be arrived at based on current stock statement. However, considering the difficulties of large borrowers, stock statements relied upon by the banks for determining drawing power should not be older than three months. The outstanding in the account based on drawing power calculated from stock statements older than three months is deemed as irregular.
- ii. **Auditor's Concern:** The stock statements, quarterly returns and other statements submitted by the borrower to the bank should be scrutinized in detail. The audited Annual Report submitted by the borrower should be scrutinized properly. The monthly stock statement of the month for which the audited accounts are prepared and submitted should be compared and the reasons for deviations, if any, should be ascertained.
- iii. **Computation of DP:** It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the Board of Directors of the respective bank and agreed upon by the

concerned statutory auditors. Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power.

- iv. **Stock Audit:** The stock audit should be carried out by the bank for all accounts having funded exposure of more than ₹ 5 crores. Auditors can also advise for stock audit in other cases if the situation warrants the same. Branches should obtain the stock audit reports from lead bank in the cases where the Bank is not leader of the consortium of working capital. The report submitted by the stock auditors should be reviewed during the course of the audit and special focus should be given to the comments made by the stock auditors on valuation of security and calculation of drawing power.

Q153. July 2021 Exam, 3 marks

Discuss the advantages of engagement team discussion done at the planning stage of the bank audit.

Answer

Advantages of engagement team discussion done at the planning stage of Bank audit are:

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

Q154. Jan 2021 Exam, 4 marks

Explain "Advances under Consortium" in the context of Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances.

Answer

Advances under Consortium: Consortium advances should be based on the record of recovery of the respective individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, an NPA. The banks participating in the consortium, therefore, need to arrange to get their share of recovery transferred from the lead bank or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

Q155. Nov 2020 Exam, 4 marks

You are appointed as Statutory Auditor of DEF Bank Limited for the year 2019-20. As an Auditor how will you verify Provisions created by DEF Bank Limited?

Answer

For audit of Provisions, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled. The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non-performing assets. The auditor may verify the loan classification on a sample basis. The auditor should obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger. The auditor should obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation. The other provisions for expenses should be examined vis-à-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

Q156. Nov 2019 Exam, 3 marks | May 2019 Exam, 4 marks

The discussion between members of the engagement team members and the audit engagement partner should be done on the susceptibility of the bank's financial statements to material misstatements. Briefly discuss the points ordinarily included in discussion of the engagement team.

Answer

The engagement team discussion ordinarily includes a discussion of the following matters:

- i. Errors that may be more likely to occur;
- ii. Errors which have been identified in prior years;
- iii. Method by which fraud might be perpetrated by bank personnel or others within particular account balances and / or disclosure;
- iv. Audit responses to engagement risk, pervasive risks and specific risks;
- v. Need to maintain professional skepticism throughout the audit engagement,
- vi. Need to alert for information or other conditions that indicates that a material misstatement may have occurred (e.g., the bank's application of accounting policies in the given facts and circumstances).

Q157. May 2019 Exam, 4 marks | RTP May 2023 | MTP Sep 2022, 4 marks

Mr. Piyush, the Bank Manager develops controls to aid in managing key business and financial risks. Discuss the various requirements for an effective risk management system in a bank.

Answer

An effective risk management system in a bank generally requires the following:

- i. **Oversight and involvement in the control process by those charged with governance:** Those charged with governance (BOD/Chief Executive Officer) should approve written risk management policies. The policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable.
- ii. **Identification, measurement and monitoring of risks:** Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria.
- iii. **Control activities:** A bank should have appropriate controls to manage its risks, including effective segregation of duties (particularly, between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting of limits, reporting and approval of exceptions, physical security and contingency planning.
- iv. **Monitoring activities:** Risk management models, methodologies and assumptions used to measure and manage risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit.
- v. **Reliable information systems:** Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

Q158. Nov 2018 Exam, 5 marks

"Ramjilal & Co. had been allotted the branch audit of a nationalized bank for the year ended 31st March, 2018. In the audit planning, the partner of Ramjilal & Co., observed that the allotted branches are predominantly based in rural areas and major portion of the advances were for agricultural purpose." Now he needs your assistance on the following points so as to incorporate them in the audit plan:

- (i) for determination of NPA norms for agricultural advances
- (ii) for accounts where there is erosion in the value of security/frauds committed by then borrowers.

Answer

- i. **NPA norms for Agricultural Advances:** As per the guidelines, Agricultural Advances are of two types,
 - (1) Agricultural Advances for "long duration" crops and
 - (2) Agricultural Advances for "short duration" crops

The “long duration” crops would be crops with crop season longer than one year and crops, which are not “long duration” crops would be treated as “short duration” crops. The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers’ Committee in each State.

The following NPA norms would apply to agricultural advances (including Crop Term Loans):

- A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons and,
- A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

ii. **Accounts where there is erosion in the value of security / frauds committed by borrowers**

Not prudent to follow stages of asset classification. It should be straightaway classified as doubtful or loss asset as appropriate.

1. Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straightaway classified under doubtful category and provisioning should be made as applicable to doubtful assets.
2. If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straightaway classified as loss asset. It may be either written off or fully provided for by the bank.

Q159. May 2018 Exam, 5 marks | RTP Nov 2020 | MTP Apr 2021, 3 marks

Mr. A approaches a bank for financial assistance for his upcoming project. The Bank Branch Manager, after verifying the proposal, is agreeable to financing Mr. A, but asks for the security to be offered to the bank. Discuss the nature of securities required to be offered to the bank.

Answer

Nature of Security:

- i. **Primary security** refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the principal security for an advance.
- ii. **Collateral security** is an additional security. Security can be in any form i.e., tangible or intangible asset, movable or immovable asset.

Examples of most common types of securities accepted by banks are the following.

- Personal Security of Guarantor
- Goods / Stocks / Debtors / Trade Receivables
- Gold Ornaments and Bullion
- Immovable Property
- Plantations (For Agricultural Advances)
- Third Party Guarantees
- Banker’s General Lien
- Life Insurance Policies
- Stock Exchange Securities and Other Instruments

Q160. RTP May 2023 | RTP May 2022 | MTP Apr 2023, 3 marks | MTP Sep 2022, 4 marks

Explain the audit approach you would follow to check the Operating Expenses of a Bank.

Answer

Auditing the Operating Expenses of a Bank: -

- a) **Internal Controls:** The auditor should study and evaluate the system of internal control relating to expenses, including authorization procedures in order to determine the nature, timing and extent of his other audit procedures.
- b) **Divergent Trends:** The auditor should examine whether there are any divergent trends in respect of major items of expenses.

- c) **Substantive analytical Procedures:** The auditor should perform substantive analytical procedures in respect of these expenses. eg. assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years.
- d) **Vouching & Verification:** The auditor should also verify expenses with reference to supporting documents and check the calculations wherever required.

Q161. RTP Nov 2022 | RTP May 2021 | RTP Nov 2019 | RTP May 2018 | MTP Oct 2019, 4 marks

In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about amounts included in balance sheet in respect of advances which are outstanding. Explain stating clearly all the considerations in this context.

Answer

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:**

- a) Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
- b) Advances represent amount due to the bank.
- c) Amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of advances.
- d) There are no unrecorded advances.
- e) The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.
- f) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
- g) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

Q162. RTP Nov 2022

CA. Puranjay is appointed as statutory branch auditor of two branches of a nationalized bank for year 2021-22. During the course of audit, he came across the following:

- (a) While verifying advances of one semi-urban branch, he noticed substantial number of accounts categorized as SMA (Special mention accounts). In this context, explain the nature and significance of SMA.
- (b) While verifying interest income of a mid-corporate branch of an urban centre having advances consisting of only cash credit limits for large borrowers, it was noticed that advances of Rs 300 crores were outstanding as on balance sheet date carrying average interest rate @8% p.a.

One articulated clerk in audit team makes quick back of the envelope calculations of interest income of Rs 24 crores on advances. However, schedule of profit & loss a/c shows interest income on advances for Rs 10 crores. Discuss any two probable reasons for such variation.

Answer

- a) Special Mention accounts (SMA) are those accounts which are resulting signs of incipient stress leading to the possibility that borrowers may default on debt obligations. These are in the nature of warning system to alert the banks about probable NPAs so that remedial action can be taken before accounts actually turn NPAs. Therefore, their significance lies in the fact that proper and timely identification of SMAs can help in preventing turning potential NPAs into actual NPAs.
- b) The probable reasons for difference in interest calculation could be due to following:
 - i. Cash credit accounts, by their very nature, are running accounts and their utilization depends upon needs of business. Further, interest on cash credit account is charged on the extent of funds utilized by the borrower. It could be possible that all cash credit limits were not fully utilized during the year which resulted in lower interest income.
 - ii. Some large accounts may have been sanctioned during later part of the year resulting in lower interest income on advances for whole year.

Q163. RTP May 2022

State with reasons whether the following statements is correct or incorrect:

A loan granted for short duration crops will be treated as NPA, if the instalments of principal or interest thereon remains overdue for one crop season.

Answer

Incorrect: A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons. A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

Q164. RTP May 2022

State with reasons whether the following statements is correct or incorrect:

It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the RBI and agreed upon by the concerned statutory auditors. Special consideration need not be given to proper reporting of sundry creditors for the purposes of calculating drawing power.

Answer

Incorrect: It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors. Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power.

Q165. RTP Nov 2021

State with reasons whether the following statements is correct or incorrect:

Collateral security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the principal security for an advance.

Answer

Incorrect: Primary security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the principal security for an advance.

Collateral security is an additional security. Security can be in any form i.e., tangible or intangible asset, movable or immovable asset.

Q166. RTP Nov 2021

The engagement team discussion ordinarily includes a discussion of the matters such as - Errors that may be more likely to occur; Errors which have been identified in prior years; Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures; etc. In the above context, explain the advantages of such a discussion.

Answer

Advantages of such a discussion: -

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

Q167. RTP Nov 2021 | RTP May 2020

In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense. Analyse and explain stating the audit approach and procedure in regard to interest expense.

Answer

In carrying out an audit of interest expense, the auditor is primarily concerned with assessing the overall reasonableness of the amount of interest expense by analysing ratios of interest paid on different types of deposits and borrowings to the average quantum of the respective liabilities during the year. In modern

day banking, the entries for interest expenses are automatically generated through a batch process in the CBS system.

The auditor should obtain from the bank an analysis of various types of deposits outstanding at the end of each quarter. From such information, the auditor may work out a weighted average interest rate. The auditor may then compare this rate with the actual average rate of interest paid on the relevant deposits as per the annual accounts and enquire into the difference, if material.

The auditor should also compare the average rate of interest paid on the relevant deposits with the corresponding figures for the previous years and analyse any material differences. The auditor should obtain general ledger break-up for the interest expense incurred on deposits (savings and term deposits) and borrowing each month/quarter. The auditor should analyse month on month (or quarter on quarter) cost analysis and document the reasons for the variances as per the benchmark stated. He should examine whether the interest expense considered in the cost analysis agrees with the general ledger. The auditor should understand the process of computation of the average balance and re-compute the same on sample basis.

The auditor should, on a test check basis, verify the calculation of interest and ensure that:

- a) Interest has been provided on all deposits up to the date of the balance sheet;
- b) Interest rates are in accordance with the bank's internal regulations, the RBI directives and agreements with the respective deposit holder;
- c) Interest on savings accounts are in accordance with the rules framed by the bank/RBI in this behalf.
- d) Interest on inter-branch balances has been provided at the rates prescribed by the head office/RBI.

The auditor should ascertain whether there are any changes in interest rate on saving accounts and term deposits during the period. The auditor should obtain the interest rate card for various types of deposits and analyse the interest cost for the period accordingly. The auditor should examine the completeness that interest has been accrued on the entire borrowing portfolio and the same should agree with the general ledgers. The auditor should re-compute the interest accrual i.e., by referring to the parameters like frequency of payment of interest amount, rate of interest, period elapsed till the date of balance sheet, etc. from the term sheet, deal ticket, agreements, etc. and ensure that the recomputed amount is tallying with the amount as per books of accounts without any significant difference.

Q168. RTP May 2021

State with reasons whether the following statements is correct or incorrect:

The assignment is the creation of an equitable charge which is created in favor of the lending bank by execution of hypothecation agreement in respect of the moveable securities belonging to the borrower.

Answer

Incorrect: The hypothecation is the creation of an equitable charge (i.e., a charge created not by an express enactment but by equity and reason), which is created in favor of the lending bank by execution of hypothecation agreement in respect of the moveable securities belonging to the borrower.

Q169. RTP May 2021

Your firm of auditors, SRG & Co., has been appointed as Statutory Central Auditors of Reliable Bank. Explain the reporting requirements of the Statutory Central Auditors (SCAs) in addition to their main audit report.

Answer

Presently, the Statutory Central Auditors (SCAs) have to furnish the following reports in addition to their main audit report:

- a) Report on adequacy and operating effectiveness of Internal Controls over Financial Reporting in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI.
- b) Long Form Audit Report. (LFAR)
- c) Report on compliance with SLR requirements.

- d) Report on whether the treasury operations of the bank have been conducted in accordance with the instructions issued by the RBI from time to time.
- e) Report on whether the income recognition, asset classification and provisioning have been made as per the guidelines issued by the RBI from time to time.
- f) Report on whether any serious irregularity was noticed in the working of the bank which requires immediate attention.
- g) Report on status of the compliance by the bank with regard to the implementation of recommendations of the Ghosh Committee relating to frauds and malpractices and of the recommendations of Jilani Committee on internal control and inspection/credit system.
- h) Report on instances of adverse credit-deposit ratio in the rural areas.

Q170. RTP Nov 2020

Depending on the nature of the item concerned, creation of security may take the form of a mortgage, pledge, hypothecation, assignment, set-off or lien. Explain with specific reference to Audit of Banks.

Answer

Depending on the nature of the item concerned, creation of security may take the form of a mortgage, pledge, hypothecation, assignment, set-off or lien.

- i. **Mortgage:** Mortgage are of several kinds but the most important are the Registered Mortgage and the Equitable Mortgage.
 - **Registered Mortgage** can be affected by a registered instrument called the 'Mortgage Deed' signed by the mortgagor. It registers the property to the mortgagee as a security.
 - **Equitable mortgage**, on the other hand, is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof.
- ii. **Pledge:** A pledge thus involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance. The legal ownership of the goods remains with the pledger while the lending banker gets certain defined interests in the goods. The pledge of goods constitutes a specific (or fixed) charge.
- iii. **Hypothecation:** The hypothecation is the creation of an equitable charge (i.e., a charge created not by an express enactment but by equity and reason), which is created in favour of the lending bank by execution of hypothecation agreement in respect of the moveable securities belonging to the borrower. Neither ownership nor possession is transferred to the bank. However, the borrower holds the physical possession of the goods as an agent/trustee of the bank. The borrower periodically submits statements regarding quantity and value of hypothecated assets (stocks, debtors, etc.) to the lending banker on the basis of which the drawing power of the borrower is fixed.
- iv. **Assignment:** Assignment represents a transfer of an existing or future debt, right or property belonging to a person in favour of another person. Only actionable claims (i.e., claim to any debt other than a debt secured by a mortgage of immovable property or by hypothecation or pledge of moveable property) such as book debts and life insurance policies are accepted by banks as security by way of assignment. An assignment gives the assignee absolute right over the moneys/debts assigned to him.
- v. **Set-off:** Set-off is a statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor. The right of set-off enables a bank to combine two accounts (a deposit account and a loan account) of the same person provided both the accounts are in the same name and same right (i.e., the capacity of the account holder in both the accounts should be the same). For the purpose of set-off, all the branches of a bank are treated as one single entity. The right of set-off can be exercised in respect of time-barred debts also.
- vi. **Lien:** Lien is creation of a legal charge with consent of the owner, which gives lender a legal right to seize and dispose / liquidate the asset under lien.

Q171. RTP May 2020

State with reasons whether the following statements is correct or incorrect:

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 180 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

Answer

Incorrect: An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

Q172. RTP May 2020

In view of the significant uncertainty regarding ultimate collection of income arising in respect of non-performing assets, the guidelines require that banks should not recognize income on non-performing assets until it is actually realised. When a credit facility is classified as non-performing for the first time, interest accrued and credited to the income account in the corresponding previous year which has not been realized should be reversed or provided for. This will apply to Government guaranteed accounts also. Analyse and explain.

Answer

Reversal of Income:

If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also.

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected. Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s). Furthermore, the auditor should enquire if there are any large debits in the Interest Income account that have not been explained. It should be enquired whether there are any communications from borrowers pointing out differences in interest charge and whether appropriate action has been taken in this regard.

Q173. RTP May 2019 | RTP Nov 2018

The auditor should examine the efficacy of various internal controls over advances in case of Banks to determine the nature, timing and extent of his substantive procedures. Explain what is included in the internal controls over advances.

Answer

Evaluation of Internal Controls over Advances: 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.

Q174. MTP Apr 2023, 2 marks

Examine with reasons (in short) whether the following statements are correct or incorrect. Classification as NPA should be based on the availability of security and asset classification would be facility wise and not borrower wise.

Answer

Incorrect: 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. Asset classification would be borrower-wise and not facility-wise.

Q175. MTP Mar 2023, 4 marks

When are following considered as non performing as per the RBI guidelines?

- Government guaranteed advances
- Advances to staff

Answer

Government Guaranteed advances:

- Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets, but regarded as NPA for Income Recognition purpose.
- The situation would be different if the advance is guaranteed by State Government, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

Advances to Staff

Interest-bearing staff advances as a banker should be included as part of advances portfolio of the bank. In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of installment of principal or payment of interest on the respective due dates. The staff advances by a bank as an employer and not as a banker are required to be included under the sub-head 'Others' under the schedule of Other Assets.

Q176. MTP Mar 2023, 4 marks

Explain pledge and set off as the modes of creation of security with respect to advance granted by a bank.

Answer

Pledge: A pledge involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance. The legal ownership of the goods remains with the pledger while the lending banker gets certain defined interests in the goods. The pledge of goods constitutes a specific (or fixed) charge.

Set-off: Set-off is a statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor. The right of set off enables a bank to combine two accounts (a deposit account and a loan account) of the same person provided both the accounts are in the same name and same right (i.e., the capacity of the

account holder in both the accounts should be the same). For the purpose of set-off, all the branches of a bank are treated as one single entity. The right of set-off can be exercised in respect of time-barred debts also.

Q177. MTP Oct 2022, 4 marks | MTP Mar 2022, 4 marks

When is an agricultural advance considered as non performing as per the RBI guidelines?

Answer

As per the guidelines, Agricultural Advances are of two types:

- 1) Agricultural Advances for "long duration" crops; and
- 2) Agricultural Advances for "short duration" crops.

The "long duration" crops would be crops with crop season longer than one year and crops, which are not "long duration" crops would be treated as "short duration" crops.

The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers' Committee in each State.

The following NPA norms would apply to agricultural advances (including Crop Term Loans):

- A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons; and
- A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

Q178. MTP Oct 2022, 4 marks

Explain hypothecation and assignment as the modes of creation of security with respect to advance granted by a bank.

Answer

Hypothecation:

The hypothecation is the creation of an equitable charge (i.e., a charge created not by an express enactment but by equity and reason), which is created in favor of the lending bank by execution of hypothecation agreement in respect of the moveable securities belonging to the borrower. Neither ownership nor possession is transferred to the bank. However, the borrower holds the physical possession of the goods as an agent/trustee of the bank. The borrower periodically submits statements regarding quantity and value of hypothecated assets (stocks, debtors, etc.) to the lending banker on the basis of which the drawing power of the borrower is fixed.

Assignment:

Assignment represents a transfer of an existing or future debt, right or property belonging to a person in favor of another person. Only actionable claims (i.e., claim to any debt other than a debt secured by a mortgage of immovable property or by hypothecation or pledge of moveable property) such as book debts and life insurance policies are accepted by banks as security by way of assignment. An assignment gives the assignee absolute right over the moneys/debts assigned to him.

Q179. MTP Oct 2021, 3 marks | MTP Apr 2021, 3 marks

In case of a Bank, explain the meaning of Funded loans. Also give examples.

Answer

Funded loans are those loans where there is an actual transfer of funds from the bank to the borrower.

Advances comprise of funded amounts by way of:

- Term loans
- Cash credits, Overdrafts, Demand Loans
- Bills Discounted and Purchased
- Participation on Risk Sharing basis
- Interest-bearing Staff Loans

Q180. MTP Mar 2021, 4 marks

There are different types of banks prevailing in India. Explain giving examples of such banks.

Answer

There are different types of banking institutions prevailing in India which are as follows:

Commercial Banks	Regional Rural Banks
Co-operative Banks	Payment Banks
Development Banks (more commonly known as 'Term- Lending Institutions')	Small Finance Banks

- 1) **Commercial banks** are the most wide spread banking institutions in India, that provide a number of products and services to general public and other segments of economy. Two of its main functions are:
 - a) accepting deposits and
 - b) granting advances.
- 2) **Regional Rural Banks** known as **RRBs** are the banks that have been set up in rural areas in different states of the country to cater to the basic banking and financial needs of the rural communities. **Examples are:** - Punjab Gramin Bank, Tripura Gramin Bank, Allahabad UP Gramin Bank, Andhra Pradesh Grameen Vikas Bank, etc.
- 3) **Co-operative Banks** function like Commercial Banks only but are set up on the basis of Cooperative Principles and registered under the Cooperative Societies Act of the respective state or the Multistate Cooperative Societies Act and usually cater to the needs of the agricultural and rural sectors. **Examples are:** - The Gujarat State Co-operative Bank Ltd, Chhattisgarh Rajya Sahakari Bank Maryadit, etc.
- 4) **Payments Banks** are a new type of banks which have been recently introduced by RBI. They are allowed to accept restricted deposits but they cannot issue loans and credit cards. However, customers can open Current & Savings accounts and also avail the facility of ATM cum Debit cards, Internet-banking & Mobile banking. **Examples are:** - Airtel Payments Bank, India Post Payments Bank, Paytm Payments Bank, etc.
- 5) **Development Banks** had been conceptualized to provide funds for infrastructural facilities important for the economic growth of the country. **Examples are:** - Industrial Finance Corporation of India (IFCI), Industrial Development Bank of India (IDBI), Small Industries Development Bank of India (SIDBI), etc.
- 6) **Small Finance Banks** have been set up by RBI to make available basic financial and banking facilities to the unserved and unorganised sectors like small marginal farmers, small & micro business units, etc. **Examples are:** - Equitas Small Finance Bank, AU Small Finance Bank, etc

Q181. MTP Oct 2020, 4 marks

Your firm of Chartered Accountants has been appointed as auditor of a Nationalised bank. Explain how will you proceed to carry out audit of provisions and contingencies.

Answer

For audit of Provisions and contingencies, the auditor should ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled. The auditor should obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into standard, sub-standard, doubtful, loss and non- performing assets. The auditor may verify the loan classification on a sample basis. The auditor should obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger. The auditor should obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation. The other provisions for expenses should be examined vis-a-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

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