

WT 3 (Ch. 5 – Audit Evidence & Ch. 6 – Completion and Review)

Instructions: Part A comprises of MCQ.

Part B comprises of descriptive questions.

Part – A (Multiple Choice Questions)

- Q.1** (c) (2 Marks)
- Q.2** (b) (1 Mark)
- Q.3** (c) (2 Marks)
- Q.4** (b) (2 Marks)

Part B (Descriptive Questions)

Q. No. 1 is Compulsory. Attempt Any two from the rest.

Q.1(a): Duties of Auditor in identifying Significant Related Party Transactions:

SA 550 “Related parties” deals with the auditor’s responsibilities regarding related party relationships and transactions when performing an audit of financial statements.

For identified significant related party transactions outside the P Ltd.’s normal course of business, the auditor shall:

- (a) 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; (1 Mark)
 - (ii) The terms of the transactions are consistent with management’s explanations; and (1 Mark)
 - (iii) The transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework; and (1 Mark)
- (b) Obtain audit evidence that the transactions have been appropriately authorised and approved. (1 Mark)

Q.1(b): Consideration of Effect of subsequent Events:

SA 560 “Subsequent Events” requires the auditor to obtain sufficient appropriate audit evidence about whether 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 are appropriately reflected in those financial statements. For this purpose, auditor shall perform the following:

- (a) Obtain an understanding of the procedures through which management has identified subsequent events.
- (b) Inquiring of management as to occurrence of Subsequent events which affect the financial statements.
- (c) Read minutes of management meetings that have been held after the date of the financial statements.
- (d) Read the entity's latest subsequent interim financial statements, if any.
- (e) If auditor identifies events that require adjustment or disclosure in the financial statements, the auditor should determine whether each such event is appropriately reflected in the financial statements.
- (f) The auditor shall request the management to provide a "Written Representation" that all events occurring subsequent to the date of the financial statements and requires adjustment or disclosure have been adjusted or disclosed.

4 Marks (One Mark for each correct Point – Any four)

Q.2: Use of information prepared by management's appointed expert as audit evidence

As per SA 500, "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management 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.

2 Marks (One Mark for each correct Point – Any two)

Matters that can impact the nature, timing and extent of audit procedures:

Nature, timing and extent of audit procedures in relation to the requirement relating to information to be used as audit evidence prepared using the work of a management's expert may be affected by such matters as:

- (1) The nature and complexity of the matter to which the management's expert relates.
- (2) The risks of material misstatement in the matter.
- (3) The availability of alternative sources of audit evidence.
- (4) The nature, scope and objectives of the management's expert's work.
- (5) Whether the management's expert is employed by the entity or is a party engaged by it to provide relevant services.
- (6) The extent to which management can exercise control or influence over the work of the management's expert.
- (7) Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
- (8) The nature and extent of any controls within the entity over the management's expert's work.

3 Marks (One Mark for each correct Point – Any three)

Q.3(a): Auditor's duties when requested WRs not provided:

If management of Deluxe Ltd. does not provide one or more of the requested written representations, CA Akash should:

- (a) Discuss the matter with management;
- (b) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- (c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705.

2 Marks (One Mark for each correct Point – Any two)

Q.3(b): Audit Procedure for identifying litigation and claim:

- SA 501 "Audit Evidence – Specific Considerations for selected items" deals with specific considerations by the auditor in obtaining sufficient and appropriate audit evidence, with respect to certain aspects of inventory, litigation and claims, and segment information in an audit of financial statements.
- Accordingly, 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:
 - (a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
 - (b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
 - (c) Reviewing legal expense accounts. **(2 Marks)**
- 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. If law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures. **(1 Mark)**

Q.4: Evaluation of Appropriateness of Going Concern Basis of Accounting:

- The indicated events or conditions in MZE Limited may cast significant doubt on ability of company to continue as going concern. **SA 570 requires that if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern through performing additional audit procedures, including consideration of mitigating factors.** **(1 Mark)**

- In the given situation, the auditor is studying management's assessment of the company's ability to continue as going concern, including its future plan of action containing projected profitability statements for the next two years containing estimates of turnover, expenses and profits. However, **as required in SA 570, auditor's procedures should focus on cash flow forecast and not on future profit projections. It is quite possible that a company may continue to carry on as a going concern so long as it can meet its liabilities. Therefore, analysing the projected profitability statements alone is insufficient to support the conclusion on the going concern assumption followed by the company.** (1 Marks)
- Therefore, the auditor should require management to prepare a cash flow forecast in the given circumstances. The auditor should then analyse the cash flow forecast in the evaluation of management's future plan of action. It includes: -
 - (a) Evaluating the reliability of the underlying data generated to prepare the forecast and
 - (b) Determining whether there is adequate support for the assumptions underlying the forecast.(2 Mark)
- Further, some major overseas payments of the company are stuck up. It is quite possible that the timing of cash inflows on account of these payments may affect the situation.

Conclusion: Auditor would have to evaluate the reliability of data for preparation for such a forecast and its underlying assumptions. He should perform procedures to obtain evidence regarding assumptions and timing of cash inflows and outflows like any restructuring undertaken by bankers providing relief to the company, future sales and consequent cash realization in downturn conditions, willingness of creditors to provide credit in such a situation, incurring of expenditures to keep the company afloat. All these assumptions underlying such cash flow forecasts need to be challenged and examined. (1 Mark)

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