

# Intermediate Paper 5 – Auditing & Ethics

## Additional Questions – To be covered with 14<sup>th</sup> Edition

[Asked in May 24 Exam; MTP (July / Aug. 24) and RTP (May 24 & Sep. 24)]

### PART I – DESCRIPTIVE QUESTIONS

#### Chapter 1 – Nature Objective & Scope of Audit

##### 1.1 – Meaning and Nature of Auditing

**Q.13A** The management of Cool Drinks Limited suspects that some employees of the company may be involved in making fraudulent payments to dummy workers at its various plants in the country. Therefore, they are considering appointment of a firm of auditors to conduct audit involving detailed examination of accounts. However, one senior person among Board members, Mr. P, objects to use of word “audit” in proposed assignment. Comment. Also, discuss how audit is different from investigation. [MTP-July 24]

**Ans.: Audit vs. Investigation:**

- Audit is distinct from investigation. Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation. The objective of audit, on the other hand, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.
- Scope of audit is general and broad whereas scope of investigation is specific and narrow.
- In the given situation, management of company suspects that some of its employees may be involved in making fraudulent payments on account of dummy workers at its different plants in the country. Such an assignment is in the nature of “investigation”.

**Conclusion:** Mr. P is right in objecting the use of word “audit” in the proposed assignment.

##### 1.3 – Meaning, Nature and Types of Engagements

**Q.23A** “Assurance engagement” means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. In this context, give three examples of assurance engagements highlighting difference in nature of assurance provided by such engagements. [MTP-Aug. 24]

**Ans.: Examples of assurance engagements:**

- (i) **Audit of financial statements:** Audit of F.S. provides reasonable assurance about whether the F.S. as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the F.S. are prepared, in all material respects, in accordance with an applicable FRF.
- (ii) **Review of financial statements:** Review provides lower level of assurance than audit. Further, review involves fewer procedures and gathers sufficient appropriate evidence on the basis of which limited conclusions can be drawn up.
- (iii) **Examination of prospective financial information (PFI):** In assurance reports involving PFI, practitioner obtains sufficient appropriate evidence to the effect that management's assumptions on which the PFI is based are not unreasonable, the PFI is properly prepared on the basis of the assumptions and it is properly presented and all material assumptions are adequately disclosed. Such type of assurance engagement provides a moderate assurance.

**Q.23B**

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

**Ans.: Assurance Engagements:**

- Audit engagement is an assurance engagement. However, assurance engagements are not restricted to auditing alone. There are other assurance engagements too like review engagements, engagements providing assurance involving PFI, engagements providing assurance on internal controls in an entity. Assurance engagements provide assurance to users. The difference is of degree. Whereas an audit provides reasonable assurance which is a high level of assurance, review provides lower level of assurance as compared to audit.
- There are also assurance engagements which relate to matters other than historical financial information like providing assurance on matters involving PFI and providing assurance on internal controls in an entity. In assurance reports involving PFI, the practitioner obtains sufficient appropriate evidence to the effect that management's assumptions on which the PFI is based are not unreasonable, the PFI is properly prepared on the basis of the assumptions, and it is properly presented, and all material assumptions are adequately disclosed.
- In the given case, Kriti is of the view that audit engagement is the only kind of assurance engagement in which practitioner gives a written assurance report in appropriate form whereas Somaya is of the view that assurance engagements are not restricted to audit alone.

**Conclusion:** View of Somaya is correct.

## Chapter 2 – Audit Strategy, Audit Planning and Audit Programme

### 2.2 – Audit Strategy

**Q.13A** Subodh has recently joined an audit firm as an articled clerk. He was in process of assembling audit working papers in audit file of Cop Limited, as per the instructions of his senior. While assembling, he noticed following working paper in audit file:

#### Timing of Audit Activities

Activity	Expected Timing
Audit Planning	July 1, 2024 - July 5, 2024
Review by EQCR	July 6, 2024 - July 7, 2024
Audit Field Work	July 10, 2024 - Aug. 20, 2024
Review by Manager	August 21, 2024
Review by Engagement Partner	Aug. 22, 2024 - Aug. 25, 2024
Review by EQCR	Aug. 26, 2024 - Aug. 27, 2024
Response on Audit Memo	August 28, 2024
Review by Partners – internally post response on audit memo	August 29, 2024
Review by EQCR	August 30, 2024
Finalization of Audit Report and Financial Statements	Sep. 01, 2024 – Sep. 02, 2024
Issuance of Audit Report and Financial Statements	Sep. 03, 2024

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

#### Ans.: Consideration of Reporting Objectives:

The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. One of the factors to be taken into consideration while establishing audit strategy relates to ascertaining of reporting objectives of engagement to plan the timing of the audit and the nature of the communications required. Some of the instances are given under:

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

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

## 2.4 – Audit Programme

**Q.29A** APR & Associates, a Chartered Accountant firm, are appointed as the auditors of Time Ltd. and Bakes Ltd. The volume and nature of business of both the companies are entirely different. CA R is the engagement partner for Bakes Ltd. CA P is the engagement partner for Time Ltd. CA R formulates an Audit Programme for conducting the audit of Bakes Ltd. He suggests CA P to use the same audit programme for Time Ltd. But CA P is of the opinion that this audit programme will not be useful for the audit of Time Ltd.

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

[May 24 (4 Marks)]

**Ans.: Points to be considered in constructing Audit Programme:** Refer Answer of Q. No. 24

**Evolving one audit programme- Not Practicable for All businesses:**

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

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

**Q.29B** Sanjana is of the view that there exist some disadvantages in the use of audit programmes but most of these can be removed by following some concrete steps. Do you agree with her perspective? Comment.

[MTP-July 24]

**Ans.: Disadvantages of Audit Programme:**

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

**Disadvantages of Audit Programme:** Refer Answer of Q. No. 28.

**Elimination of Disadvantages:** Refer Answer of Q. No. 23.

## Chapter 3 – Risk Assessment & Internal Control

### 3.1 – Audit Risk (SA 315)

**Q.20A** CDE Private Limited, a manufacturing company, had made investment in shares of some blue-chip companies. Additionally, it had temporarily deposited some of its extra funds in fixed deposits with a scheduled bank. Dividend from shares amounting to ₹ 1.80 lakhs (net of TDS, TDS = ₹ 0.20 lakhs) and bank interest of ₹ 2.70 lakhs (net of TDS, TDS = ₹ 0.30 lakhs) were credited in bank account of the company. During the year 2023-24, it has also sold some shares resulting in net gain of ₹ 5 lakhs. The company has shown above incomes under head “Other income” for consolidated amount of ₹ 9.50 lakhs in the statement of Profit and Loss. No other information is furnished in the financial statements put up for audit. As the auditor of the company, discuss whether the above situation constitutes “misstatement” in the financial statements of the company. Also state, few examples of misstatements. [MTP- Aug. 24]

**Ans.: Misstatement in the financial statements:**

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

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

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

- (a) Interest Income of ₹ 3 lakhs
- (b) Dividend Income of ₹ 2 lakhs
- (c) Net gain on sale of investments of ₹ 5 lakhs

**Examples of misstatements are:**

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

<b>Q.20B</b>	<p><b>While planning the audit of Me Limited, CA M has planned nature, timing and extent of risk assessment procedures to identify and assess risks of material misstatements. How risk should be assessed by the auditor CA M? It is also well known that assessment of risks is a matter of professional judgment.</b></p> <p><b>Which specific matters are not included in audit risk? Additionally, CA K, one of the team members of CA M, is of the view that Materiality and Audit Risk are only considered at planning stage of an audit. Comment.</b> <span style="float: right;"><b>[MTP-Aug. 24]</b></span></p>
	<p><b>Ans.: Audit Risk and Materiality:</b></p> <ul style="list-style-type: none"> <li>• Assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.</li> <li>• Audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements. For the purpose of the Standards on Auditing, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant.</li> <li>• In the given case, CA K is of the view that materiality and audit risk are only considered at planning stage of an audit. The concept of materiality is applied by the auditor both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements and in forming the opinion in the auditor's report. Thus, the view of CA K is not correct.</li> </ul>

### 3.4 – Internal Control

<b>Q.53A</b>	<p><b>While conducting the audit of Zeena Limited, CA E is trying to obtain understanding of different components of internal controls of the company. Such an understanding is necessary and is required to be documented in accordance with Standards on Auditing. In this context, how he shall obtain understanding of the risk assessment process of the company and how is this understanding important for the auditor?</b> <span style="float: right;"><b>[MTP-July 24]</b></span></p>
	<p><b>Ans.: Obtaining understanding of the Entity Risk Assessment Process:</b></p> <p>CA E, the auditor of Zeena Limited, shall obtain an understanding of whether the entity has a process for: -</p> <ol style="list-style-type: none"> <li>(a) Identifying business risks relevant to financial reporting objectives</li> <li>(b) Estimating the significance of the risks</li> <li>(c) Assessing the likelihood of their occurrence</li> <li>(d) Deciding about actions to address those risks</li> </ol> <p>The entity's risk assessment process forms the basis for the risks to be managed. If that process is appropriate, it would assist the auditor in identifying risks of material misstatement. Risks can arise or change due to factor such as new technology, new business models, products or activities, changes in operating environment etc. Whether the entity's risk assessment process is appropriate to the circumstances is a matter of judgment.</p>

### 3.13 - Internal Financial Controls (IFC)

**Q.86A** Mr. Z, at the time of appointment as an independent director in EF Ltd. a listed company, came to know that the Companies Act, 2013 has placed a greater emphasis on the effective implementation and reporting on internal controls for a listed Company. He wants to know the responsibilities as casted under Companies Act, 2013 with regards to Internal Financial Control for (1) Directors (2) Independent directors and (3) Audit committee as per section 134(5)(e), 149(8) & 177(4) (vii) respectively of the Companies Act, 2013. [May 24 (3 Marks)]

**Ans.: Internal financial controls as per regulatory requirements:**

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

Relevant provision of Companies Act, 2013	Nature of Responsibility
Sec. 134(5)(e)	In case of listed Companies, the Directors' responsibility statement shall state that the Directors had laid down Internal financial controls to be followed by the company and that such Internal financial controls are adequate and were operating effectively.
Sec. 149(8)	The company and independent directors shall abide by the provisions specified in Schedule IV which lays down the Code for independent Directors. As per this code, the role and functions of independent directors include that they shall satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible.
Sec. 177(4)(vii)	Every audit Committee shall act in accordance with the terms of reference specified in writing by the Board which shall, inter alia, include - evaluation of internal financial controls and risk management systems.



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## Chapter 4 – Audit Evidence

### 4.3 – Audit Sampling (SA 530)

**Q.62A** During the audit of a company, CA Z is using a software to select samples pertaining to sales records of the company. While performing this process, a window opens in software prompting the user to enter certain information. CA Z is in the process of entering information in this regard as given under:

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

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

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

[MTP-Aug. 24]

**Ans.: Method of Sampling:**

In the given case, method of sampling being used in software is known as interval sampling or systematic sampling. It is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval.

Sampling interval = Sampling units in population/Sample size (i.e 1000/100)

Sampling interval = 10

Records selected = 100

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

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

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

### 4.4 – Audit Evidence – Specific Considerations for Selected Items (SA 501)

**Q.72A** Quality Products Limited is engaged in manufacturing of bicycles. As part of manufacturing activities, it sends raw material to some business entities and procures finished components from them. As on 31st March 2024 inventories lying with such business entities are material. Being



**statutory auditor of Quality Products Limited, how you will obtain sufficient appropriate audit evidence regarding existence and condition of inventories lying with such business entities?**

**[RTP-Sep. 25]**

**Ans.: Audit Procedures w.r.t. Inventory lying with Third Parties:**

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

- (a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
- (b) Perform inspection or other audit procedures appropriate in the circumstances.

Other audit procedure may include:

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

#### **4.5 - External Confirmations (SA 505)**

**Q.80A CA X is contemplating the use of negative confirmation requests as the sole substantive audit procedure to verify certain accounts payable balances reflected in financial statements of a company. Which conditions need to be met to use negative confirmation requests as stated above? Additionally, CA X is of the view that negative confirmations provide same level of persuasive audit evidence as in case of positive confirmations. Do you agree with his viewpoint? Provide reasons for your answer.**

**[MTP-July 24]**

**Ans.: Use of Negative Confirmation Requests:**

In accordance with SA 505, "External Confirmations", the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

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

The failure to receive a response to a negative confirmation request does not explicitly indicate receipt by the intended confirming party of the confirmation request or verification of the accuracy of the information contained in the request.

Accordingly, a failure of a confirming party to respond to a negative confirmation request provides significantly less persuasive audit evidence than does a response to a positive confirmation request.

Therefore, view of CA X is not correct.

#### 4.8 – Analytical Procedures (SA 520)

**Q.112A** CA M, auditor of a company, has planned to use substantive analytical procedures during course of audit. In this regard, he has decided to use such procedures in following areas:

- (i) For testing relationship between sales and cost of sales
- (ii) For testing rights over certain assets forming part of account balances

Comment upon his approach along with reasons.

[MTP- Aug. 24]

**Ans.: Use of Substantive Analytical Procedures:**

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

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

- (ii) Using substantive analytical procedures is also affected by nature of assertion. Substantive analytical procedures may be more effective in providing evidence for some assertions (e.g., completeness or valuation) than for others (e.g., rights and obligations).

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



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## Chapter 5 – Audit of Items of Financial Statements

### 5.4 – Audit of Borrowings

**Q.15A** The financial statements of XYZ Limited show long-term borrowings from the banks, financial institutions, leasing, and hire purchase companies. Additionally, the company has issued debentures to its 1000 members to raise funds in accordance with the provisions of the Companies Act, 2013. The money raised by issuing debentures is also reflected in long-term borrowings. As the statutory auditor of XYZ Limited, CA X wants to verify that all borrowings on the balance sheet represent valid claims by banks or other third parties. Suggest a few audit procedures in this regard. [RTP-Sep. 24]

**Ans.: Audit Procedure while auditing Borrowings:**

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

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

### 5.5 - Audit of Trade Receivables

**Q.22A** CA J is appointed as statutory auditor of Sigma and Beta Limited for the year 2024-25. During the audit he observed trade receivables amounting to ₹ 50 crores are reflected in the financial statements of the company. He wants to obtain sufficient appropriate evidence to conclude that trade receivables have been valued appropriately. Suggest few audit procedures in this regard. [MTP-Aug. 24]

**Ans.: Audit procedure for Valuation of Trade receivable:**

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

- Review the process followed by the Company to derive an allowance for doubtful accounts. This will include a consistency comparison with the method used in the last year, and a determination of whether the method is appropriate for the underlying business environment.

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

## 5.6 - Audit of Cash and Cash Equivalents

**Q.24A** While verifying cash and cash equivalents of a company, CA D engagement partner, is very particular that Bank reconciliation statement (BRS) prepared by the management in respect of bank account maintained by the company is proper to rule out misstatements in cash and cash equivalents reflected in the financial statements of the company. The company does not use net banking and prefers to issue cheques to its creditors and receives substantial payments locally through account payee cheques. Which aspects need to be taken care of and verified by CA D in respect of BRS? [MTP-July 24]

**Ans.: Verification of BRS:**

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

**Verification of BRS shall entail the following:**

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

- Checking of all material reconciling items included under amounts or charges debited/ credited by bank but not accounted for by requesting for bank statements for the period under audit and tallying the same. If the amounts are found to be material, the auditor should ensure that the management records the adjustments for the same in its books of account.

### 5.7 - Audit of Inventories

**Q.30A** ABC & Co. are in the business of manufacturing toys. The stock taking process has been done by the company as on 31.3.2024. The company has used FIFO method for valuation of its inventories. The cost of inventory as on 31.3.24 is ₹ 25,25,000 and the net realizable value of the inventory on the same date is ₹ 25,24,000.

The cost of inventory includes the following:

(1) Material purchase cost - ₹ 25,05,000.

(2) Allocated transport cost - ₹ 18,000.

(3) Abnormal wastage - ₹ 2,000.

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

[May 24 (4 Marks)]

**Ans.: Value of Inventory:**

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

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

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

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

**Q.30B** Zed Limited is engaged in the manufacturing and export of shoes. The statutory auditor of the company wants to reasonably ensure that only the inventories recorded in the financial statements are exclusively owned by the company and do not include any inventories that belong to third parties but includes inventories owned by the company but lying with third party. Advise the auditor on the audit procedures to be performed to achieve this assurance. [MTP-July 24]

**Ans.: Audit Procedure to establish Completeness of Inventory:**

Audit procedures to be followed by the statutory auditor of Zed Limited to ensure that only the inventories held by entity have been recorded in the financial statements and do not include any inventories that belong to third parties but does include inventories owned by the entity and lying with a third party are as under:

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

**5.10 – Audit of Trade Payables and Other Current Liabilities**

**Q.41A M/s Veer and Associates is appointed as auditor of KMP limited. During the audit, auditor wants to verify that trade payables and liability balances that were supposed to be recorded have been recognized in the financial statements. Which assertion auditor wants to ensure and what audit procedures should be followed by him in this regard? [MTP-Aug. 24]**

**Ans.: Audit Procedure to establish Completeness of Trade Payables:**

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

- The auditor needs to perform the following cut off procedures:
  - For the last 5 invoices received/ recorded at the end of the reporting date (cut off date) and which have been included in the trade payables; the goods should have been received/ risk and rewards of ownership in goods should have been transferred in favour of the entity;
  - All goods received prior to the period/ year- end should have been booked in the form of purchases and included in trade creditors.

- Test purchases/ expenses on a sample basis selecting the same from the accounts payable ledgers and checking their supporting documents to ensure that the purchases were recorded at the correct amounts and correct dates.
  - Match purchase invoice dates to the gate entry (inward) dates to check whether the purchases are being recorded in the correct accounting period. This can include an examination of purchase/ expense invoices received subsequent to the period being audited, to see if they should have been included in the period under audit.
  - Review subsequent expense vouchers. Review all material expense vouchers recorded post the balance sheet date to see if they relate to transactions from within the audit period.
  - For advance received from customers/ revenue received in advance, obtain the customer wise listing along with its ageing and the nature. Enquire from the entity's management if there has been any dispute with the customer and if there is any additional liability to be recorded. For all such advances, the auditor should verify the underlying documentation based on which the entity had received the advance.
  - In relation to statutory dues liability like withholding tax (TDS) payable, GST payable, luxury tax payable, professional tax payable, PF and ESI payable etc., prepare a reasonability with respect to sales/ purchases/ employee benefit expenses. Example- GST liability for last month may be calculated by applying the applicable rate to the sales made and in case of any variance with the GST liability recorded by the entity, reasons for variance should be requested from client and in case found satisfactory, the same should be maintained as part of audit documentation.  
Similarly, Provident Fund liability for last month may be calculated by applying the applicable rate to the employee benefit expense and in case of any variance with the liability recorded by the entity, reasons for variance should be requested from client and in case found satisfactory, the same should be maintained as part of audit documentation.
- Further, the auditor should obtain and verify the challans for deposits made subsequent to the period-end for all statutory liabilities as at the balance sheet date and also analyse the reasons, if any, in consultation with the management for any variance between the amounts deposited subsequently vis-à-vis the liability recorded in books of account.
- He shall prepare a complete list of all statutory dues and consider his reporting requirements under CARO,2020.



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## Chapter 6 – Audit Documentation

### 6.1 - Audit Documentation

**Q.18A** CA N, statutory auditor of Rock Limited, is in the process of final assembly of audit file. Under what circumstances, a statutory auditor can make changes to audit documentation during final assembly process of audit file? Give a few examples of such changes. [MTP-Aug. 24]

**Ans.: Changes to Audit Documentation:**

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

Examples of such changes include: -

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



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## Chapter 7 – Completion and Review

### 7.1 - Subsequent Events (SA 560)

**Q.8A** As per SA 560, when after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that had it been known to the auditor at the date of the auditor's report, it may have caused the auditor to amend the auditor's report. In this context, what is meant by "Date the financial statements are issued"? Can it be later than the date of providing auditor's report to the entity? [MTP-Aug. 24]

**Ans.: Date the financial statements are issued:**

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

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

Therefore, "date the financial statements are issued" can be later than date of providing auditor's report to the entity.

### 7.2 - Going Concern (SA 570)

**Q.18A** Stay fit Private Limited is a start-up that has been in business for about two years It runs an application which provides valuable information pertaining to nutrition and helps its clients to access customized healthy food. The company's revenues are expected to grow in the coming period. Although company has reflected net losses in its financial statements for the last two years, it has managed to meet its financial commitments. The financial statements for last two years were prepared on going concern basis of accounting. The management of company wants to follow the same basis of accounting for the current year. Is the view of management appropriate? How does the "going concern" affect the preparation of financial statements? [MTP-July 24]

**Ans.: Use of Going Concern Basis of Accounting:**

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

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

In the given situation, company has reflected net losses in financial statements of last two years but is able to meet its financial commitments signifying its ability to carry on business/trade. The revenue of company is also expected to grow in the coming period. It shows that management has neither the intention nor the necessity of liquidation or of curtailing materially the scale of operations. Therefore, view of the management for following going concern basis of accounting in current year is appropriate.

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

**Q.18B** While conducting audit of BYN Limited, CA Y notices that company has lost one of its key markets along with important customers. Additionally, several highly successful competitors have emerged, impacting business of the company. Despite the existence of material uncertainty, CA Y finds the use of going concern basis of accounting appropriate for preparation of financial statements. The company has also disclosed material uncertainty in notes to accounts adequately. How should he deal with the matter in auditor's report? [RTP-Sep. 24]

**Ans.: Dealing of Material Uncertainty in Audit report:**

As per SA 570, "Going concern", If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:

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

#### 7.4 - Written Representations (SA 580)

**Q.28A** CA Manoj is the statutory auditor of a company. He has completed the audit and issued the audit report dated June 30, 2024. Before signing the audit report, written representations dated June 29, 2024, were obtained from the management of the company. Discuss the significance of the date of written representations. Also state whether the written representations obtained on June 29, 2024 is appropriate or not. [RTP-Sep. 24]

**Ans.: Significance of date of WR:**

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

Since written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated before the date of the written representations. Furthermore, because the auditor must consider events occurring up to the date of the auditor's

report that might require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

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

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

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## Chapter 8 – Audit Report

### 8.3 – Emphasis of Matter Paragraphs & Other Matter Paragraphs in Independent Auditor’s Report (SA 706)

**Q.40A** Pure Services Limited is into the litigation relating to some legal action initiated by the industry regulator. The matter has reached jurisdictional High Court. Keeping in view uncertainty related to future outcome of matter, statutory auditor of the company has decided to include Emphasis of Matter (EOM) Paragraph in auditor’s report.

- (i) Briefly discuss the considerations to be taken care of by the statutory auditor when EOM paragraph is included in auditor’s report.
- (ii) State any two examples of circumstances where the auditor may consider it necessary to include an EOM paragraph. [MTP-Aug. 24]

**Ans.: Emphasis of Matter Paragraph:**

- (i) When the auditor includes an Emphasis of Matter (EOM) paragraph in the auditor’s report, the auditor shall:
  - (a) include the paragraph within a separate section of the auditor’s report with an appropriate heading that includes the term “Emphasis of Matter”
  - (b) include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements and
  - (c) indicate that the auditor’s opinion is not modified in respect of the matter emphasized.
- (ii) **Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter (EOM) paragraph:** Refer Answer of Q. No. 38.

### 8.9 - Reporting Requirements under CARO, 2020

**Q.88** Discuss the reporting requirements as per CARO, 2020, regarding:

- (i) Statutory Dues and
- (ii) Transactions with Related Parties [RTP-Sep. 24]

**Ans.: Reporting under CARO,2020 regarding statutory Dues [Para 3(vii)]:** Refer Answer of Q. No. 82.

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

Refer Answer of Q. No. 86.

## Chapter 9 – Special Features of Audit of Different Type of Entities

### 9.5 - Audit of LLP

**Q.28A** While auditing the financial statements of Bro Traders LLP, CA L is carefully going through LLP agreement. Briefly discuss the key points CA L should pay attention in the LLP agreement and the reporting responsibilities of CA L concerning the financial statements of Bro Traders LLP?

[MTP-Aug. 24]

**Ans.: Key Points to be considered by Auditor in LLP Agreement:**

The auditor, CA L should read the LLP agreement & note the following provisions:

- (a) Nature of the business of the LLP.
- (b) Amount of capital contributed by each partner.
- (c) Interest – in respect of additional capital contributed.
- (d) Duration of partnership.
- (e) Drawings allowed to the partners.
- (f) Salaries, commission etc. payable to partners.
- (g) Borrowing powers of the LLP.
- (h) Rights & duties of partners.
- (i) Method of settlement of accounts between partners at the time of admission, retirement, admission etc.
- (j) Any loans advanced by the partners.
- (k) Profit sharing ratio

**Reporting Responsibilities of CA L/ concerning the financial statements of Bro Traders LLP:**

The auditor should mention:

- (a) Whether the records of the firm appear to be correct & reliable.
- (b) Whether he was able to obtain all information & explanation necessary for his work.
- (c) Whether any restriction was imposed upon him.



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## Chapter 10 – Audit of Banks

### 10.2 - Auditing Framework

**Q.13A** During the course of statutory branch audit of a nationalized bank, CA Amrish is performing audit procedures in relation to the advances. He has verified the selected sample of borrower accounts representing advances and found nothing unusual. In a banking environment, there exist documentary evidence containing observations/comments on advances which can be useful to the statutory branch auditor in performing an effective audit. List out few such documentary evidence which can be made use of by CA Amrish. [MTP-Aug. 24]

**Ans.: Reliance/Review of other Reports:**

In a banking environment, there exist documentary evidence containing observations/comments on advances which can be useful to the statutory branch auditor in performing an effective audit. CA Amrish, the auditor should take into account the adverse comments, if any, on advances appearing in the following:

- Previous year's audit reports.
- Latest internal inspection reports of bank officials.
- Reserve Bank's latest inspection report.
- Concurrent / Internal audit report.
- Report on verification of security.
- Any other internal reports specially related to particular accounts.
- Manager's charge-handing-over report when incumbent is changed.

### 10.3 - Types and Classification of Advances

**Q.29A** National Bank has advanced cash credit facility of ₹ 25 Lakh to Sun Industries. Following is the extract of account of Sun Industries reflecting in CBS of Bank from December 1, 2023 to March 31, 2024: -

Date	Particulars	Dr.	Cr.	Balance (Dr.)
01/12/2023	To Transfer	45,000		24,75,000
31/12/2023	By Clearing		1,00,000	23,75,000
31/12/2023	To Interest	25,000		24,00,000
31/01/2024	To Interest	24,700		24,24,700
29/02/2024	To Interest	24,800		24,49,700
31/03/2024	To Inspection charges	1,000		24,50,500
31/03/2024	To Interest	24,900		24,75,400

Drawing power during the above period was consistent at ₹ 25 Lakh. The account was classified as "Standard asset" as on 31.12.2023 in books of Bank. The security charged with the bank remains intact throughout this period.



**Comment on “Asset Classification” of above account as on 31st March 2024 in books of Bank in accordance with RBI Norms. [MTP-July 24]**

**Ans.: Classification of Advances:**

In accordance with RBI norms on asset classification, a non-performing asset is a loan or advance where the account remains “out of order” in respect of an Overdraft/Cash Credit.

An account should be treated as ‘out of order’ if:

- the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
- In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet; or
- credits are there but are not enough to cover the interest debited during the same period.

In the given case, although outstanding balance in account is less than sanctioned limit/drawing power of ₹ 25 lacs, there are no credits continuously for 90 days as on the date of Balance sheet. Therefore, it has become out of order and is required to be classified as NPA.

Under non-performing assets, it would be classified as “Sub-Standard Asset” as it has remained NPA for a period of less than or equal to 12 months.

#### 10.4 - Computation of Drawing Power (DP)

**Q.35A Compute the Drawing Power for Cash Credit A/c of Kirpa Limited for the month of March 2024 with following information:**

	(Amount in ₹)
Stock	60,000
Debtors	55,000
<b>(Including Debtor of ₹ 15,000 for an invoice dated 20.10.2023)</b>	
Sundry creditors	10,000
Sanctioned Limit	48,000

Margin on stock is 30% and on debtors is 40%.

**Note: Debtors older than 3 months are ineligible for calculation of DP. [RTP-Sep. 24]**

**Ans.: Computation of Drawing Power (DP) for CC A/c of Kirpa Ltd.**

Particulars of current assets		Amount (₹)	DP Amt (₹)
(A) Stocks:			
Stocks at realizable value		60,000	
Less: Unpaid stocks: Sundry creditors	10,000	10,000	
Paid for stocks		50,000	
Margin @ 30%		15,000	35,000

(B) Debtors:			
Total Debtors		55,000	
Less: Ineligible debtors		15,000	
Eligible debtors		40,000	
Margin @ 40%		16,000	16,000
<b>Total Drawing Power</b>			<b>51,000</b>

The sanctioned limit given in the question is ₹ 48,000 whereas drawing power as per the above working is ₹ 51,000. So, drawing power would be restricted to sanctioned limit i.e., ₹ 48,000.

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## Chapter 11 – Ethics and Terms of Audit Engagements

### 11.3 – Professional Skepticism

**Q.17A** Truthful Products Private Limited is engaged in trading stationery items. During the year 2023-24, there was a huge fire in one storage location of the company resulting in loss of inventories of ₹ 5 crores. As a result, the operations of the company were badly affected for about two months. Unfortunately, the insurance claim of the company was rejected due to certain defects in the policy issued and loss was booked by company in the year 2023-24 itself. There was no change in nature of business of company in relation to the last year. The draft financial statements of the company reflect following information:

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

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

**Ans.: Professional Skepticism:**

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

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

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

### 11.4 - Agreeing the Terms of Audit Engagement (SA 210)

**Q.27A** CA H has been offered audit of financial statements of a society engaged in promoting social causes, such as setting up of drug de-addiction centres for misguided youth and rehabilitating such young people by helping them find avenues of gainful employment. However, CA H failed to send audit

**engagement letter to the society's governing body and proceeded to conduct the audit. In the absence of this letter, the governing body is of the view that purpose of such an audit is to provide absolute assurance against probable errors and frauds in the financial statements. Does it constitute violation of fundamental principles governing professional ethics? State reasons for the same.** [MTP-July 24]

**Ans.: Violation of fundamental principles governing professional ethics:**

As per SA 210, "Agreeing the Terms of Audit Engagements", the auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement. Such a letter includes, inter alia, objective and scope of audit of financial statements. The absence of such a letter leads to misunderstanding between auditor and management. As auditor has failed to send engagement letter, the governing body has formed an improper view of objective and scope of audit of financial statements.

By not following requirements of SA 210, CA H is not acting ethically. He has violated principle of professional competence and due care governing professional ethics. This principle requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation and act diligently and in accordance with applicable technical and professional standards. Maintaining professional competence requires awareness of current technical and professional standards. Non sending of engagement letter shows lack of such awareness on part of CA H. Therefore, he has violated said fundamental principle governing professional ethics.

**11.5 – SQC 1 “Quality Control for Firms that perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements”**

**Q.33A SQC 1 requires assumption of leadership responsibilities for quality within firm. Are such leadership responsibilities required for audit engagements only? Who assumes such leadership responsibilities within firm? How it is important for audit quality?** [MTP-July 24]

**Ans.: Leadership responsibilities for quality within firm:**

SQC 1 requires firms to establish policies and procedures designed to promote an internal culture based on the recognition that quality is essential in performing engagements. Therefore, such leadership responsibilities are required for all engagements and not for audit engagements only.

Such policies and procedures should require the firm's chief executive officer or the firm's managing partners to assume ultimate responsibility for the firm's system of quality control. The example set by firm's leadership encourages an inner culture that recognizes high quality audit work. Further, persons assigned operational responsibilities for the firm's quality control system by the firm's chief executive officer or managing partners should have sufficient and appropriate experience, ability and the necessary authority to assume that responsibility.

**Q.33B CA N, statutory auditor of QST Limited, appointed for a term of 5 years has completed audit for the first financial year ending on 31st March 2024. In compliance with requirements of professional standards, an audit file has been assembled. After about a period of six months from date of issue**

of audit report, he gets a call from CFO of the company to share complete audit file so that financial reporting of company can be improved upon in coming periods. Is it mandatory for statutory auditors to share audit files with client? What are the requirements for making audit documentation available to clients? [MTP-Aug. 24]

**Ans.: Audit Documentation Requirements:**

Standard on Quality Control 1 (SQC 1), "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. Therefore, it is not mandatory for CA N to share audit file with client.

He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

**Q.33C** ABC & Associates, an audit firm, has been approached by a prospective company client that has been in business for about 10 years to conduct an audit of its financial statements. Before accepting the audit engagement, the firm wants to access the integrity of prospective client. With regard to the assessment of integrity, which matters should be considered by the audit firm? [RTP-Sep. 24]

**Ans.: Considerations w.r.t Integrity of Clients:**

With regard to the integrity of a client, matters that ABC & Associates should consider include, for example:

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



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# PART II - MULTIPLE CHOICE QUESTIONS

## Chapter 1 – Nature, Objective and Scope of Audit

20	<p><b>Jasmine was of the view that audited financial statements are not a guarantee against probable wrong doings in the financial matters of companies. What kind of assurance does audit of financial statements provide?</b></p> <p>(a) It provides reasonable assurance meaning a low level of assurance. (b) It provides reasonable assurance meaning a high level of assurance. (c) It provides reasonable assurance meaning an absolute level of assurance. (d) It provides reasonable assurance meaning a moderate level of assurance.</p> <p style="text-align: right;"><b>[MTP-July 24]</b></p>
21	<p><b>A practicing Chartered Accountant is appointed by a company to perform certain agreed-upon procedures relating to its trade payables. Such agreed upon procedures include verifying listing with books of accounts, sending confirmation letters and reporting factual discrepancies to company management. Which of statements is correct in this context?</b></p> <p>(a) Practicing CA shall perform work in accordance with Standards on Related Services and SA 220. (b) Practicing CA shall perform work in accordance with Standards on Related Services and SQC 1. (c) Practicing CA shall perform work in accordance with Standards on Auditing including SA 220. (d) Practicing CA shall perform work in accordance with Standards on Assurance Engagements &amp; SQC 1.</p> <p style="text-align: right;"><b>[MTP-Aug. 24]</b></p>
23	<p><b>M/s DEF &amp; Associates have been appointed as the statutory auditor of JKL Ltd. for the first time for the financial year 2024-25. The engagement partner, CA D, is briefing his engagement team about the need of Engagement Standards and quality control standards in the areas of financial statement audits and in other types of assurance services. Out of the following which one point is not correct about why standards are needed?</b></p> <p>(a) Standards equip professional accountants with professional knowledge &amp; Skill. (b) Standards ensure audit quality. (c) Standards promote uniformity as audit of financial statements is carried out following these Standards. (d) Standards ensure carrying out of audit against established benchmarks at par with local practices.</p> <p style="text-align: right;"><b>[Sep. 22 Exam (2 Marks)]</b></p>

### Answer Key to MCQs

Q. No.	Answer
20	(b) It provides reasonable assurance meaning a high level of assurance.
21	(b) Practicing CA shall perform work in accordance with Standards on Related Services and SQC 1.
22	(d) Standards ensure carrying out of audit against established benchmarks at par with local practices.

## Chapter 2 – Audit Strategy, Audit Planning and Audit Programme

22	<p><b>CA Prince, after developing the audit strategy for Vedika Limited, develops an audit plan but finds a need to revise the materiality levels set earlier and therefore, a deviation from the already set audit strategy is felt necessary. In this case, he should</b></p> <p>(a) Drop the audit and withdraw from the engagement.                  (b) Devise a new audit plan and then, change the strategy as per the Revised Plan.                  (c) First Modify the audit strategy and thereafter, prepare the audit plan according to the modified strategy.                  (d) Continue with the Audit Plan without considering the Audit Strategy. <span style="float: right;">[MTP-July 24]</span></p>
23	<p><b>CA Y has started planning for audit of a listed company. In this respect, he is considering all the matters relating to acceptance of client, assessment of compliance with ethical requirements including independence, consideration regarding the use of analytical procedures to be performed as risk assessment procedures and to have common understanding regarding terms of engagement with management. Which of the following does not fall under the preliminary engagement activities of planning process?</b></p> <p>(a) Considering all matters relating to acceptance of client.                  (b) Assessing ethical requirements including independence.                  (c) Using analytical procedures to be performed as risk assessment procedures.                  (d) Establishing common understanding regarding terms of engagement. <span style="float: right;">[MTP-Aug. 24]</span></p>
24	<p><b>RDB &amp; Co. have been appointed as statutory auditors of INA Group of hotels. This is the first time the firm is auditing an industry in food &amp; beverage. The engagement partner, CA R, and other key members of the engagement team have undertaken the activity of development of an audit plan of INA Hotels after thorough understanding the Hotel's business and its environment. As per SA 300, description of which of the following matters is not a part of developing an audit plan?</b></p> <p>(a) The nature, timing and extent of planned risk assessment procedure.                  (b) The nature, timing and extent of planned further audit procedures at assertion level.                  (c) The nature, timing and extent of resources necessary to perform the engagement.                  (d) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs. <span style="float: right;">[Sep. 24 (2 Marks)]</span></p>

### Answer Key to MCQs

Q. No.	Answer	
22	(c)	First Modify the audit strategy and thereafter, prepare the audit plan according to the modified strategy.
23	(c)	Using analytical procedures to be performed as risk assessment procedures.
24	(c)	The nature, timing and extent of resources necessary to perform the engagement.



## Chapter 5 – Audit of Items of Financial Statements

<b>47</b>	<b>CA Raman instructed his article Raju to verify whether employee benefit expense of Prep Limited has been fairly allocated between the operating expense incurred in production activities and general expense. Which of the following assertions is being addressed by this instruction?</b>
	(a) Completeness (b) Presentation and Disclosure (c) Measurement (d) Occurrence
	<b>[MTP-July 24]</b>

### Answer Key to MCQs

Q. No.	Answer
47	(b) Presentation and Disclosure

## Chapter 8 – Audit Reports

<b>40</b>	<b>The Board of Directors of a company wanted the auditor to certify Export sales during the year for submitting to the authorities. The auditor also signed the Confirmation letters to be sent to various debtors and creditors for confirming their balances as on 31.03.2024.</b> <b>UDIN is required to be generated by the auditor for:</b>
	(a) Export sales during the year certificate only. (b) Confirmation letters only. (c) Both Export sales during the year certificate and Confirmation letters. (D) No UDIN is required to be generated. (d) No UDIN is required to be generated.
	<b>[Sep. 24 (2 Marks)]</b>

### Answer Key to MCQs

Q. No.	Answer
40	(a) Export sales during the year certificate only

## Chapter 9 – Special Features of Audit of Different Type of Entities

20	<p><b>The audit of government expenditure is one of the major components of government audit. In this regard, what is meant by “Audit against rules and orders”?</b></p> <p>(a) That the expenditure is incurred with due regard to broad and general principles of financial propriety.</p> <p>(b) That there is sanction, either special or general, accorded by competent authority authorising the expenditure.</p> <p>(c) That there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority.</p> <p>(d) That the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the financial rules and regulations framed by the competent authority. <b>[MTP-Aug. 24]</b></p>
21	<p><b>Sagar Finance Corporation Limited is a government company. The audit of the company is conducted by statutory auditors appointed by Comptroller and Auditor General of India (C&amp;AG). Who is empowered to conduct “supplementary audit” of Sagar Finance Corporation Ltd.?</b></p> <p>(a) Central Government</p> <p>(b) C&amp;AG</p> <p>(c) Another independent auditor appointed by C&amp;AG</p> <p>(d) Another independent auditor appointed by Ministry of Corporate Affairs <b>[RTP-Sep. 24]</b></p>

### Answer Key to MCQs

Q. No.	Answer	
20	(d)	That the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the financial rules and regulations framed by the competent authority.
21	(b)	C&AG

## Chapter 10 – Audit of Banks

27	<p><b>CA Sargun is conducting statutory audit of branch of KBC Bank. During the course of audit, it is noticed that one borrower has availed a housing loan and a car loan from the branch. Housing loan EMIs are overdue for 120 days as on date of Balance sheet. Car loan EMIs are overdue for 60 days as on date of Balance sheet. Which of the following statements is appropriate?</b></p> <p>(a) Housing Loan should be classified as “Non-Performing Asset” in accordance with RBI norms on asset classification. However, Car loan should be classified as Standard asset.</p> <p>(b) Car Loan should be classified as “Non-Performing Asset” in accordance with RBI norms on asset classification. However, Housing Loan should be classified as Standard asset.</p> <p>(c) Both Housing loan as well as car loan should be classified as “Non-Performing Assets” in accordance with RBI norms on asset classification.</p> <p>(d) Both Housing as well as car loans should be classified as Standard assets. <b>[RTP-Sep. 24]</b></p>
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### Answer Key to MCQs

Q. No.	Answer	
27	(c)	Both Housing loan as well as car loan should be classified as “Non-Performing Assets” in accordance with RBI norms on asset classification.

## Chapter 11 - Ethics and Terms of Audit Engagements

<b>34</b>	<b>CA Chatur provides accounting and book keeping services to Shiv Ganga Limited. He is also offered an audit of the accounts to the Shiv Ganga Limited. Which threat to independence may be involved in accepting such an engagement.</b>
	(a) Self-interest threats (b) Self-review threats (c) Familiarity threats (d) Advocacy threats
	<b>[RTP-Sep. 24]</b>

### Answer Key to MCQs

Q. No.	Answer
34	(b) Self-review threats

PANKAJ GARG

# PART III - INTEGRATED CASE SCENARIO

## Chapter 5 – Audit of Items of Financial Statements

### Case Study – 78

Pluto Limited is engaged in the manufacturing and distribution of furniture. After Covid, as the number of people working from home has gone up, this customisable range home office furniture has gained lot of importance. They were able to perform very well over the years and the same has been reflected in their financial statements.

During the year 2023-24, M/s Saha and Associates was reappointed as the auditor. The new engagement team has CA Saha (partner) and five article assistants. Given the large volume of transactions, the partner instructed the article assistants to review the financial statements and auditor's report from the previous year, 2022-23, to gain a thorough understanding.

While reviewing the summary page, one of the article Kabir noticed that few points were under discussion with the partner before finalising the audit:

The team verified the following points with respect to employee benefit expenses:

- The employee benefit expenses recorded in the books were actually incurred during the relevant period.
- The expenses in respect of all personnel have been accounted for.
- The expenses recognised during the period are pertaining to the current accounting period.

It was also noted that dividend to equity shareholders for the year 2022-23, was declared on 15.04.2023 and was recognised as liability in the year 2022-23.

Another article Krish noticed that debtors constitute a major component of the company's financial statements. As part of audit procedure, the auditor requested the client to obtain external confirmations from the parties. For this, a list of all the debtors were obtained and a random sampling was performed by the auditor. The client directly obtained the selected debtor confirmations from the customers on time.

Krish also observed addition in the assets amounting ₹ 50 lakhs during the year supported by sufficient audit evidence. However, upon scrutiny, it was found that some of the invoices were not in the name of the company. Further, Cash and cash equivalents were classified as balances with banks, cheques and drafts on hand, cash on hand and earmarked balances with banks (e.g. unpaid dividend)

Based on above, answer the following questions:

[RTP-Sep. 24]

Q.1	<p>Which among the following assertions are discussed with respect to the employee benefit expenses?</p> <p>(i) Measurement (ii) Occurrence (iii) Cutoff (iv) Completeness</p> <p>Choose the correct combination from below:</p> <p>(a) (i), (ii) and (iv) (b) (ii), (iii) and (iv) (c) (i), (iii) and (iv) (d) (i), (ii) and (iii)</p>
Q.2	<p>Whether disclosure of dividend under the liability head during the year 2022-23 is appropriate?</p> <p>(a) Yes. It should be recognised in the same year irrespective of the year of declaration as the amount of dividend belongs to year 2022-23.</p>

	<p>(b) No. The amount should be recognised equally between two financial year</p> <p>(c) No. The amount should not be recognised as a liability. It should be disclosed in the notes to accounts.</p> <p>(d) No. The amount should neither be recognised as liability nor disclosure is required in the financial statements.</p>
<b>Q.3</b>	<p><b>Krish pointed out that that the method followed to obtain debtor confirmation in the previous year was not in accordance with SA 505. Therefore, M/s Saha &amp; Associated should reperform the same in the correct manner.</b></p> <p>(a) As per SA 505, confirmation should be directly obtained by the auditor. Further, for all significant account balances as on the Balance sheet date confirmations should necessarily be collected and for the smaller outstanding balances, random sampling could be performed.</p> <p>(b) It is ok to obtain confirmation through clients as they are in constant contact with their customer. Also, many customers may not respond to auditor's external confirmation request mail. Random selection can be done for all debtors irrespective of the amount in accordance with SA 505.</p> <p>(c) As per SA 505, confirmation should be directly obtained by the auditor. Whereas random selection can be done for all debtors irrespective of the amount.</p> <p>(d) Either auditor or client can obtain confirmation based on time availability. However, it is necessary to obtain confirmation for all significant account balances as on the Balance sheet date and for the remaining random sampling could be performed in accordance with SA 505.</p>
<b>Q.4</b>	<p><b>Which assertion has been affected in the case of fixed assets?</b></p> <p>(a) Existence</p> <p>(b) Rights and obligation</p> <p>(c) Completeness</p> <p>(d) Measurement</p>
<b>Q.5</b>	<p><b>Cash and cash equivalents were not properly classified by the client. Which of the following is incorrect disclosure of the same?</b></p> <p>(a) Balances with banks</p> <p>(b) Cheques and drafts on hand</p> <p>(c) Cash on hand</p> <p>(d) Earmarked balances with banks (e.g.: unpaid dividend)</p>

Answer - Case Study 78		
Q. No.	Answer	
1	(b)	(ii), (iii) and (iv)
2	(c)	No. The amount should not be recognised as a liability. It should be disclosed in the notes to accounts.
3	(a)	As per SA 505, confirmation should be directly obtained by the auditor. Further, for all significant account balances as on the Balance sheet date confirmations should necessarily be collected and for the smaller outstanding balances, random sampling could be performed.
4	(b)	Rights and obligation
5	(d)	Earmarked balances with banks (e.g.: unpaid dividend)

## Chapter 7 – Completion and Review

### Case Study – 79

Mega Power Ltd. is a manufacturer of solar lanterns, which are used in remote villages where there is no reliable supply of electricity. However, due to power projects undertaken by the government, the demand for their solar lanterns has significantly declined over the past few years.

The company was in need of ₹ 2 crores for working capital and other expenses but was not able to fund this amount. Consequently, their suppliers were paid much later than usual and hence some of them withdrew the credit terms, meaning the company had to pay cash on delivery. This created a severe cash crunch and the auditor feels that other than the cash crunch, there are several other financial indicators that cast a significant doubt on the company's ability to continue as a going concern.

The management of the company, however, assures the auditor that this is temporary and the situation will change soon as they are planning to diversify their business. They are ready to provide written representation for the same. The auditor feels that a material uncertainty still exists. The auditor wants the management to make adequate disclosure about this in the financial statements. The auditor wants to include a separate section about this in his audit report. He is also contemplating about the kind of audit report that should be issued.

The auditor has concerns about ethical values and diligence of management. He is concerned about the reliability of the representations made by the management and the audit evidence in general. The auditor is of the opinion that the written representations from management are not reliable.

Based on the above facts, answer the following questions:

[Sep. 24 (6 Marks)]

Q.1	<p>Which kind of audit report will the auditor issue, if the use of going concern basis of accounting is appropriate, but a material uncertainty exists and adequate disclosure of the material uncertainty is made in the financial statements by the management?</p> <p>(a) Adverse opinion (b) Disclaimer of opinion (c) Unmodified opinion (d) Qualified opinion</p>
Q.2	<p>If the auditor is of the opinion that the written representations are not reliable, what kind of audit opinion should be issued by him?</p> <p>(a) Disclaimer of opinion (b) Adverse opinion (c) Unmodified opinion and mention the facts in Other Matters Paragraph (d) Unmodified opinion and mention the facts in Emphasis of Matter Paragraph</p>
Q.3	<p>Financial events or conditions that may cast significant doubt on the entity's ability to continue as a going concern does not include.</p> <p>(a) Inability to comply with the terms of loan agreements. (b) Inability to pay creditors on due dates. (c) Shortage of important supplies. (d) Substantial operating losses.</p>

### Answer - Case Study 79

Q. No.	Answer	
1	(c)	Unmodified Opinion
2	(a)	Disclaimer of Opinion
3	(c)	Shortage of Important Supplies

## Chapter 10 - Audit of Banks

### Case Scenario - 80

M/s Vishwacharya and Associates, a CA firm based in Orissa, is appointed as an auditor of CBF Bank for the financial year 2023-24. During the course of audit, it came to notice that CBF Bank has sanctioned an overdraft facility of ₹ 75 lakh to Times Ltd. However, as per the stock statement furnished for the last quarter, the drawing power was calculated to be ₹ 50 lakh. It was observed that few advances were guaranteed by the:

- (i) Central Government as part of 'Make in India' initiative. However, the guarantee was not invoked, and the advances were overdue by 75 days. These advances were classified as standard assets and were regarded as NPA for income recognition purpose.
- (ii) State Government as part of power generation initiative. However, the guarantee was not invoked, and the advances were overdue by 80 days. These advances were also classified as standard assets and were regarded as NPA for income recognition purpose.

Additionally, XYZ Ltd., is a borrower availing cash credit facility of ₹ 110 Lakh against security of paid stocks and debtors up to 90 days. Margin stipulated was 25% of stock as and 40% for debtors. Bank has calculated drawing power based on following information provided by XYZ Ltd.

Particulars	Amount (₹)
Value of Stocks (as on 31.12.2023)	130 Lakh
Value of Debtors (as on 31.12.2023)	75 Lakh
Value of stocks (Fully damaged and included in (i) above)	7 Lakh
Value of Debtors (exceeding 90 days included in (ii) above)	10 Lakh
Value of creditors for goods	60 Lakh

Also, the outstanding balance in one of the Loan accounts was ₹ 25 Lakh and the realisable value of the security as assessed by the bank / approved valuers was ₹ 2.25 Lakh. Bank identified the same as erosion in the value of security. It was classified as doubtful category and provision was made for the doubtful assets. A discussion also took place among the team members regarding issuance of the audit reports after completion of the bank audit and annexure to the same such as Long Form Audit Report, Report on compliance with SLR Requirements, Report on Treasury Operations - as per RBI guidelines, Report on compliance as per Ghosh committee recommendations and Report on adverse credit - lending ratio in the rural areas, etc.

Based on the above facts, answer the following:



Q.1	<p>With respect to the overdraft facility sanctioned to Times Ltd., the account would be termed as out of order if:</p> <p>(i) The outstanding balance remains continuously in excess of ₹ 75 Lakh.</p> <p>(ii) The outstanding balance remains continuously in excess of ₹ 50 Lakh.</p> <p>(iii) The outstanding balance in the account is less than ₹ 75 Lakh but there are no credits or payments deposited into the account continuously for 90 days as on balance sheet date</p> <p>(iv) The outstanding balance is less than ₹ 50 Lakh.</p> <p>Choose the correct option from below:</p> <p>(a) (i), (ii) and (iii)</p> <p>(b) (i), (iii) and (iv)</p> <p>(c) (ii), (iii) and (iv)</p> <p>(d) (iii) and (iv)</p>
Q.2	<p>Which of the treatment by the bank on the provisioning and income recognition is correct in case of bank guarantee given by the Central Government and State Government?</p> <p>(a) Both (i) and (ii) are correct</p> <p>(b) Only (ii) is correct</p> <p>(c) Only (i) is correct</p> <p>(d) Both (i) and (ii) are incorrect.</p>
Q.3	<p>In the given case drawing power of the borrower XYZ Limited should be:</p> <p>(a) ₹ 86.25 Lakh</p> <p>(b) ₹ 76.35 Lakh</p> <p>(c) ₹ 96.25 Lakh</p> <p>(d) ₹ 85.45 Lakh</p>
Q.4	<p>The Bank has identified an erosion in the value of security and made provision for doubtful assets. Whether the treatment by bank for the doubtful asset is correct?</p> <p>(a) Yes. The security should be classified under doubtful category. It may be either written off or fully provided by the bank.</p> <p>(b) No. The existence of such security should be ignored, and the asset should straight away be classified as loss asset. It may be either written off or fully provided by the bank.</p> <p>(c) Yes. The security should be classified under doubtful category and provisioning should be made as applicable for doubtful assets.</p> <p>(d) No. The existence of the security should be ignored, and the asset should straight away be classified as loss asset. Provisioning should be made for doubtful assets.</p>
Q.5	<p>The Statutory Central Auditors of a bank must furnish, in addition to the main audit report, various other audit reports. From the options, choose the audit reports that M/s Vishwacharya and Associates shall furnish.</p> <p>(i) Long Form Audit Report</p> <p>(ii) Report on compliance with SLR Requirements</p> <p>(iii) Report on Treasury Operations – as per RBI guidelines</p> <p>(iv) Report on compliance as per Ghosh committee recommendations</p> <p>(v) Report on adverse credit - lending ratio in the rural areas.</p> <p>Choose the correct answer:</p>

- (a) (i), (ii), (iii), (iv) and (v)
- (b) Only (i), (ii), (iii) and (iv)
- (c) Only (i), (ii) and (iii)
- (d) Only (i), (ii) and (v)

**Answer - Case Study 80**

Q. No.	Answer	
1	<b>(a)</b>	(i), (ii) and (iii)
2	<b>(c)</b>	Only (i) is correct
3	<b>(a)</b>	₹ 86.25 Lakh
4	<b>(b)</b>	No. The existence of such security should be ignored, and the asset should straight away be classified as loss asset. It may be either written off or fully provided by the bank.
5	<b>(b)</b>	Only (i), (ii), (iii) and (iv)

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## Miscellaneous Topics

### Case Study - 81

DS & Co., Chartered Accountants, are statutory auditors of SAR Industries Pvt Ltd, a company engaged in manufacturing business since 2018. The company is operating from rented premises and it does not have building of its own. It had upgraded its machinery last time in 2020. Except interest in this company, promoters, directors, key managerial persons and their relatives do not have interest or ownership in any other entity. Also, the company does not enter into any business dealings with promoters, directors, key managerial persons and their relatives. The directors and key managerial persons get only reasonable remuneration from the company. Though company has an internal control system in place, it has not appointed internal auditor. It is also not mandatorily required to make such an appointment under the provisions of the Companies Act, 2013.

DS & Co. have accepted audit of the above company for year 2022-23 for the first time. Promoters and directors of the company are known to engagement partner only socially for quite some time. However, it is for the first time that any type of professional work related to this company has been accepted by them.

While formulating audit plan for the company, CA D (engagement partner) has planned certain risk assessment procedures and further audit procedures consisting of tests of controls and substantive procedures in relation to different areas.

The following is extract of financial information of the company:

(figures in rupees crores)			
S. No.	Particulars	Year 2022-23	Year 2021-22
1.	Turnover	30.00	15.00
2.	Inventories	5.00	2.00
3.	Property, plant and equipment (Gross block)	1.25	1.25
4.	Property, plant and equipment (Netblock)	1.00	1.25
5.	Gross profit	6.00	3.75
6.	Trade receivables	12.50	5.00

The PPE items consist of machinery only. While planning procedures in respect of Property, Plant and Equipment, auditor has included audit procedures like inspecting and reviewing company's plan for performing physical verification of PPE, assessing depreciation method used, verifying cost of PPE items acquired during the year with purchase bills and recalculation of depreciation charged instatement of profit and loss.

Further, while performing risk assessment procedures to identify risk of material misstatements in financial statements., engagement partner has come to notice that there is considerable variation in gross profit ratio as compared to last year. During performance of substantive procedures, he has also studied data of purchases and sales of the company during the year under audit and has also compared such data with preceding year and earlier years also. [RTP-May 24]

Q.1	Keeping in view description provided in the case scenario, which of the following statements is likely to be most appropriate?
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	<p>(a) Engagement partner is known socially to promoters and directors of the company. The situation mandatorily involves advocacy threat casting a doubt on auditor's independence. Irrespective of this, detection risk in engagement is low.</p> <p>(b) Engagement partner is known socially to promoters and directors of the company. The situation mandatorily involves familiarity threat casting a doubt on auditor's independence. Irrespective of this, detection risk in engagement is high.</p> <p>(c) The situation reflected in the case scenario may not constitute threat to independence of auditor. Irrespective of this, detection risk in engagement is low.</p> <p>(d) The situation reflected in the case scenario may not constitute threat to independence of auditor. Irrespective of this, detection risk in engagement is high.</p>
<b>Q.2</b>	<p><b>CA D has included in audit plan certain procedures in respect of PPE items. Which of the following audit procedure included in audit plan is not likely to be relevant?</b></p> <p>(a) Inspecting and reviewing company's plan for physical verification of PPE</p> <p>(b) Assessing depreciation method used</p> <p>(c) Verifying cost of PPE items acquired during the year with purchase bills</p> <p>(d) Recalculation of depreciation charged in statement of profit and loss</p>
<b>Q.3</b>	<p><b>Which of the following statements is likely to be most suitable to explain the fact relating to variation in gross profit ratio as compared to last year?</b></p> <p>(a) Gross profit ratio has decreased in year 2022-23 as compared to year 2021-22. It may be due to the reason that sales prices may have been reduced by the company to procure more orders.</p> <p>(b) Gross profit ratio has increased in year 2022-23 as compared to year 2021-22. It may be due to the reason that cost of materials purchased by company could have decreased.</p> <p>(c) Gross profit ratio has decreased in year 2022-23 as compared to year 2021-22. It may be due to the reason that office staff salary engaged in administrative functions and office maintenance expenditure could have increased.</p> <p>(d) Gross profit ratio has decreased in year 2022-23 as compared to year 2021-22. It may be due to the reason that company has not made an allowance for obsolescence in respect of inventories during year.</p>
<b>Q.4</b>	<p><b>CA D has also studied purchases and sales data of the company during the year and has also compared such data with preceding year and earlier years also. It is an example of _____?</b></p> <p>(a) Ratio analysis forming part of substantive analytical procedures</p> <p>(b) Trend analysis forming part of substantive analytical procedures</p> <p>(c) Reasonable test forming part of substantive analytical procedures</p> <p>(d) Structural modelling forming part of substantive analytical procedures</p>
<b>Q.5</b>	<p><b>Considering case scenario in totality, identify which of following combination of Standards is not proper for their likely relevance in performing and completing above engagement?</b></p> <p>(a) SQC 1, SA 220, SA 501, SA 505</p> <p>(b) SA 550, SA 510, SA 220, SA 610</p> <p>(c) SA 700, SA 510, SA 220, SA 500</p> <p>(d) SQC 1, SA 700</p>

<b>Q.6</b>	<b>CA D has also studied purchases and sales data of the company during the year and has also compared such data with preceding year and earlier years also. It is an example of _____?</b>
	(a) Ratio analysis forming part of substantive analytical procedures (b) Trend analysis forming part of substantive analytical procedures (c) Reasonable test forming part of substantive analytical procedures (d) Structural modelling forming part of substantive analytical procedures

#### Answer – Case Study 81

Q. No.	Answer
1	<b>(d)</b> The situation reflected in the case scenario may not constitute threat to independence of auditor. Irrespective of this, detection risk in engagement is high.
2	<b>(c)</b> Verifying cost of PPE items acquired during the year with purchase bills
3	<b>(a)</b> Gross profit ratio has decreased in year 2022-23as compared to year 2021-22. It may be due to the reason that sales prices may have been reduced by the company to procure more orders.
4	<b>(b)</b> Trend analysis forming part of substantive analytical procedures
5	<b>(b)</b> SA 550, SA 510, SA 220, SA 610
6	<b>(b)</b> Trend analysis forming part of substantive analytical procedures

#### Case Study – 82

**CA M. Raja has accepted offer of appointment of auditor of an entity. As business carried on by the entity is new to him, he wants to gain an understanding about the entity and its environment including its internal control. In this regard, he has performed procedures to obtain audit evidence about design and implementation of relevant controls. He has performed various procedures like inquiry, inspection and observation in this regard.**

**He wants reasonable assurance that accounting system is adequate and that all accounting information which should be recorded has, in fact, been recorded.**

**Further, during the course of audit, he has noticed as under: -**

- **As required by the management, bank reconciliation is required to be performed monthly. However, the same is not carried out as stipulated due to time constraints faced by accountant.**
- **The entity has a system of procuring its raw material supplies on the basis of valid purchase orders issued by the entity. However, purchase orders are not numbered in a sequence properly.**
- **Wage sheets are not verified by a responsible official as required by management.**
- **Staff of the entity is responsible for bringing cash from centers in nearby areas to entity's premises from where it is deposited into entity's bank account. However, concerned officer has not renewed insurance for cash in transit.**

**Based on above, answer the following questions:**

**[RTP-May 24]**

<b>Q.1</b>	<b>The auditor has performed procedures to obtain audit evidence about design and implementation of controls. Which of the following procedures is more reliable to obtain audit evidence relating to application of a control?</b>
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	<ul style="list-style-type: none"> <li>(a) Observing application of control</li> <li>(b) Inspecting documentation pertaining to control</li> <li>(c) Inquiry about application of control</li> <li>(d) Studying design of control</li> </ul>
<b>Q.2</b>	<p><b>Examination and evaluation of internal control is indispensable for CA M. Raja. It provides him necessary comfort relating to completeness of accounting information. However, review of internal controls of the entity will not enable him to know _____</b></p> <ul style="list-style-type: none"> <li>(a) whether errors or frauds are likely to be located in ordinary course of operations of business</li> <li>(b) whether an effective internal audit department is operating</li> <li>(c) whether his opinion needs modification</li> <li>(d) whether any administrative control has bearing on his work</li> </ul>
<b>Q.3</b>	<p><b>As regards weaknesses identified by the auditor in control system, which of the following represent(s) significant deficiencies in internal control?</b></p> <ul style="list-style-type: none"> <li>(a) Not performing bank reconciliation timely and not verifying wage sheets by responsible official only</li> <li>(b) Not performing bank reconciliation timely and lack of proper sequence in purchase orders only</li> <li>(c) Not performing bank reconciliation timely, lack of proper sequence in purchase orders, not verifying wage sheets by responsible official and lack of insurance for cash in transit</li> <li>(d) Lack of insurance for cash in transit only</li> </ul>
<b>Q.4</b>	<p><b>Which of the following is most appropriate regarding auditor's responsibility in accordance with SA 265?</b></p> <ul style="list-style-type: none"> <li>(a) To communicate significant deficiencies in internal control to management</li> <li>(b) To communicate significant deficiencies in internal control along with explanation of their potential effects to management</li> <li>(c) To communicate significant deficiencies in internal control along with explanation of their potential effects, to provide sufficient information to understand context of communication to management and express opinion on effectiveness of internal control</li> <li>(d) To communicate significant deficiencies in internal control along with explanation of their potential effects and to provide sufficient information to understand context of communication to management</li> </ul>

**Answer - Case Study 82**

Q. No.	Answer
1	(a) Observing application of control
2	(c) whether his opinion needs modification
3	(c) Not performing bank reconciliation timely, lack of proper sequence in purchase orders, not verifying wage sheets by responsible official and lack of insurance for cash in transit
4	(d) To communicate significant deficiencies in internal control along with explanation of their potential effects and to provide sufficient information to understand context of communication to management

### Case Study – 83

Priority Limited is a large company engaged in manufacturing of terry towels making steady profits on a year-to-year basis. PMR & Associates, statutory auditors of the company since last two years, are in process of establishing audit strategy for conducting statutory audit under Companies Act, 2013 for year 2023-24.

The company has 5 branches which are audited by independent auditors appointed under Companies Act, 2013. It also has a wholly owned subsidiary company which is audited by another audit firm under name of JKL & Associates. The engagement team has noticed that company has maintained several bank accounts and there is substantial movement in fixed deposits during the year leading to risk of misstatement in cash and cash equivalents. The engagement team has planned procedures regarding the same.

(i) At planning stage, engagement partner is also trying to set materiality for financial statements as a whole. The following information extracted from financial statements is given as under:

Particulars	(Amount in ₹ crores)
Revenue	100
Total Assets	40
Profit before Tax	8
Total Liabilities (excluding Equity)	30

(ii) While designing a sample for verifying revenues of company as part of tests of details, engagement partner has determined “tolerable misstatement” for ₹ 5.00 Lakh in order to address the risk that aggregate of individual immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements. One of the newly joined engagement team members has little conceptual understanding of “tolerable misstatement” determined by engagement partner. He also has no idea of the effect of change in tolerable misstatement on sample size.

(iii) During course of audit, while performing tests of details, engagement team has come across certain misstatements in selected sample pertaining to verification of revenues. The team has projected misstatements to population of revenues. The team wants to comply with the Standards on Auditing strictly.

Based on the above facts, answer the following:

[MTP-July 24]

Q.1	<p>The auditors of company are in process of establishing audit strategy. Which of the following is not a relevant factor in establishing overall audit strategy in the given case scenario?</p> <p>(a) Consideration of 5 branches which are audited by independent auditors</p> <p>(b) Consideration of wholly owned subsidiary company audited by another audit firm</p> <p>(c) Expected time of holding AGM in accordance with provisions of Companies Act, 2013</p> <p>(d) Nature, timing and extent of planned procedures for cash and cash equivalents</p>
Q.2	<p>For Priority limited, which benchmark would the engagement partner most likely to use for setting materiality for the financial statements as a whole?</p> <p>(a) A percentage of Revenue</p> <p>(b) A percentage of Total assets</p> <p>(c) A percentage of Profit before tax</p> <p>(d) A percentage of Total liabilities (excluding equity)</p>

<b>Q.3</b>	<p><b>In the given case scenario, assume that the engagement partner has decided to increase tolerable misstatement to ₹ 10.00 Lakh while designing sample described. Select the correct statement.</b></p> <p>(a) It would lead to decrease in sample size.  (b) It would lead to an increase in sample size.  (c) It would have no effect on sample size.  (d) It is not possible to draw inference on sample size due to increase in tolerable misstatement.</p>
<b>Q.4</b>	<p><b>While performing procedures on designed sample, the engagement team identified certain misstatements in selected sample and projected these to the entire population of revenues. According to the requirements of the Standards on Auditing, which statement is correct in this regard?</b></p> <p>(a) Anomalous misstatement is auditor's best estimate of misstatement in population.  (b) The projected misstatement plus anomalous misstatement, if any, is best estimate of misstatement in population.  (c) When projected misstatement exceeds tolerable misstatement, sample provides a reasonable basis for conclusion about tested population.  (d) When projected misstatement plus anomalous statement, if any, exceeds tolerable misstatement, sample provides a reasonable basis for conclusion about tested population.</p>

**Answer – Case Study 83**

Q. No.	Answer
1	<b>(d)</b> Nature, timing and extent of planned procedures for cash and cash equivalents
2	<b>(c)</b> A percentage of Profit before tax
3	<b>(a)</b> It would lead to decrease in sample size.
4	<b>(b)</b> The projected misstatement plus anomalous misstatement, if any, is best estimate of misstatement in population.

**Case Scenario – 84**

**Bandhu Charitable Trust is considering appointment of MNO & Associates, Chartered Accountants, as independent auditors of its financial statements. The Trust is engaged in providing affordable healthcare services. It is in interest of both auditor and client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent. It is, therefore, important that each party should be clear about nature of engagement. It should exactly specify the scope of work. Such an “engagement letter” is exchanged between Trust management and auditors.**

**While performing audit procedures, it is noticed by auditors that bills of two vehicles are not in name of Trust but in name of trustees. However, payment of these vehicles was made from bank account of Trust. The said vehicles are used for activities of Trust.**

**It is also noticed that a sum of ₹ 50.00 Lakh is reflected in Trust's financial statements in name of Gamma Instrument and Equipment in schedule of creditors. The said amount is outstanding since two years The auditors sent confirmation request to the said supplier and seek management's co-operation in this regard. However, management of the Trust informs the auditor regarding certain dispute going on with the supplier of equipment due to some quality issues. It is further informed that dispute is near settlement and it would not be proper to send confirmation request as it can affect negotiation process.**

**Based on the above facts, answer the following:**

**[MTP-July 24]**



<b>Q.1</b>	<p><b>As regards exchange of engagement letter between Trust management and auditors is concerned, which of following statements is likely to be true?</b></p> <p>(a) Engagement letter is sent by MNO &amp; Associates to Bandhu Charitable Trust. It includes reference to the expected form and content of report to be issued by them and a statement that there may be circumstances in which such report may differ from its expected form and content.</p> <p>(b) Engagement letter is sent by Bandhu Charitable Trust to MNO &amp; Associates. It includes reference to the expected form and content of report to be issued by auditors. However, it does not include a statement that such report may differ from its expected form and content.</p> <p>(c) Engagement letter is sent by MNO &amp; Associates to Bandhu Charitable Trust. It includes reference to expected form and content of report to be issued by them. However, it does not include a statement that such a report may differ from its expected form and content.</p> <p>(d) Engagement letter is sent by MNO &amp; Associates to Bandhu Charitable Trust. It does not include reference to the expected form and content of report to be issued by them.</p>
<b>Q.2</b>	<p><b>Considering the issues related to vehicles as described in the case study, identify the most appropriate statement.</b></p> <p>(a) Auditors have identified misstatement concerning “Existence” assertion made by Trust management.</p> <p>(b) Auditors have identified misstatement concerning “Rights and Obligations” assertion made by Trust management.</p> <p>(c) Auditors have identified misstatement concerning “Accuracy” assertion made by Trust management.</p> <p>(d) Auditors have identified misstatement concerning “Completeness” assertion made by Trust management.</p>
<b>Q.3</b>	<p><b>What course of action should the auditor take regarding the amount payable to the equipment supplier when management has communicated that sending a confirmation request could negatively impact the negotiation process?</b></p> <p>(a) The auditor should issue adverse opinion in auditor’s report.</p> <p>(b) The auditor should seek audit evidence as to the validity and reasonableness of the reasons for refusal and perform alternative audit procedures.</p> <p>(c) The auditor should withdraw from engagement as Trust management’s refusal is a limitation on scope of independent audit.</p> <p>(d) The auditor should disclaim opinion in auditor’s report.</p>

**Answer – Case Study 84**

Q. No.	Answer
1	(a) Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It includes reference to the expected form and content of report to be issued by them and a statement that there may be circumstances in which such report may differ from its expected form and content.
2	(b) Auditors have identified misstatement concerning “Rights and Obligations” assertion made by Trust management.
3	(b) The auditor should seek audit evidence as to the validity and reasonableness of the reasons for refusal and perform alternative audit procedures.

DLP & Associates, a firm of Chartered Accountants, are in midst of conducting audit of Twist and Spin Limited. The company is in business since last 15 years and have appointed DPL & Associates as their auditor for the first time for a term of 5 years beginning from financial year 2023-24. While identifying and assessing the risk of material misstatement at assertion level, the engagement team had assessed risk of material misstatement for revenues and trade receivables to be high.

The team is considering to send negative confirmation requests as sole substantive procedure to some business entities representing trade receivables appearing in the financial statements of the company. The company had made sales to these business entities in January, 2024. Such business entities are few and have quite large balances as on 31st March, 2024. However, team members are not on the same page regarding sending negative confirmation requests.

Besides considering sending of confirmation requests, engagement team has planned certain audit procedures pertaining to trade receivables. These procedures include:

1. Verification of invoices issued during last 7 days of financial year 2023-24 to verify that goods have been despatched by the company.
2. Selection of a few invoices from ageing report of the month March 2024 for verification of correctness of the billed amounts, to correct customers and on correct dates.
3. Preparation of schedule of movement of bad debts.
4. Review of the process of providing discounts to ensure that it is in accordance with company policy.

Another junior team member, S, observed that “Share Options Outstanding Account” reflected in the financial statements of the company. He started searching classification requirements of Schedule III of Companies Act, 2013 in this regard.

The engagement team wants to ensure that only the inventories held by company have been recorded in the financial statements and do not include any inventories belonging to third parties. They are keen to verify completeness assertion for inventories. The team has planned following audit procedures in this respect: -

1. Comparison of inventory turnover ratio of current period with previous years;
2. Vertical analysis of current period with previous years;
3. Comparison of budgetary expectations vis-à-vis actuals;
4. Performing purchase and sales cut-off tests

During the course of audit, R, a team member concluded that company has followed a particular accounting policy for revenue recognition during year 2023-24 which is in accordance with Accounting Standards and applicable financial reporting framework, but it was not consistently applied in preceding period having an impact upon opening balances of trade receivables of current year 2023-24. R is confused regarding the possible implications on auditor’s report on this issue.

Based upon above, answer the following questions:

[MTP-Aug. 24]

Q.1	<p>The engagement team members are not able to take decision on sending negative confirmation requests to some entities described in case scenario. Which of the following statements is in accordance with Standards on Auditing?</p> <p>(a) It would be appropriate for engagement team to send negative confirmation requests to these business entities.</p> <p>(b) It would be inappropriate for engagement team to send negative confirmation requests to these business entities.</p>
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	<p>(c) Sending negative confirmation requests depends upon auditor's professional judgment and Standards on Auditing do not spell out any confirmation requirements in this respect.</p> <p>(d) Business entities are more likely to respond in case of disagreement. Therefore, sending negative confirmation requests always provides better qualitative audit evidence as compared to other confirmation modes.</p>
<b>Q.2</b>	<p><b>Which of the planned audit procedure(s) pertaining to trade receivables described in case scenario is/are not related to verification of "Completeness assertion"?</b></p> <p>(a) 2 only  (b) 2 and 3  (c) 3 only  (d) 1 and 3</p>
<b>Q.3</b>	<p><b>Guide team member S by selecting the correct option with respect to "Share Options Outstanding Account":</b></p> <p>(a) It is required to be classified under head "Current liabilities".  (b) It is required to be classified under Shareholder funds under "Share Capital". Further, it is to be classified separately under "Paid up Share Capital".  (c) It is required to be classified under Shareholder funds under "Reserves &amp; Surplus". Further, it is to be classified separately as such under "Reserves &amp; Surplus".  (d) It is required to be classified under Shareholder funds under "Reserves &amp; Surplus". However, it is shown as part of Capital Reserve. No Separate disclosure is mandated under Schedule III of Companies Act, 2013.</p>
<b>Q.4</b>	<p><b>Which of the planned audit procedures in relation to the inventories described in the case scenario is/are not in nature of analytical procedure(s)?</b></p> <p>(a) 2 and 3  (b) 3 only  (c) 2 and 4  (d) 4 only</p>

**Answer - Case Study 85**

<b>Q. No.</b>	<b>Answer</b>	
<b>1</b>	<b>(b)</b>	It would be inappropriate for engagement team to send negative confirmation requests to these business entities.
<b>2</b>	<b>(c)</b>	3 only
<b>3</b>	<b>(c)</b>	It is required to be classified under Shareholder funds under "Reserves & Surplus". Further, it is to be classified separately as such under "Reserves & Surplus".
<b>4</b>	<b>(d)</b>	4 only

Case Study – 86

CA J is nearing completion of audit of Cheap Cost Private Limited, a manufacturing company for the year 2023-24. The draft financial statements of the company show a profit before tax of ₹ 5 crores. Materiality for financial statements as a whole has been determined @ 5% of Profit before Tax. At the end of June 2024, he is considering following issues flagged during the course of audit which remain uncorrected: -

- A fire took place in one of the premises of the company on 1st May, 2024 resulting in damages to all the inventories lying there amounting to ₹ 1 crores. The inventories of affected premises are insured with Quick Bima Limited for ₹ 50 lakhs and company has also lodged a claim with it which is still to be settled.
- The company has debited ₹ 10 lakhs under “Machinery Account” whereas expenditure relates to normal wear and tear of high-speed automated machinery. The amount has been wrongly capitalised under “Machinery account”. (Ignore depreciation effect)
- The company has not properly accounted for necessary elements of cost in arriving at work in progress. Further, estimates regarding various stages of production have not been made properly. All such factors have resulted in overstatement of work in progress inventories by ₹ 20 lakhs.

No other issues except as stated above merit attention. Besides, written representation letter has also been obtained on matters concerning management’s responsibilities regarding fulfilment of responsibilities for preparation of financial statements and providing access to all information to CA J. However, written representation provided to CA J begins in the below stated manner:

“This representation letter is provided in connection with your audit of the financial statements of Cheap Cost Private Limited for the year ended March 31, 2024, for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the applicable accounting standards in India. We confirm that (to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves) .....

Based upon above, answer the following questions:

[MTP-Aug. 24]

Q.1	<b>Which of following statements is most appropriate as regards to fire incident?</b>
	(a) The auditor should ask management to adjust financial statements for period under audit and book a loss of ₹ 50 lakhs in its Statement of Profit and Loss. (b) The auditor should ask management to adjust financial statements for period under audit and book a loss of ₹ 1 crores in its Statement of Profit and Loss. (c) The auditor should ask management to disclose it in notes to accounts. (d) The auditor has no responsibility regarding described fire incident.
Q.2	<b>Identify the correct option regarding materiality of uncorrected misstatements relating to wrong capitalisation under “Machinery Account” and overstatement of inventories of work in progress.</b>
	(a) The uncorrected misstatements are not material in context of audit of financial statements as a whole as these are below materiality level determined by auditor. (b) The uncorrected misstatements are material in context of audit of financial statements as a whole and their effect on opinion should be considered by auditor. (c) The uncorrected misstatements are not material in context of audit of financial statements as a whole as these are in nature of management’s judgment. (d) The uncorrected misstatements are material in context of audit of financial statements as a whole and auditor should correct these.

<b>Q.3</b>	<b>The auditor has performed certain audit procedures described in case scenario relating to inventories of work in progress. Such procedures are related to verification of _____ assertion.</b>
	(a) Completeness (b) Valuation (c) Existence (d) Rights and obligations
<b>Q.4</b>	<b>Which of the following statements is correct in respect to manner of providing written representations by management?</b>
	(a) The extract of written representations provided in case scenario is proper. (b) The use of words “having made such enquiries” is not permitted. (c) The use of words “to the best of our knowledge and belief” is not permitted. (d) The use of both kind of words “having made such enquiries” and “to the best of our knowledge and belief” is not permitted.

#### Answer - Case Study 86

Q. No.	Answer
1	(c) The auditor should ask management to disclose it in notes to accounts.
2	(b) The uncorrected misstatements are material in context of audit of financial statements as a whole and their effect on opinion should be considered by auditor.
3	(b) Valuation
4	(a) The extract of written representations provided in case scenario is proper.

#### Case Scenario - 87

**MPM & Associates, a firm of Chartered Accountants, have received offer letter from PST Bank for carrying out statutory audit of their Chandigarh branch for the financial year 2023-24. The offer letter, inter alia, requests audit firm to give an undertaking in writing that firm is not disqualified under Section 141(3)(d)(ii) of Companies Act, 2013. Such provision relates to disqualification of a person as auditor of a company if he, his relative or partner is indebted to the company subject to certain prescribed conditions. Before accepting the said audit, the firm checks out whether it complies with law requirements. However, there is a difference of opinion among firm personnel whether such an undertaking can be given in case of banks.**

**The offer letter also contains following declaration to be signed by the auditors in case they choose to accept the appointment: -**

**“We declare that we will not communicate or allow to be communicated to any person, not legally entitled thereto, any information relating to the affairs of PST Bank or to the affairs of the person having any dealing with the Bank, nor will we allow any such person to inspect or have access to any books or documents belonging to or in possession of the Bank relating to the business of any person having any dealing with the Bank.”**

**The audit firm has also received a document kit provided by Statutory Central Auditors of Bank. It relates to scope of audit, areas of special consideration while performing audit and requires audit firm to confirm certain matters like adherence to RBI Master Circulars for income recognition, asset classification & provisioning and adequacy of checking of books of accounts based on sample etc. to them by way of a letter.**

The document kit received also requires MPM & Associates to consider adverse comments made by stock auditors of borrowers enjoying cash credit facilities in their reports for purpose of reporting. It also contains specific instructions to check foreign letter of credits (FLCs) issued during the year in compliance with sanction terms of the respective borrowers and to verify income recognized in respect of FLCs.

Based upon above, answer the following questions:

[MTP-Aug. 24]

Q.1	<p><b>Which of the following statements is likely to be most appropriate regarding required undertaking in accordance with the Companies Act, 2013?</b></p> <p>(a) The referred provision mainly addresses self-interest threats to independence of auditors. The audit firm can give such an undertaking after verifying if it complies with such requirements.</p> <p>(b) The referred provision mainly addresses self-review threats to independence of auditors. The audit firm can give such an undertaking after verifying if it complies with such requirements.</p> <p>(c) The referred provision mainly addresses self-interest threats to independence of auditors. However, the audit firm can't give such an undertaking as such provisions are applicable to companies and not to banks.</p> <p>(d) The referred provision mainly addresses self-review threats to independence of auditors. However, the audit firm can't give such an undertaking as such provisions are applicable to companies and not to banks.</p>
Q.2	<p><b>The declaration relating to non-communication of information related to affairs of Bank is related to adherence to which fundamental principle governing professional ethics?</b></p> <p>(a) Objectivity</p> <p>(b) Confidentiality</p> <p>(c) Independence</p> <p>(d) Professional Competence and due care</p>
Q.3	<p><b>MPM &amp; Associates are required to report on adverse comments made by stock auditors of borrowers of branch enjoying cash credit facilities. Which of the following statements is most appropriate in this regard?</b></p> <p>(a) Stock auditors make comments in their reports on valuation of security and calculation of drawing power.</p> <p>(b) Stock auditors make comments in their reports on valuation of security only. However, no comments are made on calculation of drawing power.</p> <p>(c) Stock auditors make comments in their reports on valuation of security, documentation made by bank in respect of sanctioned credit facilities, leakage of revenue and calculation of drawing power only.</p> <p>(d) Stock auditors make comments in their reports on calculation of drawing power only.</p>
Q.4	<p><b>Keeping in view matter of foreign letters of credits (FLCs) described in case scenario, consider following statements: -</b></p> <ol style="list-style-type: none"><li><b>Foreign letter of credit issued by branch is a non-funded loan.</b></li><li><b>Branch earns interest on issuance of foreign letter of credit which is credited in interest earned account of profit and loss account of branch.</b></li><li><b>The bank which receives foreign letter of credit is known as beneficiary bank.</b></li></ol> <p><b>Which of following statement(s) is/are true?</b></p> <p>(a) Only statement 1 is correct.</p> <p>(b) Only statements 1 and 3 are correct.</p> <p>(c) Only statements 1 and 2 are correct.</p> <p>(d) Only statements 2 and 3 are correct.</p>

**Answer – Case Study 87**

Q. No.	Answer	
1	(a)	The referred provision mainly addresses self-interest threats to independence of auditors. The audit firm can give such an undertaking after verifying if it complies with such requirements.
2	(b)	Confidentiality
3	(a)	Stock auditors make comments in their reports on valuation of security and calculation of drawing power.
4	(a)	Only statement 1 is correct.

**Case Scenario – 88**

M/s KRISH & Company is a firm of Chartered Accountants based in Punjab. CA K, CA R, CA I, and CA SH are the partners of the firm. The firm is engaged in various audit assignments. The engagement partners, who were handling their respective assignments for the financial year 2023-24, dealt with the following issues raised during the course of their respective audits.

- M/s KRISH & Co. is appointed as the joint auditor along with M/s. PK and Associates and M/s. RS and Associates for the audit of a large manufacturing company for the financial year 2023-24. CA K is in charge of this audit. They have divided their audit areas and have also identified the common audit areas, which will be applicable to all the joint auditors. While forming the opinion, CA K had a different opinion whereas, the other two audit firms shared the same opinion. Both of them contended that as they were forming a majority, M/s KRISH & Co. will have to agree with their opinion.
- CA R is conducting the statutory audit of PAWAN Ltd. He observed that, during the year, the company has issued shares at premium and has transferred the amount received as premium to securities premium account. He wants to ensure that PAWAN Ltd. has utilised the amount available in the securities premium amount for the purposes permitted under the Companies Act, 2013.
- Registrar of Co-operative Societies has appointed M/s KRISH & Co. as the statutory auditor of NAND Co-operative Society for the financial year 2023-24. CA I is looking after the audit of the said registered society. During the year, in terms of Section 34 of the cooperative societies Act, with the sanction of the Registrar, Society has contributed for charitable purposes as defined in section 2 of the Charitable Endowments Act, 1890. CA I is ensuring whether requirements, as regards contribution made, have been complied with.
- All the engagement partners and the audit team of M/s KRISH & Co. have deliberations and discussions every week through google meet to review the progress of their respective assignments. During last such meet, CA SH, the managing partner, briefed to the team about the form, content, and extent of audit documentation in terms of SA 230, while citing examples of records to be excluded as well as to be included as a part of audit documentation.

Based on the above facts, answer the following questions: (Q. No. 1 to Q. No. 4)

[Sep. 24 (8 Marks)]

Q.1	<p><b>The securities premium account of PAWAN Ltd. cannot be applied for which of the following purposes?</b></p> <p>(a) In writing off the debit balance in the Profit &amp; Loss account.</p> <p>(b) In writing off the expenses of, or the commission paid or discount allowed on any issue of equity shares of the company.</p>
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	(c) For the purchase of its own shares or other securities under section 68. (d) In paying up unissued equity shares of the company to be issued to the members of the company as fully paid bonus shares.
<b>Q.2</b>	<b>CA I, who is in charge of audit of NAND Co-Operative Society, wants to ensure that the society has contributed for charitable purposes within the limits prescribed. How much is the society allowed to contribute for charitable purposes?</b> (a) contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund. (b) contribute an amount at the appropriate rate as per class of the society. (c) contribute an amount not exceeding 20% of the net profits remaining after compulsory transfer to the reserve fund. (d) contribute annually at prescribed percentage of the profits as approved by the General body of the society.
<b>Q.3</b>	<b>Which of the following need not be included by the audit team as a part of audit documentation during handling of their respective assignments?</b> (a) Significant and specific contracts and agreements. (b) Draft audit engagement letter. (c) Summaries of significant matters. (d) Checklists.
<b>Q.4</b>	<b>In case of difference of opinion between the joint auditors, what course of action can M/s. KRISH &amp; Co. take while issuing the audit report?</b> (a) They will have to agree with the opinion formed by the majority of auditors. (b) They will have to agree with the opinion formed by the majority auditors, but they can mention their view in the Emphasis of Matter Paragraph. (c) They can add a separate audit opinion paragraph in the common audit report. (d) They can issue a separate audit report and the audit reports issued by the joint auditors shall make a reference to each other's audit report.

#### Answer - Case Study 88

Q. No.	Answer
1	(a) In writing off the debit balance in the Profit & Loss account.
2	(a) Contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund.
3	(b) Draft audit engagement letter
4	(d) They can issue a separate audit report and the audit reports issued by the joint auditors shall make a reference to each other's audit report



Case Scenario – 89

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

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

The company had spent huge amount on employee benefits. Hence, CA B instructed his assistants to test the controls that the company had set around the employee benefit expenses. After being satisfied with the controls maintained by the company, he instructed his team to bifurcate the employee benefit expenses into salaries and wages, contribution to PF, expenses on ESOP/ ESPP and staff welfare expenses.

The engagement partner CA B, while evaluating, validating and reporting on the design and efficiency of internal financial controls at GHB Ltd., also impressed upon the directors, independent directors and the audit committee the way in which the Companies Act, 2013 has placed a greater emphasis on the effective implementation and reporting on the internal controls of a company.

Due to time constraints, CA B is under pressure to issue a clean report in the limited time frame. He has insufficient time to properly perform or complete the relevant duties and issue appropriate audit report.

The Board of Directors want CA B to certify the debtors to be sent to the bank without checking. CA B agrees, as most of the professional income of BPP & Co. LLP comes from GHB Ltd. They have undue dependence on the fees from GHB Ltd. hence; they are concerned about losing the engagement.

Based on the above facts, answer the following:

[Sep. 24 (10 Marks)]

Q.1	<p><b>Which assertion concerning the bifurcation of employee expenses into various heads is being verified by CA B?</b></p> <p>(a) Occurrence (b) Measurement (c) Completeness (d) Disclosures</p>
Q.2	<p><b>With reference to reporting on the internal financial controls system under the Companies Act, 2013, which of the following does not fall within the nature of responsibility of GHB Ltd.?</b></p> <p>(a) In accordance with the terms of reference specified in writing by the Board, act of every audit committee to include evaluation of internal financial controls and risk management systems.</p> <p>(b) Directors' responsibility statement to state that the Directors had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.</p> <p>(c) Board of Directors have to appoint an expert to state that the internal financial controls of the company are commensurate with the size and nature of its business.</p> <p>(d) In terms of code for Independent Directors, independent directors to get themselves satisfied that financial controls and systems of risk management are robust and defensible.</p>

<b>Q.3</b>	<b>Due to tight deadlines, CA B has insufficient time to properly perform or complete the relevant duties and he has to sign off clean audit report. Which fundamental principle governing professional ethics is disregarded by him?</b> (a) Professional competence and due care (b) Professional behaviour (c) Integrity (d) Objectivity
<b>Q.4</b>	<b>Undue dependence on the fees from GHB Ltd. creates which threat of independence for the auditors?</b> (a) Intimidation threat (b) Familiarity threat (c) Self-interest threat (d) Advocacy threat
<b>Q.5</b>	<b>Since it became impracticable for CA B, on 31st March, 2024, to attend physical inventory counting at the warehouse and also became impossible to perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and conditions of inventory, CA B shall:</b> (a) Take Management Representation regarding the existence and valuation of inventory and mention in Emphasis of Matter paragraph. (b) Rely on GHB Ltd.'s perpetual inventory records as audit evidence and express unmodified opinion. (c) Omit altogether the audit procedure of physical inventory counting from the audit programme because of impracticability. (d) Modify the opinion in the auditor's report in accordance with SA 705 as a result of the scope limitation.

**Answer – Case Study 89**

<b>Q. No.</b>	<b>Answer</b>
<b>1</b>	<b>(d)</b> Disclosures
<b>2</b>	<b>(c)</b> Board of Directors have to appoint an expert to state that the internal financial controls of the company are commensurate with the size and nature of its business
<b>3</b>	<b>(a)</b> Professional competence and due care
<b>4</b>	<b>(c)</b> Self-interest threat
<b>5</b>	<b>(d)</b> Modify the opinion in the auditor's report in accordance with SA 705 as a result of the scope limitation