

Suggested Answers and Marking Scheme

MTP 5 (Chapter 7 – Completion and Review and Chapter 8 – Audit Reports)

Marks: 27

Time: 50 Minutes

Instructions: Part A comprises of MCQ.

Part B Comprises of descriptive questions.

Part – A (Multiple Choice Questions)

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| Q.1 | (c) A disclaimer of opinion will be issued and basis for disclaimer of opinion will also be provided. Besides, statement in audit report will be changed from “financial statements have been audited” to “auditor was engaged to audit financial statements.” | 2 |
| Q.2 | (c) It amounts to non-disclosure of a material contingent liability by the company. Qualified opinion needs to be expressed by auditor. | 2 |
| Q.3 | (d) Adverse opinion | 2 |
| Q.4 | (c) Instead of giving emphasis of matter paragraph, separate paragraph on ‘Material Uncertainty Related to Going Concern’ in report should be given in accordance with SA 570 | 2 |

Part B (Descriptive Questions)

Q. No. 1 is Compulsory. Attempt ANY TWO from the rest.

- Q.1 (a) Communication of Significant Deficiencies:**
- As per SA 265, “Communicating Deficiencies in Internal Control to Those Charged with Governance and Management”, while pointing out significant deficiencies in internal control, auditor has not only to communicate significant deficiencies giving their description but also explain the potential effects and sufficient information to those charged with governance and management to understand context of communication. **(1 Mark)**
 - In the given situation, auditor noticed significant deficiency in internal control over inventories and he pointed out the same to management i.e. “Physical verification of inventories is not being conducted at regular intervals as stipulated by management.” Therefore, the above communication is not proper. **(1 Mark)**
 - Not only significant deficiency has to be communicated, it should also be explained to management the potential effects of not carrying out physical verification of inventories at regular intervals as stipulated by management. It should explain that such a significant deficiency can lead to misstatement of inventories impacting profits of the company. **(1 Mark)**
 - Highlighting the importance of such a control, it should be stated that responsibility be fixed for concerned person(s) for adhering to such an important control. **(1 Mark)**

Q.1 (b) Factors to be considered while determining Key Audit matters:

The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- (i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.
- (ii) Significant auditor judgements relating to areas in the financial statements that involved significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty.
- (iii) The effect on the audit of significant events or transactions that occurred during the period.

(3 Marks)

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

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

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

- (a) Key audit matters are those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements [of the current period]; and
- (b) These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

(2 Marks)

- Q.2 (a)** In the given case, the auditor has come to know of legal claim against the company before issue of audit report. It has also come to his knowledge that management of the company has agreed to an out of court settlement of ₹ 5 crore. It is an example of subsequent event between the date of the financial statements and the date of the auditor's report as per SA 560. Auditor's responsibilities regarding subsequent events between the date of the financial statements and the date of the auditor's report are as under:

- (i) Perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.

(1 Mark)

- (ii) If such subsequent events that require adjustment of, or disclosure in, the financial statements have been identified, it shall be determined whether each such event is appropriately reflected in those financial statements.

(1 Mark)

- (iii) Obtain a written representation from management or those charged with governance that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.

(1 Mark)

(b) Reporting Under CARO, 2020:

As per clause (ii) of Paragraph 3 of CARO, 2020 the auditor is required to report, in respect of physical verification of inventory and in respect of sanctioned working capital, that:

- (i) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in 13 the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account. **(1 Mark)**
- (ii) whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details. **(1 Mark)**

Q.3 Additional audit procedures to be performed in accordance with SA 570:

Loss of major markets, key customers and inability to obtain financing for new product development are examples of events or conditions that may cast a significant doubt on the entity's ability to continue as going concern.

Additional Audit procedures:

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

Marking Scheme – One Mark for One Point (5 Marks)

Q. 4 Two approaches of comparative information:

The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in terms of engagement. **(1 Mark)**

Essential reporting difference:

The essential audit reporting differences between the approaches are:

- (a) For corresponding figures, the auditor's opinion on the financial statements refers to the current period only; whereas
- (b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented. **(1 Mark)**

Meaning of Comparative Information:

- SA 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements" defines the term comparative information as the amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable FRF.
- Comparative information where amounts and other disclosures for the prior period, are included as an integral part of current period financial statements and are intended to be read only in relation to the amounts and other disclosures relating to the current period is known as Corresponding Figures.
- Comparative information where amounts and other disclosures for the prior period, are included for comparison with the financial statements of the current period but, if audited, are referred to in the auditor's opinion is known as Comparative financial statements. **(1 Mark)**

Audit procedures regarding comparative information:

- (a) Determine whether F.S. include Comparative information required by FRF, & Whether such information is classified appropriately.
- (b) Evaluate the following:
 - Whether the comparative information agrees with the amounts and other disclosures presented in the prior period; and
 - Whether the accounting policies reflected in the comparative information are consistent with those applied in the current period.
 - Whether, changes in accounting policies, if any, have been properly accounted for and adequately presented and disclosed.
- (c) In case, auditor has doubt over existence of Possible Material Misstatement, then auditor is required to perform additional audit procedures to obtain sufficient appropriate audit evidence to determine existence of material misstatement.
- (d) Obtain Written Representation from management to reaffirm that the Written Representation it previously made with respect to the prior period remain appropriate.

Marking Scheme – One Mark for Any Two Point (2 Marks)