Star Rating

On the basis of Maximum marks from a chapter ☆☆☆☆☆

On the basis of Questions included every year from a chapter ☆☆☆☆☆

On the basis of Compulsory questions from a chapter ☆☆☆☆☆

CHAPTER	
1A	**Auditing Standards, Statements and Guidance Notes**

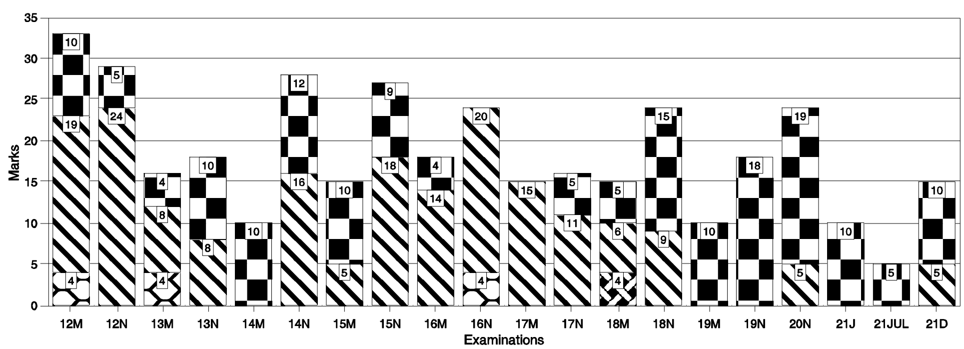
THIS CHAPTER COMPRISES OF

☞ Auditing and Assurance Standards Board-Scope and Functions: Setting up of AASB; Scope and Functions of AASB; Scope of SAs; Procedure for Issuing SAs; Compliance with the SAs; Linkage between SAs and Disciplinary Proceedings ☞ Framework of Standards and Guidance Notes on Related Services ☞ Quality Control and Engagement Standards: Structure of SAs ☞ Guidance Notes.

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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SHORT NOTES

2012 - May [7] Write short note on the following:
(e) Statistical and Non-Statistical Sampling. (4 marks)

Answer:

Audit sampling means the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

As per SA 530, "Audit Sampling", the auditor should select sample items in such a way that the sample can be expected to be representative of the population. This requires that all items in the population have an opportunity of being selected.

There are two major methods in which the size of the sample and the selection of individual items of the sample are determined. These methods are statistical and non-statistical sampling.

1. **Statistical sampling:**
   - A method of Audit sampling wherein the auditor selects the sample randomly.
   - This is a method of audit testing which is more scientific than testing based entirely on the auditor's own judgement because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.
   - Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, debtors' confirmation, payroll checking, vouching of invoices and petty cash vouchers.
2. **Non-statistical sampling:**
   - A method of Audit Sampling where in the auditor selects sample size which is neither random selection nor based on use of theory of probability.

- Under this method, the sample size and its composition are determined on the basis of the personal experience and knowledge of the auditor.
- This method has been in common application for many years because of its simplicity in operation.
- Traditionally, the auditor on the basis of his personal experience will determine the size of the sample and express it in terms that number of pages or personal accounts in the purchases or sales ledger to be checked. For example, March, June & September may be selected in year one and different months would be selected in the next year. An attempt would be made to avoid establishing a pattern of selection year after year to maintain an element of surprise as to what the auditor is going to check. It is a common practice to check large number of items towards the close of the year so that the adequacy of cut-off procedures can also be determined.

—— Space to write important points for revision ——

2013 - May [7] Write short note on the following:

(c) Corresponding figures. (4 marks)

Answer :

Corresponding Figures:

As per SA - 710, "Comparative Information- Corresponding Figures and Comparative Financial statements", corresponding figures means: comparative information where amounts and other disclosures for the preceding period are included as part of the current period financial statements and are intended to be read in relation to the amounts and other disclosures relating to the current period. These corresponding figures are not presented as complete financial statements capable of standing alone, but are an integral part of the current period financial statements intended to be read only in relationship with the current period figures.

Auditors Responsibilities in Respect of Corresponding Figures:

Please refer 2010 - May [3] (c) on page no. 29

—— Space to write important points for revision ——

2016 - Nov [7] Write short note on the following:
(e) Objectives of compilation engagement. (4 marks)

Answer:

The objective of a compilation engagement is for the accountant to use accounting expertise, as opposed to auditing expertise, to collect, classify and summarize financial information. This ordinarily entails reducing detailed data to a manageable and understandable form without a requirement to test the assertions underlying that information. The procedures employed are not designed and do not enable the accountant to express any assurance on the financial information. However, users of the complied financial information derive some benefit as a result of the accountant's involvement because the service has been performed with professional competence and due care.

A compilation engagement would ordinarily include the preparation of financial statements (which may or may not be a complete set of financial statements) but may also include the collection, classification and summarization of other financial information.

—— Space to write important points for revision ——

DISTINGUISH BETWEEN

2018 - May [6] (d) (i) Self-interest threat from self-review threat in an Assurance Engagement. (4 marks)

Answer:

Self review threats, which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement or when a member of the audit team was previously a director or Senior employee of the client. Instances where such threats come into play are :

(i) When an auditor having recently been a director or senior officer of the company; and
(ii) When auditors perform services that are themselves subject matters of audit.

—— Space to write important points for revision ——

DESCRIPTIVE QUESTION

2009 - May [5] Answer the following :

(c) What are the considerations to be kept in mind while performing analytical procedures on data prepared by the client. (6 marks)

Answer :

Analytical procedures implies evaluation of financial information through analysis of relationships among both financial and non financial data. SA 520, Analytical Procedures', deals with auditors use of analytical procedures as substantive procedures and as procedures near the end of audit that assist the auditor when forming an overall conclusion on financial statement.

SA-520, (Revised) 'Analytical Procedures' states that analytical reviews are "analysis of significant ratios and trends including the resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or which deviate from predicted amounts.

As per SA 520 (Revised) Analytical Procedures, when the auditor intends to perform analytical procedures on data prepared by the client, the following should be considered:

1. **Determine the suitability of particular substantive analytical procedures for given assertions**, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions;
2. **Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed**, taking account of source, comparability and nature and relevance of information available and controls over preparation;
3. **Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise** to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated; and
4. **Determine the amount of any difference of recorded amounts from expected values** that is acceptable without further investigation and if analytical procedures performed in accordance with this SA identify

fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by:

(i) Inquiring of management and obtaining appropriate audit evidence relevant to management's responses; and

(ii) Performing other audit procedures as necessary in the circumstances.

Thus, **Analytical procedures are used:**

- to assist the auditor in planning the nature, timing and extent of other audit procedures.
- as substantive procedures
- as an overall review of the financial statements in final review stage of the audit.

—— Space to write important points for revision ——

2009 - May [8] Answer the following:

(a) What are the points to be considered while evaluating the "Knowledge of the Business" in the conduct of an audit? (8 marks)

Answer :

SA 315, Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment lays down the broad matters to be considered while obtaining knowledge of business for a new audit assignment. **These are:**

1. Relevant industry, regulatory, economic and other external factors including the applicable financial reporting framework.
2. The nature of the entity, including:
   (i) Its operations.
   (ii) Its ownership and governance structures.
   (iii) The types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
   (iv) The way that the entity is structured and how it is financed; to enable the auditor to understand the classes of transactions, account balances and disclosures to be expected in the financial statements.

3. The entity's selection and application of accounting policies.
4. The entity's objectives and strategies and those related business risks that may result in risks of material misstatement.
5. The measurement and review of the entity's financial performance.

—— Space to write important points for revision ——

2009 - Nov [3] (a) Briefly explain:

(i) Audit procedures on subsequent events (4 marks)

Answer :

Audit Procedures on Subsequent Events:

As per SA 560 "Subsequent Events", subsequent events includes events occurring between the dates of Financial Statements and Audit Report and the facts that become known to the auditor after the date of the auditor's report.

The Auditor should perform the following procedure to obtain sufficient appropriate evidence to find out the adjustments or disclosures of those subsequent events:

1. Review the procedures adopted by the management to identify subsequent events.
2. Examine the minutes of the Board of Directors, Executive Committees and the General Meetings of the shareholders.
3. Collect information from the other sources like budgets/estimates, cash flows, forecasts, interim financial statements etc.
4. Make enquiries and hold discussions with the top management.
5. Details from company's lawyers for any litigation matter.
6. The auditor shall request the management to provide a written representation that all subsequent events which require adjustment or disclosures have been adjusted or disclosed.

—— Space to write important points for revision ——

2009 - Nov [4] Answer the following :

(c) Explain briefly duties and responsibilities of an auditor in case of material misstatement resulting from Management Fraud. (6 marks)

Answer :

Duties and Responsibilities of an auditor in case of Material misstatement resulting from Management Fraud

Misstatement in the financial statements can arise from fraud or error. The term fraud refers to an 'Intentional Act' by one more individuals among management, those charged with governance. The auditor is concerned with fraudulent acts that cause a material misstatement in the financial statements.

Fraud involving one or more members of management or those charged with the governance is referred to as "management fraud". The primary responsibility for the prevention and detection of fraud rests with those charged with the governance and the management of the entity.

Various SAs state the requirements for the auditor to consider the risk of fraud in an audit of financial statements and the manner of dealing with the same:

1. **Paragraph 27 of SA 315, "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment",** requires the auditor to consider the risk of fraud in determining which risks are significant risks.
2. **Paragraphs 22 and 23 of SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements",** requires the auditor, *inter alia*, to communicate to those charged with governance (the Audit Committee/Board of Directors) when there is a non - compliance with laws and regulations, that come to the auditor's attention during the course of the audit, which he/she believes is intentional and material, without delay.
3. **SA 240, *"The Auditors responsibilities relating to fraud in an audit of financial statements", inter alia,* States the following:**
   Paragraph 5 - 'An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.'

Paragraph 40 - ‘If the auditor has identified a fraud or has obtained information that indicates that a fraud may exist, the auditor shall communicate these matters on a timely basis to the appropriate level of management in order to inform those with primary responsibility for the prevention and detection of fraud of matters relevant to their responsibilities’.

Paragraph 43 - ‘If the auditor has identified or suspects a fraud, the auditor shall determine whether there is a responsibility to report the occurrence or suspicion to a party outside the entity. Although the auditor’s professional duty to maintain the confidentiality of client information may preclude such reporting, the auditor’s legal responsibilities may override the duty of confidentiality in some circumstances’.

Paragraph A66 - ‘In some cases, requirements for reporting fraud, whether or not discovered through the audit process, may be subject to specific provisions of the audit mandate or related legislation or regulation’.

Further, as per Sec. 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is one crore rupees or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than one crore rupees) within such time and in such manner is prescribed. Under Rule 13 of Companies Audit and Auditors Rules, 2014.

Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed:

Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

Provided further that the companies, whose auditors have reported frauds under this sub-section to the audit committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

Time and Manner of Reporting prescribed under Rules - Rule 13:

1. If an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the CG.
2. The auditor shall report the matter to the CG as under:
   (a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;
   (b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the CG within 15 days from the date of receipt of such reply or observations.
   (c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the CG along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
   (d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgment Due or by Speed Post followed by an e-mail in confirmation of the same;
   (e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contract telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
   (f) the report shall be in the form of a statements as specified in Form ADT-4.

3. In case of a fraud involving amount less than ₹ 1 Cr., the auditor shall report the matter to Audit Committee constituted u/s 177 or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:
   a. Nature of Fraud with description;
   b. Approximate amount involved; and
   c. Parties involved.
4. The following details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year shall be disclosed in the Board's Report:
   a. Nature of Fraud with description;
   b. Approximate Amount involved;
   c. Parties involved, if remedial action not taken; and
   d. Remedial actions taken.
5. The provision of this rule shall also apply, mutatis mutandis, to a Cost Auditor and a Secretarial Auditor during the performance of his duties under section 148 and section 204 respectively.

The auditor is also required to report as per Clause (xi) of 3rd Para of CARO, 2020,

(a) whether any fraud by the company or any fraud on the company has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated;

(b) whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT- 4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;

(c) whether the auditor has considered whistle- blower complaints, if any, received during the year by the company.

As per Para 4 of CARO 2020,

1. Where in the auditor's report, the answer to any of the questions referred to in paragraph 3 is unfavorable or qualified, the auditor's report shall also state the basis for such unfavorable or qualified answer, as the case may be.

2. Where the auditor is unable to express any opinion on any specified matter, his report shall indicate such fact together with the reasons as to why it is not- possible for him to give his opinion on the same.

—— Space to write important points for revision ——

2010 - May [1] Comment on the following :

(c) S Ltd. issued Bonds to the tune of ₹ 100 lacs and provided security to the tune of ₹ 80 lacs for the same. It insists that it will disclose the Bonds as "Secured" in the Balance Sheet of the Company. (5 marks)

Answer :

Prima facie, the Bonds issued to the tune of ₹ 100 lacs are provided with security to the tune of ₹ 80 lacs i.e. neither fully secured nor unsecured. Guidance Note on the "Terms used in Financial Statements" issued by ICAI, states "Secured Loans" as loan secured wholly or partly against an asset. Hence the Bonds should be classified under 'Secured Loans' for the purpose of disclosure in the Balance Sheet. However the nature of security should be clearly specified.

—— Space to write important points for revision ——

2010 - May [3] (a) In the course of audit of ABC Ltd. its management refuses to provide written representations. As an auditor what is your duty? (4 marks)

Answer:

Duty of an Auditor if management refuses to provide written representations:

According to **SA 580 (Revised) "Written Representations",** if the management does not provide one or more of the requested written representations, the auditor shall:

1. Discuss the matter with management
2. Re-evaluate the Integrity of the management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general and

3. Take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

The auditor should disclaim an opinion on the financial statements if management does not provides written representations.

—— Space to write important points for revision ——

2010 - May [3] (b) While planning the audit of S Ltd. you want to apply sampling techniques. What are the risk factors you should keep in mind ? (4 marks)

Answer:

Risk Factors to be kept in mind while applying sampling techniques:

According to **SA 530 (Revised) "Audit Sampling"**, sampling risk is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure.

Sampling risk can lead to two types of misleading conclusions.

1. In the case of a test of controls, that controls are more effective than they actually are, or in the case of tests of details, that a material misstatement does not exists when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
2. In the case of test of controls, the controls are less effective than they actually are, or in the case of tests of details, that a material misstatements exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect.

—— Space to write important points for revision ——

2010 - May [3] (c) What are the auditors responsibilities in respect of corresponding figures? (4 marks)

Answer :

As per SA 710 "Comparatives Information-Corresponding figures, and Comparative Financial Statements", the auditors responsibilities in respect of corresponding figures are as follows:

1. The auditor should obtain sufficient appropriate audit evidence that the corresponding figures meet the requirements of the relevant financial reporting framework. The extent of audit procedure performed on the corresponding figures is significantly less than that for the audit of current period figures and is ordinarily limited to ensuring that the corresponding figures have been correctly reported and are appropriately classified. This involves the auditor assessing whether:
   (a) accounting policies used for corresponding figures are consistent with those of the current period or whether appropriate adjustments and/or disclosures have been made and
   (b) corresponding figures agree with the amounts and other disclosures presented in the prior period or whether appropriate adjustments and/or disclosures have been made.
2. When the financial statements of the prior period have been audited by another auditor, the incoming auditor should assess whether the corresponding figures meet the conditions specified above.
3. When the financial statements of the prior period have not been audited, the incoming auditor nonetheless should assess whether the corresponding figures meet the conditions specified above.
4. If the auditor becomes aware of a possible material misstatement in the corresponding figures when performing the current period audit, the auditor should perform such additional procedures as are appropriate in the circumstances.

Space to write important points for revision

2010 - May [3] (d) IT systems also pose specific risks to an entity's internal control ? What are those risks ? (4 marks)

Answer:

Specific Risk to an Entity's Internal Control :

As per **SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment"**, IT system also poses specific risks to an entity's Internal Control.

They are:

1. Reliance on systems or programs that are inaccurately processing data, processing inaccurate data or both
2. Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorized or non existent transactions, or inaccurate recording of transactions. Particular risk may arise when multiple users access a common database.
3. The possibility of IT personnel gaining access beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
4. Unauthorised changes to data in Master files
5. Unauthorised changes to systems or programs.
6. Failure to make necessary changes to systems or programs.
7. In appropriate manual intervention
8. Potential loss of data or inability to access data as required.

Space to write important points for revision

2010 - Nov [3] (b) While doing audit, Ram, the Auditor requires reports from experts for the purpose of Audit evidence. What types of reports/opinions he can obtain and to what extent he can rely upon the same ? (4 marks)

Answer :

As per **SA 620, "Using the Work of an Auditor's Expert"**, during the audit, the auditor may seek to obtain, in conjunction with the client or independently, audit evidence in the form of reports, opinions, valuations and statements of an expert.

While doing audit, Ram, the auditor can obtain the following types of reports, or options or statements of an expert for the purpose of audit evidence:

- Valuations of certain types of assets, for example, land and buildings, plant and machinery, works of art, and precious stones.
- Determination of quantities or physical condition of assets, for example, minerals stored in stockpiles, mineral and petroleum reserves, and the remaining useful life of plant and machinery.
- Determination of amounts using specialised techniques or methods, for example, an actuarial valuation.
- The measurement of work completed and to be completed on contracts in progress for the purpose of revenue recognition.
- Legal opinions concerning interpretations of agreements, statutes, regulations, notifications, circulars, etc.

Extent:

When the auditor intends to use the work of an expert, he should seek reasonable assurance that the expert's work constitutes appropriate audit evidence in support of the financial information, by considering the sufficiency, relevance and reliability of source data used, the assumptions and methods used and, if appropriate, their consistency with the prior period, and the results of the expert's work in the light of the auditor's overall knowledge of the business and of the results of his audit procedures.

Overall objectives of Independent Auditor and the conduct of an Audit in accordance with standards on auditing also states that when the auditor uses work performed by experts, he will continue to be responsible for forming and expressing his opinion on the financial information. However, he will be entitled to rely on work performed by others, provided he exercises adequate skill and care and is not aware of any reason to believe that he should not have so relied.

—— Space to write important points for revision ——

2011 - May [1] {C} (b) In the course of audit of T Ltd., the audit team is not sure of the possible source of misstatements in the financial statements. As the audit manager identify the sources of misstatements. (4 marks)

Answer:

According to SA 450 "Evaluation of Misstatements Identified during the Audit", misstatements may result from

1. An inaccuracy in collecting or processing data by which the financial statements are prepared.
2. An omission of an amount which should have been disclosed.
3. An accounting estimate incorrect due to overlooking or clear misinterpretation of facts.
4. Judgements of management concerning accounting estimates that the auditor considers unreasonable.
5. The selection and application of accounting policies that the auditor considers inappropriate.

—— Space to write important points for revision ——

2011 - May [1] {C} (c) While auditing Z Ltd., you observe certain material financial statement assertions have been based on estimates made by the management. As the auditor how do you minimize the risk of material misstatements? (6 marks)

Answer:

According to SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor should assess the following with relation to identification and assessment of the risk of material misstatement.

1. The requirements of the applicable financial reporting framework relevant to the accounting estimates, including related disclosures.
2. How is the Management identifying those transactions, events and conditions that might give rise to the need for, accounting estimates to be recognised or disclosed , in the financial statement.
3. In obtaining this understanding, the auditor shall make inquiries of management about changes in circumstances that may give rise to new, or the need to revise existing, accounting estimates.
4. The estimation making process adopted by the management including
   (i) The method, including where applicable the model, used in making the accounting estimates

(ii) Relevant controls
(iii) Whether management has used an expert ?
(iv) The assumption underlying the accounting estimates
(v) Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, and if so, why; and
(vi) Whether and, if so, how the management has assessed the effect of estimation uncertainty.

—— Space to write important points for revision ——

2011 - May [3] (b) Y Ltd. engaged an actuary to ascertain its employee cost, gratuity and leave encashment liabilities. As the auditor of Y Ltd., you would like to use the report of the actuary as an audit evidence. How do you evaluate the work of the actuary ? (8 marks)

Answer:

Actuary work evaluation:

As per AS-500 "Audit Evidence", the auditor should evaluate following:

- Evaluate the competence, capabilities and objectivity of that expert;
- obtain an understanding of the work of that expert;
- Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.

The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as personal experience with previous work of that expert, discussion with that expert knowledge of expert's qualification etc.

Auditor should also evaluate:

- Relevance and reasonableness of expert's finding or conclusions, consistency with audit evidence etc;
- Expert's relevance and reasonableness of assumptions and methods etc.

—— Space to write important points for revision ——

2011 - Nov [6] (b) State briefly the basic elements of Management Representation Letter. (2 marks)

Answer :

Basic Elements of a Management Representation Letter:

As per **SA 580 "Written Representation",** some of the basic elements of a Management Representation letter are :

1. It is a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence.
2. It does not include financial statements, the assertions therein, or supporting books and records.
3. Auditor shall request management to provide a written representation that it has fulfilled its responsibility regarding preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation, as set out in the terms of the audit engagement.
4. The written representations shall be for all financial statements and period (s) referred to in the auditor's report.

—— Space to write important points for revision ——

2012 - May [1] {C} (c) In the course of the statutory audit of Z Ltd, its statutory auditors, having determined that the work of internal auditor is likely to be adequate for the purpose of statutory audit, wanted to use the work of internal auditor in respect of physical verification of fixed assets. How an evaluation of this specific work done by the internal auditor can be done? (5 marks)

Answer:

Using Specific Work of the Internal Auditors

As per SA 610, "Using the Work of the Internal Auditors",

In order for the external auditor to use specific work of the internal auditors, the external auditor shall evaluate and perform audit procedures on that work to determine its adequacy for the external auditor's purposes.

The nature, timing and extent of the audit procedures performed on specific work of the internal auditors will depend on the external auditor's assessment of the risk of material misstatement, the evaluation of the internal audit function, and the evaluation of the specific work of the internal auditors.

Such audit procedures may include:

- Examination of items already examined by the internal auditors;
- Examination of other similar items; and
- Observation of procedures performed by the internal auditors.

To determine the adequacy of specific work performed by the internal auditors for the external auditor's purposes, the external auditor shall evaluate whether:

(a) The work was performed by internal auditor having adequate technical training and proficiency;

(b) The work was properly supervised, reviewed and documented;

(c) Adequate audit evidence has been obtained to enable the internal auditors to draw reasonable conclusions;

(d) Conclusions reached are appropriate in the circumstances and any reports prepared by the internal auditors are consistent with the results of the work performed; and

(e) Any exceptions or unusual matters disclosed by the internal auditors are properly resolved.

Space to write important points for revision

2012 - May [4] (a) In the course of audit of Q Ltd. its statutory auditor wants to be sure of the adequacy of related party disclosures? Kindly guide the auditor in identifying the possible source of related party information.

(8 marks)

Answer:

Identification of Related Parties:

As per SA 550 "Related Parties" the auditor shall remain alert, when inspecting records or documents with respect to arrangements or information indicating the existence of related party relationships or transactions, not previously identified or disclosed to the auditor.

The auditor shall inquire of management regarding:

(a) The identity of the entity's related parties, including changes from the prior period;

(b) The nature of the relationships between the entity and these related parties; and

(c) Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.

The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to:

(a) Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;
(b) Authorise and approve significant transactions and arrangements with related parties; and (Ref: Para. A21)
(c) Authorise and approve significant transactions and arrangements outside the normal course of business.

During the audit, the auditor may inspect records documents that may provide information about related party relationship and transactions, for example

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and TCWG.
5. Records of the entity's investments and those of its pensions plans.
6. Contracts and agreements with key management or TCWG.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Specific invoices and correspondence from the entity's professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.
11. Internal auditors' reports.
12. Documents associated with the entity's filings with a securities regulator (for example, prospectuses).

2012 - May [6] (c) In the course of audit of A Ltd. you suspect the management has indulged in fraudulent financial reporting? State the possible source of such fraudulent financial reporting. (6 marks)

Answer:

As per SA - 240, "The Auditor's responsibilities relating to fraud in an audit of Financial Statement", the possible source of such fraudulent financial reporting are as follows:

1. Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
2. Inappropriately adjusting assumptions and changing judgements used to estimate account balances.
3. Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
4. Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.
5. Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
6. Altering records and terms related to significant and unusual transactions.
7. Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).

Space to write important points for revision

2012 - Nov [3] Comment on the following:

(a) While carrying out the statutory audit of a large entity, what are the substantive procedures to be performed to assess the risk of material misstatement? (8 marks)

Answer :

Substantive procedures to be performed to assess the risk of material misstatement:

As per **SA 330, “The Auditor’s Responses to Assessed Risks”**, substantive procedure is an audit procedure designed to detect material misstatements at the assertion level. They comprise tests of details and substantive analytical procedures.

- **Test of Details:**
  Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance, and disclosure. This requirement reflects the facts that: (I) the auditor’s assessment of risk is judgmental and so may not identify all risks of material misstatement; and (ii) there are inherent limitations to internal control, including management override.
- **Substantive Analytical Procedure:**
  Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. SA 520, “Analytical Procedures” establishes requirements and provides guidance on the application of analytical procedures during an audit.
- Thus, the auditor may determine that:
  1. Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level.
  2. Only tests of details are appropriate.
  3. A combination of substantive analytical procedures and tests of details are most responsive to th e assessed risks.

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2012 - Nov [4] Answer the following:

(b) Under the applicable Standards on Auditing, in what circumstances does the report of the statutory auditor require modifications? What are the types of modifications possible to the said report? (8 marks)

Answer :

Modified Audit Report :

According to SA 700 (Revised), Forming an Opinion and Reporting on Financial Statements, under following situations Auditor's Report may have to be modified

- If the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatements; or
- If the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatements.

Types of Modifications:

Matters that do affect the auditor's opinion: For such matters, he can provide any of following as per stated criterion :

1. A **'qualified opinion'** should be expressed when the auditor concludes that an unqualified opinion cannot be expressed but that the effect of any disagreement with the management is not so material and pervasive as to require an adverse opinion, or limitation on scope is not material and pervasive as to require a disclaimer of opinion.
2. A **'disclaimer of opinion'** should be expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor is unable to obtain sufficient appropriate audit evidence and is thus unable to express an opinion on the financial statements.
3. An **'adverse opinion'** should be expressed when the disagreement with management is so material and pervasive to the financial statements that the auditor concludes that a qualification of the report is inadequate to disclose the misleading or incomplete nature of the financial statements.

2012 - Nov [5] Answer the following:

(b) As an auditor how will you verify the existence of Related Parties? (8 marks)

Answer :

Please refer 2012 - May [4] (a) on page no. 36

—— Space to write important points for revision ——

2013 - May [3] (b) In audit plan for T Ltd., as the audit partner you want to highlight the sources of misstatements, arising from other than fraud, to your audit team and caution them. Identify the sources of misstatements. (4 marks)

Answer :

Please refer 2011 - May [1] {C} (b) on page no. 32

—— Space to write important points for revision ——

2013 - May [3] (d) R & Co., a firm of Chartered Accountants have not revised the terms of engagements and obtained confirmation from the clients, for last 5 years despite changes in business and professional environment. Please elucidate the circumstances that may warrant the revision in terms of engagement. (4 marks)

Answer:

SA-210 on "Agreeing the Terms of Audit Engagements", the auditor may decide not to send a new audit engagement letter or other written agreement each period.

However, the following factors may make it appropriate to revise the terms of audit engagement or to remind the entity of existing terms:

1. An indication that the entity misunderstands the objective and scope of the audit.
2. Any revised or special terms of the audit.
3. A recent change of senior management in the organisation structure.
4. A significant change in ownership of the enterprise.
5. A significant change in nature or size of the entity's business.

6. A change in legal or regulatory requirement.
7. A change in the financial reporting framework adopted in the preparation of the financial statements.
8. A change in reporting requirements.

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2013 - Nov [2] (d) Mr. X was appointed as the auditor of M/s Easy go Ltd. and intends to apply the concept of materiality for the financial statements as a whole. Please guide him as to the factors that may affect the identification of an appropriate benchmark for this purpose. (4 marks)

Answer:

Use of Benchmark in determining materiality SA 320 on "Materiality in Planning and Performing an Audit", prescribes the use of Benchmarks in determining materiality for the financial statements as a whole.

Determining materiality involves the exercise of professional judgement. **Factors that may affect the identification of an appropriate benchmark include the following:**

(i) The elements of the financial statements (for example, assets, liabilities, equity revenue, expenses);

(ii) Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);

(iii) The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;

(iv) The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and

(v) The relative volatility of the benchmark.

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2013 - Nov [3] (c) In the audit of Hotel Great Stay Ltd. its auditor wants to use the analytical procedure as substantive procedure in respect of room rental income as well as payroll costs. Guide him as to how it can be done. (4 marks)

Answer:

According to provisions of **SA 520 on "Analytical Procedures"**, in some cases, even an unsophisticated predictive model may be effective as an analytical procedure.

In case of Payroll cost - Where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy.

In case of Room Rental Income of Hotel - Different types of analytical procedures provide different levels of assurance. It can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified.

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2014 - Nov [1] {C} (c) Discuss the impact of uncorrected misstatements identified during the audit and the auditor's response to the same. (5 marks)

Answer:

As per SA-450, "Evaluation of misstatements identified during the Audit", the Auditor has to consider the impact of identified mistakes/misstatement on the audit. Whether on the basis of these identified misstatements the original audit programme needs modification.

There may be some mistakes which were identified and colleted during the audit process by the auditor but remain uncorrected, the auditor has to evaluate the impact of these uncorrected misstatement on the financial statements.

As per SA 320, "Materiality in Planning and performing an Audit," the aggregate of uncorrected misstatements comprises:

1. specific misstatements identified by the auditor including the net effect of uncorrected misstatements identified during the audit of previous periods; and
2. the auditors' best estimate of other misstatements which cannot be specifically identified (that is, projected errors).

The auditor have to determine whether uncorrected misstatements are material, individually or when considered together with other misstatements accumulated during the audit.

Impact of Misstatements: If the aggregate of the uncorrected misstatements that the auditor has identified approaches the materiality level, or if auditor determines that the aggregate of uncorrected misstatements causes the financial information to be materially misstated, he should consider requesting the management to adjust the financial information or extending his audit procedures. In any event, the management may want to adjust the financial information for known misstatements. The adjustment of financial information may involve, for example, application of appropriate accounting principles, other adjustments in amounts, or the addition of appropriate disclosure of inadequately disclosed matters. If the management refuses to adjust the financial information and the results of extended audit procedures do not enable the auditor to conclude that the aggregate of uncorrected misstatements is not material, the auditor should express a qualified or adverse opinion, as appropriate.

Further:

- The auditor shall communicate with those charged with governance. Uncorrected misstatements and the effect that they, individually or in aggregate may have an opinion in the auditor's report.
- The auditor shall request a written representation from management and where appropriate, those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statements as a whole.

2014 - Nov [2] (c) Describe the principal methods of selection of samples. (4 marks)

Answer:

According to **SA 530 "Audit Sampling"**, the principal methods of selecting samples are the use of random selection, systematic selection, monetary unit sampling selection, haphazard selection and block selection.

Methods of sampling

1. **Random sampling:** This method of sampling is easy to operate types (a) simple Random or (b) stratified Random.
2. **Interval sampling:** samples following an interval will be selected types (a) Block sampling or (b) Cluster sampling
3. **Monetary unit sampling/value** weighted selection (i.e. selecting high value items for verification)
4. **Haphazard selection:** This is a Non-statistical method of sampling, by which auditor selects the samples by his own choice.
5. **Block selection:** This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

—— Space to write important points for revision ——

2014 - Nov [3] (d) Discuss the Auditor's responsibility to provide access to his audit working papers to Regulators and third parties. (3 marks)

Answer:

Auditors responsibility to provide access to his audit working papers to regulators and third parties:

- Working papers are the property of the Auditor and the Auditor should adopt reasonable procedures for custody and confidentiality of his working papers.

- He should retain them for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirement of record retention.
- Working papers should be properly filed, in order to ensure that they are easily retrievable.
- In case of recurring audits, some working paper files may be classified as permanent file or current file.
- Working papers of the Auditor constitute his property and should not be provided to client. However, the Auditor may at his discretion, if considered appropriate, make portion of or extracts from his working papers available to the client.

Clause (1) of Part I of Second Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of his client or otherwise than as required by law for the time being in force.

SA 200 on "Overall Objectives of the Independent Auditor and the conduct of an audit in accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of the information obtained and should not disclose any such information to any third party without specific authority or unless there is a legal or professional duty to disclose".

If there is a request to provide access by the regulator based on the legal requirement, the same has to be complied with after informing the client about the same.

Standard on Quality Control (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. 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.

As per SA 230, Audit Documentation serves a number of additional purposes, including the enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.
Therefore, it is auditor's responsibility to provide access to his audit working papers to Regulators whereas it's at auditor's discretion, to make portions of or extract from his working paper to third parties.

—— Space to write important points for revision ——

2014 - Nov [4] (d) In the course of your audit you have come across a related party transaction which *prima facie* appears to be biased. How would you deal with this? (4 marks)

Answer:

As per SA 550 on, "Related Parties", the auditor should review information provided by the management of the entity identifying the name of all known related parties and for this purpose, he may inspect records or documents that may provide information about related party relationships and transactions.
In this case, the auditor is finding a related party transaction which *prima facie* appears to be biased. So, the auditor is required to confirm the same.
For identified significant related party transactions outside the entity's normal course of business, the auditor shall inspect the underlying contracts or agreements, if any, and evaluate whether:

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

In addition, the auditor needs to be alert for transactions which appear unusual in the circumstances and which may indicate the existence of previously unidentified related parties. Where the applicable financial reporting framework establishes related party requirements, the auditor shall obtain written representations from management and where appropriate, those charged with governance that they have disclosed to the auditor the identity of the entity's related parties and all the related party relationships and transactions of which they are aware; and they have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirements of the framework.

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2015 - May [1] {C} (c) When a sub-service organization performs services for a service organization, there are two alternative methods of presenting the description of controls. The service organization determines which method will be used. As a user auditor what information would you obtain about controls at a sub-service organization? (5 marks)

Answer:

In accordance with **SA 402 "Audit Considerations relating to an Entity Using a Service Organisation"**, a user entity may use a service organisation that in turn uses a sub-service organisation to provide some of the services provided to a user entity that are part of the user entity's information system relevant to financial reporting.

Report on the description and design of controls at a service organisation (Called as Type 1 Report):

A report given by Service Auditor to user Entity's Auditor that comprises:

1. A description, prepared by Management of the service organization, of the service organization's system, control objectives and related controls that have been designed and implemented as at a specified date, and
2. A report by the Service Auditor, with objective of conveying reasonable assurance that includes the Service Auditor's opinion on the description of the Service Organization's System, control objectives and related controls and the suitability of the design of the controls to achieve the specified control objectives.

Report on the description, design and operating effectiveness of controls at a service organization (called as Type 2 Report)

A report given by Service Auditor to user Entity's Auditor that comprises:

1. A description, prepared by management of the service organization, of the service organization's system, control objectives and related controls, their design and implementation as at a specified date or throughout a specified period and in some cases, their operating effectiveness throughout a specified period, and
2. A report by the Service Auditor with the objective of conveying reasonable assurance that includes:
   (i) The service Auditor's opinion on the description of the Service Organization's System, control objectives and related controls, the suitability of the design of the controls to achieve the specified control objectives and the operating effectiveness of the controls, and
   (ii) A description of the Service Auditor's tests of the controls and the results thereof.

If the Type 1 or Type 2 report excludes the control at a sub-service organization and the services provided by the sub-service organization are relevant to the audit of the user entity's financial statements, the user auditor is required to apply the requirements of the SA 402 in respect of the sub-service organization.

The nature and extent of work to be performed by the user auditor regarding the services provided by a sub-service organization depend on the nature and significance of those services to the user entity and relevance of those services to the audit.

—— Space to write important points for revision ——

2015 - Nov [1] {C} (a) Mr. A, a practicing Chartered Accountant, has been appointed as an auditor of True Pvt. Ltd. What factors would influence the amount of working papers required to be maintained for the purpose of his audit? (5 marks)

Answer:

Working papers are the material that auditors prepare or obtain and retain in connection with the performance of the audit. It may be in the form of data stored on paper, film, electronic media, or other media. They can also be used in Court as evidence.

Reasons in preparing Working Papers:

1. Basis for planning the audit.
2. Record the evidences accumulated and the results of the audit.
3. Data for determining the proper type of Audit Report.
4. Basis for review by supervisors and partners.

In this case, Mr. A, CA has been appointed as an Auditor of True Pvt. Ltd. The factors that influence the amount of working papers required to be maintained for the purpose of audit are :

Factors and Content of Working Papers: As per SA 230 'Audit Documentation', the amount of Audit working paper and content depend on the following factors:

1. The size and complexity of the entity.
2. The nature of the audit procedure to be performed.
3. The identified risk of material misstatement.
4. The significance of the audit evidence obtained.
5. The nature and extent of exceptions identified.
6. The audit methodology and tool used.

These are the factors required to be maintained by Mr. A, CA for the purpose of his Audit.

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2015 - Nov [1] {C} (c) "If inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence of inventory by attending the physical inventory counting unless impracticable." Discuss. (5 marks)

Answer:

SA 501"Audit Evidence - specific Considerations for Selected Items", requires from the auditor that when inventory is material to the financial statements, he shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by attendance at physical inventory counting, unless impracticable, to:

(a) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
(b) Observe the performance of management's count procedures;
(c) Inspect the inventory; and
(d) Perform test counts;

Attendance at physical inventory counting involves:

(a) Inspecting the inventory to ascertain its existence and evaluate its condition, and performing test counts;
(b) Observing compliance with management's instructions and the performance of procedures for recording and controlling the results of the physical inventory count; and
(c) Obtaining audit evidence as to the reliability of management's count procedures.

These procedures may serve as test of controls or substantive procedures depending on the auditor's risk assessment, planned approach and the specific procedures carried out.

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2015 - Nov [2] (c) The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, what are the relevant criteria which determine whether the data is reliable for the purposes of designing substantive analytical procedures? (4 marks)

Answer:

Analytical procedures is a substantive technique which can be used at:

- Initial planning stage of the audit.
- During the course of the detailed audit work.
- At or near the completion of the audit when reviewing the financial statements.
- These are the relevant criteria which determine whether the data is reliable for the purposes of designing substantive analytical procedures.

SA 520 on 'Analytical Procedures' provides that the reliability of data is influenced by its sources and nature and is dependent on the circumstances under which it is obtained.

Reliability of Data to be compared:

- Sources of information available (e.g. It is more reliable if obtained from some independent source.)
- Relevance of the data available (budget should be realistic).
- Comparability of information available (entities should be realistic.)
- Control over preparation of information.

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2015 - Nov [2] (d) JY & Co. is appointed as auditor of Breeze Ltd. JY & Co. seeks your guidance for reviewing the records and documentation of the company regarding 'related party transactions in the normal course of business'. Describe the steps to be followed. (4 marks)

Answer:

Please refer 2012 - May [4] (a) on page no. 36

—— Space to write important points for revision ——

2016 - May [1] {C} (a) Mr. Z who is appointed as auditor of Elite Co. Ltd. wants to use confirmation request as audit evidence during the course of audit. What are the factors to be considered by Mr. Z when designing a confirmation request? Also state the effects of using positive external confirmation request by Mr. Z. (5 marks)

Answer :

As per SA 505, "External Confirmation", following factors to be considered when designing confirmation request:

1. The assertions being addressed .
2. Specific identified risks of material misstatement, including fraud risks.
3. The layout and presentation of the confirmation request.
4. Prior experience on the audit or similar engagements.
5. The method of communication.
6. Management's authorisation or encouragement to the confirming parties to respond to the auditor.

Effects of using positive external confirmation request:

- Positive external confirmation request asks the confirming party to reply to the auditor in all cases.
- More reliable and authentic reply can be received.
- Reply or confirmation can be received even if replying party disagree with some points.

—— Space to write important points for revision ——

2016 - May [1] {C} (b) R & M Co. wants to be alert on the possibility of non-compliance with Laws and Regulations during the course of audit of SRS Ltd. R & M Co. seeks your guidance for identifying the indications of non compliance with Laws and Regulations. (5 marks)

Answer :

Indications of non Compliance with Laws and Regulations:

As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor shall perform the audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements by inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and Inspecting correspondence, if any, with the relevant licensing or regulatory authorities.

Following are indicators:

- Investigation by regulatory organisation and government departments.
- Payment of fines or penalties.
- Payments for unspecified services or loan to consultant, related parties, employees or government employees.
- Purchase at price significantly above or below market price.
- Unusual payments towards legal and retainer ship fees.
- Unusual payment in cash.

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2016 - May [2] (a) ENP Ltd. engaged an actuary to ascertain its employee cost, gratuity and leave encashment liabilities. As an auditor of ENP Ltd., you would like to use the report of the actuary as an audit evidence. How would you evaluate the work of the actuary? (4 marks)

Answer:

Actuary work evaluation:

Please refer 2011 - May [3] (b) on page no. 34

—— Space to write important points for revision ——

2016 - Nov [1] {C} (a) Mr. Ram, an auditor, identified some events that cast significant doubt on the entity's ability to continue as a going concern. What are the additional procedures he should perform as per the related Standard on Auditing? (5 marks)

Answer:

Additional Audit Procedures when events or conditions are identified:

As per SA 570 (Revised) "Going Concern", when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors.

These procedures shall include:

(i) **Management's Assessment:**
When 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 Future Plans:**
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. Evaluating management's plant's for future actions may include inquiries of management as to its plans for future action, including, for example, its plans to liquidate assets, borrow money or restructure or delay expenditures, or increase capital.

(iii) **Analysing Financial Aspects:**
Analysing and discussing cash flow, profit and other relevant forecasts with management. Analysing and discussing the entity's latest available interim financial statements. Reading the terms of debentures and loan agreements and determining whether any have been breached. Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties. The prospective financial information for recent prior periods with historical results, and the prospective financial information for the current period with results achieved to date.

(iv) **Enquiring Legal Aspects:**
Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications.
Confirming the existence, legality and enforceability of such arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds.

Space to write important points for revision

2016 - Nov [1] {C} (b) Mr. Mohan, an auditor of KTEN Limited wants to use the work of an expert. With reference to the Standard on Auditing state the factors which suggest the need for detailed and written agreement between the auditor and the auditor's expert. (5 marks)

Answer:

As per SA 620, "Using the work of an Auditor's expert", some matters noted in paragraph 8 may affect the level of detail and formality of the agreement between of auditor and the auditor's expert, including whether it is appropriate that the agreement be in writing for example the following factors may suggest the need for more a detailed agreement than would otherwise be the case, or for the agreement to be set out in writing.

- The auditor's expert will have access to sensitive or confidential entity information.

- The respective roles or responsibility of the auditor and the auditor's expert are different from those normally expected.
- Multi-jurisdictional legal or regulatory requirements apply.
- The matter to which the auditor's expert's work relates is highly complex.
- The greater the extent of the auditor's expert's work, and its significance in the context of the audit.

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2016 - Nov [1] {C} (c) With reference to the Standards on Auditing state the examples of accounting estimates that may have a high estimation uncertainty. (5 marks)

Answer:

Examples of Accounting Estimates that may have a High Estimation Uncertainty: As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures", the auditor shall determine whether, in the auditor's judgment, any of those accounting estimates that have been identified as having high estimation uncertainty give rise to significant risks.

For some accounting estimates, however, there may be relatively high estimation uncertainty, particularly where they are based on significant assumptions, for example:

- Accounting estimates relating to the outcome of litigation.
- Fair value accounting estimates for derivative financial instruments not publicly traded.
- Fair value accounting estimates for which a highly specialised entity-developed model is used or for which there are assumptions or inputs that cannot be observed in the marketplace.

—— Space to write important points for revision ——

2016 - Nov [1] {C} (d) Is it appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it? Discuss. (5 marks)

Answer:

Auditor to make Inquiries regarding Management's own Assessment of Risk of Fraud and Controls:

As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", management accepts responsibility for the entity's internal control and for the preparation of the entity's financial statements. Accordingly, it is appropriate for the auditor to make inquiries of management regarding management's own assessment of the risk of fraud and the controls in place to prevent and detect it. The nature, extent and frequency of management's assessment of such risk and controls may vary from entity to entity.

The auditor shall make inquiries of management regarding:

(a) Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments;

(b) Management's process for identifying and responding to the risk of fraud in the entity, including any specific risks of fraud that management has identified or that have been brought to its attention, or classes of transactions account balances, or disclosures for which a risk of fraud is likely to exist;

(c) Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity; and

(d) Management's communication, if any, to employees regarding its views on business practices and ethical behavior.

—— Space to write important points for revision ——

2017 - May [2] (c) The auditor should select sample items in such a way that the sample can be expected to be representative of the population. Comment. (5 marks)

Answer:

Selection of the sample:

As per SA 530, 'Audit Sampling' the auditor should select sample items in such a way that the sample can be expected to be representative of the population.

The principal methods of sampling are :
- Random selection
- Systematic selection
- Monetary units
- Haphazard selection
- Block selection

There are two major methods in which the size of the sample and the selection of individual items of the sample are determined. These methods are statistical and non-statistical sampling.

1. **Statistical sampling:**
   - A method of Audit sampling wherein the auditor selects the sample randomly.
   - This is a method of audit testing which is more scientific than testing based entirely on the auditor's own judgement because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.
   - Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, debtors' confirmation, payroll checking, vouching of invoices and petty cash vouchers.
2. **Non-statistical sampling:**
   - A method of Audit Sampling where in the auditor selects sample size which is neither random selection nor based on use of theory of probability.
   - Under this method, the sample size and its composition are determined on the basis of the personal experience and knowledge of the auditor.
   - This method has been in common application for many years because of its simplicity in operation.
   - Traditionally, the auditor on the basis of his personal experience will determine the size of the sample and express it in terms that number of pages or personal accounts in the purchases or sales ledger to be checked. For example, March, June & September may be selected

in year one and different months would be selected in the next year. An attempt would be made to avoid establishing a pattern of selection year after year to maintain an element of surprise as to what the auditor is going to check. It is a common practice to check large number of items towards the close of the year so that the adequacy of cut-off procedures can also be determined.

—— Space to write important points for revision ——

2017 - May [3] (a) Describe the principal method of design of the samples and its evaluation. (4 marks)

Answer:

Principal Method of Design of Samples

As per SA 530 "Audit Sampling", when designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose.

In designing an audit sample, the auditor has to consider the following:

1. **Audit objectives:** Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn.
2. **Population:** The population is the entire set of data from which the auditor wishes to sample in order to reach a conclusion. The auditor determines that the population from which he draws the sample is appropriate for the specific audit objective. Population must be sufficiently large. The system which produces the records to be tested must be sufficiently reliable. All items within a particular population must be homogeneous and must be identifiable and accessible.
3. **Confidence level:** The reliability referred to is unusually termed the confidence level. More precisely, in an auditing context, it is the mathematical probability that the misstatement rate in the sample will not differ from the error rate in the population by more than a stated amount.
4. **Precision:** The precision may be defined with which we can describe the attributes of a given population.

5. **Evaluating Results of Audit Sampling:** The auditor shall evaluate:
   (i) The results of the sample; and
   (ii) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

   If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:
   - Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or
   - Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance.

—— Space to write important points for revision ——

2017 - May [4] (a) Explain briefly the duties and responsibilities of an auditor in case of material misstatement resulting from management fraud.

(6 marks)

Answer:

Please refer 2009 - Nov [4] (c) on page no. 23

—— Space to write important points for revision ——

2017 - Nov [3] (c) The auditor of XY & Co. Ltd. has intimated the management that certain misstatements identified during the course of audit need to be corrected. As an auditor, discuss the impact of such misstatements in case the management does not carry out the said corrections. (5 marks)

Answer:

- **As per SA - 450, "Evaluation of Misstatements identified during the audit",** if the auditor identifies any misstatements during the audit then he shall require to communicate such misstatement to TCWG or appropriate level of management.

- In the present case, the auditor of XY & Co. Ltd. has intimated the management that certain misstatements identified during the course of audit need to be corrected. If management does not carry out the said corrections then auditor shall require to evaluate the effect of uncorrected misstatements.
- The auditor prior to evaluating the effect of uncorrected misstatements, shall reassess materially determined in accordance with SA-320 to confirm whether it remains appropriate in the context of the entity's actual financial results.
- The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate having regard to the size and nature of the misstatements and the effect of uncorrected misstatements related to prior periods on the relevant class of transactions account balances or disclosures and the financial statements as a whole.
- The auditor shall communicate with TCWG uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation with a request that uncorrected misstatements be corrected.
- The auditor shall also communicate with TCWG the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures and the financial statements as a whole.
- The auditor shall request a written representation from management and where appropriate, TCWG whether they believe the effect of uncorrected misstatements are immaterial, individually and in aggregate to the financial statements as a whole. A summary of such items shall be included in or attached to the written representation.

—— Space to write important points for revision ——

2017 - Nov [4] (c) Discuss the points and indications to be noted while examining and evaluating the 'Going Concern' assumption for an entity.

(6 marks)

Answer:

SA 570 "Going Concern", requires that while planning a performing audit procedure and in evaluating the results thereof, the auditor should consider the appropriateness of the going concern assumption underlying the preparation of the financial statements. In assessing such a risk, the auditor should examine the following indications:

(a) Financial Indications:

- Net liability or net current liability position.
- Fixed-term borrowings approaching maturity without realistic prospects or renewal or repayment; or excessive reliance on short-term borrowings to finance long-term assets.
- Indications of withdrawals of financial support by creditors..
- Negative operating cash flows indicated by historical or prospective financial statements.
- Adverse key financial ratios.
- Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- Arrears or discontinuance of dividends.
- Inability to pay trade payables on due dates.
- Inability to comply with the terms of loan agreements.
- Change from credit to cash-on-delivery transactions with suppliers.
- Inability to obtain financing for essential new product development or other essential investments.

(b) Operating Indications:

- Management intentions to liquidate the entity or to cease operations.
- Loss of key management without replacement.
- Loss of a major market, key customer(s), franchise, license, or principal supplier(s).
- Labour difficulties.
- Shortages of important supplies.
- Emergence of a highly successful competitor.

(c) Other Indications:

- Non-compliance with capital or other statutory requirements.
- Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy.
- Changes in law or regulation or government policy expected to adversely affect the entity.
- Uninsured or under insured catastrophes when they occur.

The significance of such events or conditions often can be mitigated by other factors. **For example**, the effect of an entity being unable to make its normal debt repayments may be counter-balanced by management's plans to maintain adequate cash flows by alternative means, such as by disposing of assets, rescheduling loan repayments, or obtaining additional capital. Similarly, the loss of a principal supplier may be mitigated by the availability of a suitable alternative source of supply.

—— Space to write important points for revision ——

2018 - May [5] (e) Neverpermit Limited refuses to allow you to get direct confirmation of the outstanding balances of trade receivables. You want to ensure on grounds of materiality that at least outstanding above a threshold limit needs to be confirmed and reconciliation is to be carried out before finalising the audit. If the Company does not relent, how will you respond?

(4 marks)

Answer:

- **SA 505, "External Confirmations"**, establishes standards on the auditor's use of external confirmation as a means of obtaining audit evidence. It requires that the auditor should employ external confirmation procedures in consultation with the management. The auditor may come across certain situations in which the management may request him not to seek confirmation from certain parties because of dispute with trade, receivables etc. The management for example, might make such a request on the grounds that due to a dispute with the particular trade receivable, the request for confirmation might aggravate the sensitive negotiations between the entity and the trade receivables.

- In such cases, when an auditor agrees to management's request not to seek external confirmation regarding certain trade receivable, the auditor should consider validity of grounds for such a request and access management's integrity and obtain evidence to support the same. The auditor should also ask the management to submit its request in a written form, detailing therein the reasons for such a request.
- If the auditor of Never permit Ltd. agrees to management's request not to seek external confirmation regarding a particular matter, the auditor should document the reasons for acceding to the management's request and should apply alternative procedures to obtain sufficient appropriate evidence regarding the matter. While considering the validity of request, in case of the auditor of Never permit Ltd. reaches at a conclusion that the same was not valid, he may appropriately modify the report.

—— Space to write important points for revision ——

2018 - May [6] (d) (ii) Reasonable Assurance Engagement from Limited Assurance Engagement. (4 marks)

Answer:

- Reasonable assurance is the reduction in assurance engagement risk to an acceptably low level in circumstances of engagement as a basis of a positive form of expression practitioners conclusion.
- Limited assurance is the reduction of assurance engagement risks to a level that is acceptable in the circumstances of the engagement but where that risk is greater than for a reasonable assurance engagement, as a basis of a negative form.

—— Space to write important points for revision ——

2018 - Nov [2] (d) State what may be the evaluative or review procedures that the Statutory Auditor may do before concluding as to relevance and reasonableness of Auditor's Expert work for using it for his audit purposes. (5 marks)

Answer:

The evaluative or review procedures before concluding as to relevance and reasonableness of Auditor's Expert work using for his audit purposes the auditor may perform:

1. Inquiries of the auditor's expert
2. Reviewing the auditor's experts working papers and reports
3. Corroborative procedures, such as:
   - Observing the auditor's expert's work;
   - Examining published data, such as statistical reports from reputable, authoritative sources;
   - Confirming relevant matters with third parties;
   - Performing detailed analytical procedures; and
   - Re-performing calculations.
4. Discussion with another expert with relevant expertise when, for example, the findings or conclusions of the auditor's expert are not consistent with other audit evidence.
5. Discussing the auditor's expert's report with management.

Space to write important points for revision

2018 - Nov [6] (c) A Review Report of an Auditor is negative in form in expression of conclusion-Explain. (4 marks)

Answer:

When the practitioner expresses an adverse conclusion on the financial statements, the practitioner shall, unless otherwise required by law or regulation use one of the following phases as appropriate;

(a) "Based on our review, due to the significance of the matter(s) described in the Basis for Adverse conclusion paragraph, the financial statements do not give a true and fair view (or do not present fairly, in all material aspects), in accordance with the applicable financial reporting framework", (for financial statements prepared using a fair presentation framework); or

(b) "Based on our review, due to the significance of the matter(s) described in the Basis of Adverse conclusion paragraph, the financial statements are not prepared, in all material aspects, in accordance with the applicable Financial Reporting Framework," (for financial statements prepared using a compliance framework.)

Space to write important points for revision

2020 - Nov [6] (b) In the course of audit of Quick Ltd, you suspect that the management has made misstatements in the financial statements intentionally to deceive the users and to succumb to pressures to meet market expectations. Elucidate how the fraudulent financial reporting may be accomplished and also discuss the techniques of committing fraud by management overriding controls. (5 marks)

Answer:

(b) In the given case, management of Quick Ltd has made intentional misstatements to deceive the users in order to meet market expectations. Auditor is suspecting such intentional behavior of the management and in such situations, SA 240 discusses how fraudulent financial reporting may be accomplished and also discusses techniques of committing fraud by management overriding controls.

As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements"

Fraudulent financial reporting may be accomplished by the following:

(i) Manipulation, falsification (including forgery), or alteration of accounting records or supporting documentation from which the financial statements are prepared.

(ii) Misrepresentation in or intentional omission from, the financial statements of events, transactions or other significant information.

(iii) Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation, or disclosure.

Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

(i) Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.

(ii) Inappropriately adjusting assumptions and changing judgments used to estimate account balances.

(iii) Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.

(iv) Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.

(v) Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.

(vi) Altering records and terms related to significant and unusual transactions.

—— Space to write important points for revision ——

2021 - Dec [5] (a) Mr. Agarwal, in the course of audit of PQ Limited, wants to perform external confirmation procedures to obtain audit evidence. Guide Mr. Agarwal, listing out the factors that may assist him in determining whether external confirmation procedures are to be performed as substantive audit procedures. (5 marks)

PRACTICAL QUESTIONS

2008 - Nov [1] {C} Comment on the following :

(c) You are the auditor of Easy Communications Ltd. for the year 2007-08. The inventory as at the end of the year i.e. 31.3.08 was ₹ 2.25 crores. Due to unavoidable circumstances, you could not be present at the time of annual physical verification. Under the above circumstances how would you ensure that the physical verification conducted by the management was in order? (5 marks)

Answer :

As per SA 501, "Audit Evidence-specific considerations for selected Items", the auditor should perform audit procedures, designed to obtain sufficient appropriate audit evidence during his attendance at physical inventory counting.

If the auditor is unable to be present at the physical inventory count on the date planned due to unforeseen circumstances, the auditor should take or observe some physical counts on an alternative date and where necessary, perform alternative audit procedures to assess whether the changes in inventory between the date of physical count and the period end date are correctly recorded.

The auditor would also verify the procedure adopted, treatment given for the discrepancies noticed during the physical count.

The auditor would also ensure that appropriate cut off procedures were followed by the management.

He should also get management's written representation on (a) the completeness of information provided regarding the inventory and (b) assurance with regard to adherence to laid down procedures for physical inventory.

By following the above procedure it will be ensured that the physical verification conducted by the management was in order.

—— Space to write important points for revision ——

2008 - Nov [1] {C} Comment on the following :

(d) You have been appointed as the auditor of Good Health Ltd. for 2007-08 which was audited by CA Trustworthy in 2006-07. As the Auditor of the company state the steps you would take to ensure that the Closing Balances of 2006-07 have been brought to account in 2007-08 as Opening Balances and the Opening Balances do not contain misstatements. (5 marks)

Answer:

Audit Procedure for ensuring correctness of Opening Balances:

As per **SA 510 "Initial Audit Engagements-Opening Balances",** the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by-

1. Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;

2. Determining whether the opening balances reflect the application of appropriate accounting policies; and
3. By evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or performing specific audit procedures to obtain evidence regarding the opening balances.

Being a new assignment audit evidence regarding opening balances can be obtained by perusing the copies of the audited financial statements.

For current assets and liabilities some audit evidence can ordinarily be obtained as part of audit procedures during the current period. **For example**, the collection/payment of opening balances of receivables and payables will provide audit evidence as to their existence, rights and obligations, completeness and valuation at the beginning of the period.

In respect of other assets and liabilities such as fixed assets, investments, long term debt, the auditor will examine the records relating to opening balances. The auditor may also be able to get confirmation from third parties (e.g., balances of long term loan obtained from banks).

—— Space to write important points for revision ——

2009 - May [1] {C} Comment on the following :

(a) You are appointed to compile financial statements of Y & Co. for tax purposes. During the course of work, you learn that the inventory is grossly understated. On pointing the same, the partners of Y & Co. tell you that since you are not conducting an audit, the said figures duly certified by the firm should be accepted. (5 marks)

Answer :

According to SRS 4410 "Compilation Engagements" if an accountant becomes aware of material misstatements, the accountant should persuade the management to carry out necessary amendments in the financial statements or other compiled financial information. If such amendments are not made and the financial statements are still considered to be misleading the accountant should withdraw from the engagement. Hence, in this case, there is a clear violation of SRS 4410.

Further, as per Guidance Note on Tax Audit under section 44AB of the Income Tax Act, 1961, the tax auditor should study the procedure followed by the assessee in taking the inventory of closing stock at the end of the year and the valuation thereof. The tax auditor should also examine the basis adopted for ascertaining the cost and this basis should be consistently followed. It is very necessary for an auditor to ensure that the method followed for valuation of stock results in disclosure of correct profit and gains.

Present Case:

Appointment was made to compile financial statements for tax audit purpose of Y & Co., a firm. It is Y & Co's duty to ensure that method followed for valuation of stock results in disclosure of correct profit and gains.

In this case the stock valuation was grossly understated. Consequently, disclosure of profit is also not correct. Hence, contention of the Y & Co., that you are not the conducting an audit, the said figures duly certified by the firm should be accepted is not correct.

—— Space to write important points for revision ——

2009 - May [1] {C} Comment on the following :

(c) Z Ltd. had appointed an outside expert to assess accrued gratuity liability of the company. Based on the said report, the company provides ₹ 80 lakhs as gratuity in the financial statements. (4 marks)

Answer :

As per SA 500 "Audit Evidence" when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall perform the following:

1. **Evaluate the competence, capabilities and objectivity of that expert:** For this purpose, auditor may consider his qualification, membership of a professional body or industrial association license to practice etc.
2. **Obtain an understanding of the work of that expert:** It may include areas of specialty, applicable professional standards and other legal requirements.

3. Evaluate the appropriateness of that expert's work:

With respect to following:

(i) Relevance and reasonableness of that expert findings and conclusion.

(ii) Relevance and reasonableness of assumptions and methods used; and

(iii) Relevance, completeness and accuracy of source data.

—— Space to write important points for revision ——

2009 - May [1] {C} Comment on the following :

(d) A Company's net worth is eroded and creditors are unpaid due to liquidity constraints. The management represents to the statutory auditor that the promoter's wife is expected to give an unsecured loan to meet the liquidity constraints and that negotiations are underway to secure large export orders. (4 marks)

Answer:

SA 570 "Going Concern" requires that the auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Eroded net worth and nonpayment to creditors are one of the examples of such event.

As per SA 570, when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists through performing additional audit procedures, including consideration of mitigating factors.

In this case, it is subjective, but prima-facie a mere expectation of future cash flows from the promoter's wife without any firm commitment and the possibility of an export order being negotiated, may not that be sufficient appropriate audit evidence of mitigating factors for resolving the going concerns question under SA 570, "Going Concern".

—— Space to write important points for revision ——

2009 - Nov [1] Comment on the following :

(c) Moon Limited replaced its statutory auditor for the Financial year 2008-09. During the course of audit, the new auditor found a credit item of ₹ 5 lakhs. On enquiry, the company explained him that it is a very old credit balance. The creditor had neither approached for the payment nor he is traceable. Under the circumstances, no confirmation of the credit balance is available. (5 marks)

Answer :

This is a case of external confirmation, covered by SA 505 "External Confirmation". The identity of creditor are not traceable to confirm the credit balance as appearing in the financial statement of the company. It is also not a case of pending litigation.

It might be a case that an income of ₹ 5 lakhs had been hidden in previous year/s. The statutory auditor should examine the validity of the credit balance as appeared in the company's financial statements. He should obtain sufficient evidence in support of the balance. He should apply alternative audit procedures to get documentary proof for the transaction/s and should not rely entirely on the management representation. Finally, he should include the matter by way of a qualification in his audit report to the members.

—— Space to write important points for revision ——

2009 - Nov [1] Comment on the following :

(d) The statutory audit of Fortune Limited for the year ended on 31.03.2009 was completed and auditor also submitted his report with the audited Financial Statements to the management of the company. Thereafter, the management of the company approached the auditor to revise certain items in the Financial Statements. (5 marks)

Answer :

As per the Guidance Note on Revised Accounts of Companies Before Circulation to Shareholders, management can revise its accounts after adoption on which report has been issued by the Auditors, but before circulation to the shareholders.

In the instant case, the statutory auditor should ascertain whether the original audit report along with audited accounts has been circulated to the share-holders. If not, he can issue a revised report on the amended financial statements as laid down by the said Guidance Note:

(i) For the same, the revised accounts must be re-approved by the Board of Directors of the company.

(ii) He should ask the company to return all the original copies of the earlier audit report along with the audited accounts.

(iii) The fact of revision of financial statements with reasons should be incorporated in the Directors' Report. It is neither included nor found adequately disclosed in the Director's Report, he should include the fact with figures and reasons in his revised audit report to the shareholders. He should specifically mention that it is a revised audit report.

—— Space to write important points for revision ——

2011 - May [1] {C} (a) In the course of the audit of R Ltd., the audit manager of ABC & Co. observed that R Ltd. has outsourced certain activities to an outsourcing agency. As the engagement partner guide the audit manager in the assessment of services provided by the outsourcing agency in relation to the audit. (4 marks)

Answer :

According to SA 402 "Audit Considerations relating to an Entity Using A Service Organisation" the user auditor shall obtain an understanding of how a user entity uses the services of a service organization.

It shall include an understanding of :

1. The nature of services provided by the service organisation and the significance of such services to the user entity, including its effect on the internal control of user entity.
2. The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation.
3. The degree of interaction between the activities of the service organization and those of user entity and

4. The nature of the relationship between the user entity and the service organization including the relevant contractual terms for the activities undertaken by the service organisation.

—— Space to write important points for revision ——

2011 - May [1] {C} (d) The management of S Ltd. request you not to seek confirmation from its debtors. As the auditor of S Ltd., what can be an appropriate response? (6 marks)

Answer:

SA 505 "External Confirmations", establishes standards on the auditor's use of external confirmation as means of obtaining audit evidence. If the management refuses to allow the auditor to send a confirmation request, **the auditor shall**

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

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those in charge of governance and also determine its implication for the audit and his opinion.

—— Space to write important points for revision ——

2011 - May [4] (c) Z Ltd. has its entire operations including accounting computerized. As the audit partner you are concerned about inherent and control risk for material financial statement assertions. What could be the areas you look forward for deficiencies and risk identification? (4 marks)

Answer :

The auditor in accordance with **SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment"**, should make an assessment of inherent and control risk for material financial statement assertions.

In a CIS environment the risk of a Material financial statement assertion being erroneously stated could arise from the deficiencies in the following case as:

1. Program Development and maintenance.
2. System Software support.
3. Operations including processing of data.
4. Physical CIS security.
5. Control over access to specialized utility program.

These deficiencies would tend to have a negative impact on all application systems that are processed through the computer.

—— Space to write important points for revision ——

2011 - Nov [1] {C} Comment on the following :

(a) The auditor of SS Ltd. accepted the gratuity liability valuation based on the certificate issued by a qualified actuary. However, the auditor noticed that the retirement age adopted is 65 years as against the existing retirement age of 60 years. The company is considering a proposal to increase the retirement age. (5 marks)

Answer :

Using the Work of an Expert :

As per **SA 620 "Using the Work of an Auditor's Expert"**, the expertise of an expert may be required in the actuarial calculation of liabilities associated with insurance contracts or employee benefit plans. However, the auditor has sole responsibility for the audit opinion expressed, and his responsibility is not reduced by the use of the work of an expert.

The auditor shall evaluate the adequacy of the expert's work, including the relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence as per SA 500.

If the expert's work involves use of significant assumptions and methods, then the relevance and reasonableness of those assumptions and methods and if the expert's work involves the use of source data that is significant to that expert's work the relevance, completeness, and accuracy of that source data in the circumstances must be ensured by the auditor.

Present case:

A qualified actuary has issued a certificate for gratuity liability valuation, for which retirement age adopted is 65 years against the existing retirement age of 60 years; however, the company is considering a proposal to increase the retirement age. In view of SA 500 and SA 620, the assumption made by actuary has no relevance and reasonableness as presently retirement age is 60 years. Hence the auditor should bring out the facts to the notice of management and advice the modification accordingly. If there is failure of compliance of the Same the auditor may qualify the report.

—— Space to write important points for revision ——

2012 - May [1] {C} (b) R & Co. is the statutory auditor of S Ltd. For the financial year ended on 31st March 2012, S Ltd. had disclosed in the notes (Note No. X) "The state pollution control board had ordered the closure of the company's only manufacturing plant on the ground that it is environmentally damaging, which the company had challenged in a law suit. Pending the outcome of the law suit the financial statements are prepared on a going concern basis". Further the financial statements prepared by the management of S Ltd. include financial statements of certain branches which are audited by other auditors. What are the reporting responsibilities of R & Co? (10 marks)

Answer:

SA 570 on "Going Concern" requires the auditor to consider the appropriateness of the going concern assumption underlying the preparation of the financial statements which may no longer be appropriate.

As per SA - 620 i.e. Using the work of an Auditor's Expert an Auditor during the course of an audit may have to place reliance on the work of an expert. During the course of audit, an auditor may seek to obtain, either independently or from client audit evidence by way of reports, opinions, valuations and statements of experts.

The auditor should satisfy himself regarding the experts skill and competence and consider the objectivity of the expert.

As per SA 570, pending legal proceedings is a condition that, individually may cast significant doubt about the going concern assumption.

- When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:
  (a) Adequately describe the principal events that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and
  (b) Disclose clearly that there is a material uncertainty related to going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

If adequate disclosure is made in the financial statement, the auditor shall express an unmodified opinion and include an emphasis matter para as per SA 706.

In the present situation management of S Ltd. had disclosed the above fact in the financial statement. Further, use of the going concern assumption is appropriate but a material uncertainty exists so assuming the assessment and disclosure of S Ltd. in order, R & Co. should include an Emphasis of Matter paragraph in the auditor's report.

As per Sec. 143(8) of the Companies Act, 2013, the auditor has to state that whether the report on the accounts of any branch office audited under Sec. 143 by a person other than the company's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.

Further, as per SA 600, Using the work of Another Auditor, when the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors.

2012 - Nov [1] {C} As a statutory auditor of a company, comment on the following:

(b) While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws.

(5 marks)

Answer:

Compliance with other laws

According to SA 250 (Revised), "Consideration of Laws and Regulation in an Audit of Financial Statement", the auditor shall obtain sufficient audit evidence with regards to compliance with the provisions of those laws and regulation which generally are recognised to have a direct effect on the determination of material amounts and disclosures in the financial statement including tax and labour laws.

Even if non compliance does not have direct effect but if it results in fines, litigation or other consequences, it may have to be considered for the purpose of financial statements.

Present Case:

While verifying the employee records in a company, it was found that a major portion of the labour employed was child labour. On questioning the management, the auditor was told that it was outside his scope of the financial audit to look into the compliance with other laws.

The contention of management is not correct. This is so because the cost of fine, litigation or other consequences may have material effect on the financial statement.

Auditor's Duty

- The auditor should make sure the disclosure of above fact and provision for the cost of fines, litigation for the organisation.
- If the auditor is of the view that non compliance has a material effect on the financial statement, he may express a qualified or adverse opinion on the financial statement.

2013 - May [3] (c) The auditor of H Ltd. wanted to obtain confirmation from its creditors. But the management made a request to the auditor not to seek confirmation from certain creditors citing disputes. Can the auditor of H Ltd. accede to this request? (4 marks)

Answer:

As per **SA - 505, "External Confirmation"**, the auditor should employ external confirmation procedures in consultation with the management. The auditor may come across certain situations in which the management may request him not to seek external confirmation from certain parties because of dispute as the request for confirmation might aggravate the sensitive negotiations between the Company and creditor.

In such cases, when an auditor agrees to management's request not to seek external confirmation regarding certain creditors, the auditor should consider validity of grounds for such a request and assess management's integrity and obtain evidence to support the same.

Present Case: If the auditor of H Ltd. agrees to management's request not to seek external confirmation regarding a particular matter, the auditor should document the reasons for acceding to management's request and should apply alternative procedures to obtain sufficient appropriate evidence regarding the matter. While considering the validity of request, in case the auditor of H Ltd. reaches at a conclusion that the same was not valid, he may appropriately modify the report.

—— Space to write important points for revision ——

2013 - Nov [1] {C} (b) G Ltd. is a mobile phone operating company. Barring the marketing function it had outsourced the entire operations like maintenance of mobile infrastructure, customer billing, payroll, accounting functions, etc. Assist the auditor of G Ltd. as to how he can obtain an understanding of how G Ltd. uses the services of the outsourced agency in its operations. (5 marks)

Answer:

Please refer 2011 - May [1] {C} (a) on page no. 73

—— Space to write important points for revision ——

2013 - Nov [1] {C} (d) M/s Honest Limited has entered into a transaction on 5th March, 2013, near year-end, whereby it has agreed to pay ₹ 5 lakhs per month to Mr. Y as annual retainer-ship fee for "engineering consultation". No amount was actually paid, but ₹ 60 lakhs is provided in books of account as on March 31, 2013.

Your inquiry elicits a response that need-based consultation was obtained round the year, but there is no documentary or other evidence of receipt of the service. As the auditor of M/s Honest Limited, what would be your approach? (5 marks)

Answer:

SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" relates to any fraud can be committed by management overriding controls using such techniques as Recording Fictitious Journal Entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.

Accordingly, the auditor would adopt the following approach:

If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters some exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor should:

1. Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted.
2. Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment in some cases.
3. If the auditor withdraws:
   (i) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal.
   (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

Reporting Under Companies Act, 2013:

Sec. 143(12) of the Companies Act, 2013 read with Rule 13 of Companies (Audit & Auditors) Rules, 2014 requires that if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the audit committee within 2 days of his knowledge (as amount involved is less than ₹ 1 Cr.) mentioning the following:

(i) Nature of fraud with description;
(ii) Approximate amount involved; and
(iii) Parties involved etc.

Reporting Under CARO 2020

The auditor is also required to report as per Clause (xi) of paragraph 3 of CARO 2020, if there is any fraud on or by the company has been noticed during the year.

—— Space to write important points for revision ——

2014 - May [1] {C} (a) ABC Company files a law suit against Unlucky Company for ₹ 5 crores. The Attorney of Unlucky Company feels that the suit is without merit, so Unlucky Company merely discloses the existence of the law suit in the notes accompanying its financial statements. As an auditor of Unlucky Company, how will you deal with the situation? (5 marks)

Answer :

As per **AS 29 "Provisions, Contingent liabilities and Contingent Assets",** a contingent liability is a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise.

Further, future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the event will occur.

As per **SA 570 "Going Concern",** there are certain examples of events or conditions that, individually or collectively, may cast significant doubt about the going concern assumption. Pending legal or regulatory proceedings against the entity that may, if successful, result in claims that the entity is unlikely to be able to satisfy is one of the example of such event.

When the auditor concludes that the use of the going concern assumption is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements adequately describe the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

Present Case:

ABC Company has filed a law suit against Unlucky Company for ₹ 5 crores. Though, the attorney of Unlucky Company feels that the suit is without merit so the company merely discloses the existence of law suit in the notes accompanying its financial statements. But the auditor may evaluate the source data on which basis the opinion is formed. If the auditor finds the uncertainty, he may request the management to adjust the sum of ₹ 5 crores by making provision for expenses as per AS 29. If the management does not accept the request the auditor should qualify the audit report.

Space to write important points for revision

2014 - May [1] {C} (d) During the course of audit of Star Limited the auditor received some of the confirmation of the balances of creditors outstanding in the balance sheet through external confirmation by negative confirmation request. In the list of Sundry Creditors there are number of creditors of small balances except one, old outstanding of ₹ 15 Lacs, of whom, no confirmation on the credit balance received. Comment with respect to Standard of Auditing. (5 marks)

Answer:

Auditor need to generate necessary audit evidences for the transactions contained in the financial statements mainly through vouching, verification or even external confirmation. The question relates to a case of external confirmation covered by SA 505-**"External confirmations".**

The identity of creditors are not available to confirm the credit balance as appearing in Financial statement. As it is also not a case of pending litigation so he should observe other possibilities as well as evidences. Auditor should examine the validity of the credit balance as shown in the company's financial statements. He should obtain sufficient evidence in support of the balance. He should apply alternative audit procedures to get documentary proof for the transactions and should not rely entirely on the management representation.

But, if Auditor cannot verify the same by any means then he should include the matter by way of Qualification in his audit report to the members due to non availability of information.

Present Case:

The auditor sent the negative confirmation requesting the trade payables having outstanding balances in the balance sheet while doing audit of Star Limited. One of the old outstanding of ₹ 15 lacs has not sent the confirmation on the credit balance. In case of non response, the auditor may examine subsequent cash disbursements or correspondence from third parties, and other records, such as goods received notes. Further non response for negative confirmation request does not means that there is some misstatement as negative confirmation request itself is to respond to the auditor only if the confirming party disagrees with the information provided in the request. So, Auditor should state in his report about non availability of evidences about the creditor's balances outstanding.

But, if the auditor identifies factors that give rise to doubts about the reliability of the response to the confirmation request, he shall obtain further audit evidence to resolve those doubts.

—— Space to write important points for revision ——

2014 - Nov [1] {C} (b) The Auditor of PQR Pvt. Ltd. having turnover of ₹ 12 crore, was not able to get the confirmation about the existence and value of certain stock. However, a certificate from the Management has been obtained regarding the existence and value of the stock at the year end. The auditor relied on the same and without any further procedure, signed the Audit Report. Is he right in his approach? (5 marks)

Answer:

The physical verification of stock is the primary responsibility of the management. As per **SA-501**, **"Audit evidence - specific considerations for selected items",** the auditor, however, is required to examine the verification programme adopted by the management. He must satisfy himself about the existence and valuation of stock.

Present Case :

In the case of PQR Pvt. Ltd., the auditor has not been able to verify the existence and value of certain stock despite the verification procedure followed in routine audit. He accepted the certificate given to him by the management without making any further enquiry.

As per **SA 580 "Written Representations"**, when representation relate to matters which are material to the financial information, then the auditor should seek corroborative audit evidence for other sources inside or outside the entity.

He should evaluate whether such representations are reasonable and consistent with other evidences and should consider whether individuals making such representations can be expected to be well informed on the matter. "Written Representations" cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available.

If the auditor is unable to obtain sufficient appropriate audit evidence that he believes would be available regarding a matter, which has or may have a material effect on the financial information, this will constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter. Therefore, the approach adopted by the auditor is not tenable.

—— Space to write important points for revision ——

2014 - Nov [3] (a) Big and Small Ltd. received a show cause notice in December 2013 from the Central Excise department intending to levy a sum of ₹ 25 lakhs. The Company replied to the above notice in January 2014 contending that it is not liable for the proposed levy. No further action was initiated by the Central Excise department up to the finalization of the audit for the year ended on 31st March, 2014. As the Auditor of the Company, how would you deal with this matter in your report? (3 marks)

Answer:

- **As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statements",** the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.
- During the audit, the auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the auditor's attention.
- Then the auditor shall discuss the matter with management and where appropriate, those charged with governance. If management or as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws and regulations and in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice.
- In case, if the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.
- Again, **as per AS 29 "Provisions, Contingent liabilities and Contingent Assets**", future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that the event will occur.

  Present Case:

  Issuance of show cause notice by Excise Department does not tantamount to demand payable by the Company. In so far as the Company has replied to the notice and no further correspondence was received from the Department. This show cause notice may be an alert or indication of non-compliance for the auditor. So auditor need to discuss with management and apply additional procedure. If the auditor concludes that there is non-compliance then provision for the same should be made as per AS 29. If the management does not accept the request the auditor should qualify the audit report accordingly or *vice versa.*

—— Space to write important points for revision ——

2014 - Nov [4] (b) You are appointed to compile financial statements of Z & Company (a partnership firm) for tax purposes. During the course of work, you learn that the inventory is grossly understated. On pointing out the same, the partners of Z & Co., tell you that it is outside your scope since you are not conducting an audit and the said figures duly certified by the firm should be accepted. Comment. (4 marks)

Answer:

Please refer 2009 - May [1] (a) on page no. 69

—— Space to write important points for revision ——

2015 - May [1] {C} (a) As an auditor of RST Ltd. Mr. P applied the concept of materiality for the financial statements as a whole. On the basis of obtaining additional information of significant contractual arrangements that draw attention to a particular aspect of a company's business, he wants to re-evaluate the materiality concept. Please guide him. (5 marks)

Answer:

1. **Re-evaluation of the Materiality Concept:**
   As per SA 320, **"Materiality in Planning and Performing an Audit",** the Auditor shall revise materiality for the financial statements as a whole (and, if applicable, the materiality level(s) for particular classes of transactions, account balances or disclosures) in the event of becoming aware of information during the audit that would have caused the Auditor to have determined a different amounts initially.
2. **Revision of materiality may happen as a result of:**
   (i) a change in circumstances that occurred during the audit, (for example, a decision to dispose of a major part of the entity's business),
   (ii) New information, or
   (iii) a change in the Auditor's understanding of the Entity & its operations as result of further audit procedures.

3. If the Auditor concludes that a lower materiality for the financial statements as a whole (and, if applicable, materiality level(s) for particular classes of transactions, account balances or disclosures) than that initially determined is appropriate, the Auditor shall determine whether it is necessary to revise performance materiality, and whether the nature, timing and extent of the further audit procedures remain appropriate.

Thus, Mr. P can re-evaluate the materiality concepts after considering the necessity of such revision.

—— Space to write important points for revision ——

2015 - May [1] {C} (d) In an initial audit engagement the auditor will have to satisfy about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements, which may materially affect the current financial statements. Lay down the audit procedure, you will follow, when financial statements are audited for the first time. If, after performing the procedure, you are not satisfied about the correctness of 'Opening Balances', what approach you will adopt in drafting your audit report?

(5 marks)

Answer:

Audit Procedures for ensuring correctness of Opening Balance:

Please refer 2008 - Nov [1] {C} (d) on page no. 68

Drafting Audit Report:

If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further if the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

—— Space to write important points for revision ——

2015 - Nov [1] {C} (b) M/s. T K Projects Limited, a manufacturing company in the Steel industry was allegedly involved in some irregularity relating to allotment of coal blocks for which a complaint was lodged against the company by the government. The financial institutions stopped additional working capital finance which caused a financial crisis resulting in stoppage of production. The company incurred a massive loss during the year 2014-15. There were delays in salary and other payments. Certain key managerial personnel including GM Finance and certain other employees left the company. The company has no sound action plan to mitigate these situations. Guide the statutory auditor on how he should deal with this situation. (5 marks)

Answer:

As per SA 570, "Going Concern" an entity is viewed as continuing in business for the force able future. As per going concern assumption, an entity is expected to work for long time and it has no intention to shut down its operation for the force able future.

SA 570 on "Going Concern" requires the auditor to consider the appropriateness of the going concern assumption underlying the preparation of the financial statements which may no longer be appropriate.

But, there are many indicators which create doubt in continuation of business on going concern basis. These are when key business has been suspended or management is not in the position to come out from this worst situation or any legal proceeding is going against the company which create doubt for continuing its business etc.

As here, M/s. TK Projects Limited have following indicators which create doubt of its continuing business profile.

- Complaint lodged for irregularity relating to allotment of coal blocks.
- Financial institutions stopped additional working capital finance which caused a financial crisis result in stoppage of production.
- Company incurred heavy losses.
- Delay in other payments and salary payments.
- Certain key managerial personnel left the company.
- There is no sound action plan to mitigate these situation.

As per SA 570, when auditor comes to the knowledge of above mentioned indicators, he should mentioned in his report the following:

(i) Financial indicators which create doubt on going concern assumption.

(ii) Reasons.

(iii) Financial impact of such indicators.

Auditor should first communicate these to management and those charged with Governance. After receiving reply and recommendation from management, if auditor is not satisfied with the reply of management, he should report it in his report.

Space to write important points for revision

2015 - Nov [2] (a) In the course of the statutory audit of Z Ltd., its statutory auditors, having determined that the work of internal auditor is likely to be adequate for the purpose of statutory audit, wanted to use the work of the internal auditor in respect of physical verification of fixed assets. How should an evaluation be carried out of this specific work done by the internal auditor? (4 marks)

Answer:

Please refer 2012 - May [1] {C} (c) on page no. 35

Space to write important points for revision

2016 - May [4] (b) During the course of audit of M/s CT Ltd. for the financial year 2014-15, it has noticed that ₹ 2.00 lakhs of employee contribution and ₹ 9.50 lakhs of employer contribution towards employee state insurance contribution have been accounted in the books of accounts in respective heads. Whereas, it was found that ₹ 4.00 lakhs only has been deposited with ESIC department during the year ended 31st March, 2015. The Finance Manager informed the auditor that due to financial crunch they have not deposited the amount due, but will deposit the amount overdue along with interest as and when financial position improves.

Comment as a statutory auditor. (4 marks)

Answer:

Non-Compliance of Laws and Regulations and Reporting Requirements:

As per statutory provision of Companies Act, all companies are required to submit its government dues on time to comply with statutory requirements. All expenses and dues are required to be accounted correctly and dues to be paid for government dues to claim it as deduction from income as expenses.

As per **SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement",** it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.

The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework.

If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

As here M/s CT Ltd. has not paid full amount ESIC which are government dues and contended that it will pay it with interest when financial position improves is not acceptable reason. Auditor has to report separately on this and auditor is required to qualify his report.

—— Space to write important points for revision ——

2017 - Nov [1] {C} (b) You have been appointed statutory auditor of a company for the financial year ended 31st March, 2017 in place of the retiring auditor. During the course of audit, you observe that a fraud had been committed by a general manager who retired in March 2017. While going into further details, it was found that the fraud was going on since last 2-3 years and the total amount misappropriated was likely to exceed ₹ 100 lakhs. As statutory auditor, what would be your reporting responsibilities to the government? (5 marks)

Answer:

- **As per Sec. 143(12) of the Companies Act, 2013, read with Rule 13(1) of the Companies (Audit and Auditors) Rules, 2014,** it has been prescribed that, if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 cr. or above, is being or has been committed against the company by its officers or employees, the auditor, shall report the matter to the Central Government.
- **The manner of reporting the matter to the Central Government is as follows:**
  (a) The auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than two days of his knowledge of the fraud, seeking their reply or observations within forty five days;
  (b) On receipt of such reply or observations, the auditor shall forward his report and reply or observations of the Board or Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;
  (c) In case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of forty five days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or Audit Committee for which he has not received any reply or observations;

(d) The report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgment due or by Speed Post followed by an e-mail in confirmation of the same;

(e) The report shall be on the letter- head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his membership number; and

(f) The report shall be in the form of a statement as specified in form ADT - 4.

- In this case, it was found that the fraud was going on since last two to three years and total amount misappropriated was likely to exceed One hundred lakh rupees in the company. So as a statutory auditor of the company the above procedure shall be followed.

—— Space to write important points for revision ——

2018 - May [1] {C} (c) Y & Co., Chartered Accountants have come across in the course of audit of a company that certain machinery had been imported for production of new product. Although the Auditors have applied the concept of materiality for the Financial Statements as a whole, they now want to re-evaluate the materiality concept for this transaction involving foreign exchange. Give your views in this regard. (5 marks)

Answer:

- In the instant case, Y & Co., Charted Accountants as an auditor of the company has applied the concept of materiality for the financial statements as a whole. But he wants to re-evaluate the materiality concept on the basis of as they come across in the course of audit that certain machinery had been imported for production of new product.
- AS per SA 320, “Materiality in Planning and Performing an Audit’, while establishing the overall audit strategy. The auditor shall determine materiality for the financial statement as a whole. They should set a benchmark on the basis of which he performs their audit procedure. If, in the specific circumstances of the entity, there is one or more particular

classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. The auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

- The auditor shall revise materiality for the financial statements in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.
- If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.
- Thus, Y & Co., Chartered Accountants can re-evaluate the materiality concepts after considering the necessity of such revision.

—— Space to write important points for revision ——

2018 - Nov [1] {C} (a) You are the Auditor of Power Supply Corporation Limited, a Government Company for the year ended on 31st March 2018. The turnover of the Company for the period was ₹ 12,000 crores from sale of power. During your audit, you found that the Company had procured Spares for Transmitters for ₹ 850 crores from abroad through a Corporation by name Procurement and Supply India Limited which is also owned and controlled by Government of India. The Financial Statements of the Power Supply Corporation Limited, prepared in compliance with Ind AS for the year ended on 31/03/2018 did not contain any additional disclosure regarding the procurement of spares as referred to above. To your query as to whether any disclosure regarding Related Party Transaction would be required, the Management of the Corporation replied that no such disclosure would be necessary for transactions between State Controlled Enterprises. Analyse this issue in finalizing the Audit Report. (5 marks)

Answer:

Provision: Related Party Disclosures:

Para. 25 of Ind AS 24 provides exemption to Government-related entities for making disclosure of Related Party Transactions. As per this para.

A reporting entity is exempt from the disclosure requirements of paragraph 18 in relation to related party transactions and out standing balances, including commitments, with:

(a) A Government that has control, joint control or significant influence over the reporting entity; and

(b) Another entity that is a related party because the same government has control, joint control or significant influence over both the reporting entity and the other entity.

As per Para. 26, if a reporting entity applies the exemption in paragraph 25 above, it shall disclose the following about the transactions and related outstanding balances related to referred to in para. 25:

(a) The name of the Government and the nature of its relationship with the reporting entity (i.e. control, joint control, or significant influence);

(b) The following information is sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:

   (i) The nature of and amount of each individually significant transaction; and

   (ii) For other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent. Types of transactions include those listed in paragraph 21.

Present Case:

In this case, Power Supply Corporation Ltd. is a Government Company, which has procured spares for transmitters for ₹ 850 crores from abroad through a corporation by name Procurement and Supply India Ltd. which is also owned and controlled by Government of India. As per Indian AS 24 Power Supply Corporation Ltd. and Procurement and Supply India Ltd. becomes the Related parties as they are owned or controlled by the Government. So adequate disclosure required for transaction between them as per Ind AS 24.

However, para. 25 of Ind AS 24, specifically exempt from disclosure requirement of para 18 in relation to related party transactions and outstanding balances with other entity that is a related party because the same government has control, joint control and the other entity.
The contention of management tenable, it is exempted to make disclosure as per para 25. However, Power Supply Corporation Ltd. is taking exemption benefit here then it shall required to make adequate disclosure as provided in para 26, as above.

—— Space to write important points for revision ——

2018 - Nov [1] {C} (c) M/s Airlift Ltd., carrying on the business of Passenger Transportation by air is running into continuous financial losses as well as reduction in Sales due to stiff competition and frequent break down of its own aircrafts. The Financial Statements for the Year ended on 31/03/2018 are to be now finalized. The Management is quite uncertain as to its ability to continue in near future and has informed the Auditors that having seized of this matter, it had constituted a committee to study this aspect and to give suggestions for recovery, if any, from this bad situation. Till the study is completed, according to the Management, the issue involves uncertainty as to its ability to continue its business and it informs the Auditor that the fact of uncertainty clamping on the "Going Concern" would suitably be disclosed in notes to accounts. State the reporting requirement if any, in the Independent Auditor's Report in respect of this matter. (5 marks)

Answer:

Provision:

As per SA 570 on "Going Concern", it is the responsibility of the auditor to obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about entity's ability to continue as a going concern. The auditor shall evaluate management's assessment of the entity's ability to continue as a going concern. In evaluating management's assessment, the auditor shall consider whether management's assessment includes all relevant information of which the auditor is aware as a result of the audit.

Present Case:
In this case, M/s. Airlift Ltd. has occurred financial loss and reduction in sales due to stiff competition and frequent break down in its own aircrafts. The management is not sure as it can continue in future or not, the study of which is in process. The management is feels that it is uncertainty about going concern.
The auditor should ask management for its adequate disclosure in the financial statement and include the same in his report. However, if the management fails to make adequate disclosure, the auditor should express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised). But, if the result of the appropriate assumption used in the preparation of financial statements is material and pervasive as to make the financial statements misleading, the auditor should express an adverse opinion and in the Basis for Qualified (Adverse) opinion section of the auditor's report, state that a material uncertainty exists that may cost significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

Space to write important points for revision

2018 - Nov [1] {C} (d) There are certain circumstances in which Emphasis of Matter in Auditor's Report is mandated to be included. Explain this statement in the light of mandatory requirements of matters that are to be emphasised in Auditor's Report when the Audit Report is on Financial Statements prepared in accordance with Special Purpose Framework.

(5 marks)

Answer:
SA 706 contain specific requirements for the auditor to include Emphasis of matter paragraph in the Auditor's report in certain circumstances.

These circumstances include:
- When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.
- To alert users that the financial statements are prepared in accordance with a special purpose framework.

- When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report.
- The following are the example of circumstances where the auditor may consider to include Emphasis of matter paragraph.
- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event occurs between the date of the financial statements and the date of auditor's report.
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statement.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

Space to write important points for revision

2019 - May [1] {C} (a) You are engaged by M/s Active Ltd. to examine and report on prospective financial information which the management of the company has prepared for presentation at an Investor meet program organized by a State Government to attract investment in their state. The company in its vision document descripted various plans and proposals of the company with projected financial goals and means to achieve the same and various benefits accruing to the economic development of the State. What important matters will be considered by you, while determining the nature, timing and extent of examination procedure to be applied in the review of the same? (5 marks)

Answer:

Examination Procedures: As per SAE 3400, "The Examination of Prospective Financial Information", when determining the nature, timing and extent of examination procedures, the auditor should consider matters such as:

(i) the knowledge obtained during any previous engagements;
(ii) management's competence regarding the preparation of prospective financial information;
(iii) the likelihood of material misstatement;

(iv) the extent to which the prospective financial information is affected by the management's judgment;

(v) the sources of information considered by the management for the purpose, their adequacy, reliability of the underlying data, including data derived from third parties, such as industry statistics, to support the assumptions;

(vi) the stability of entity's business; and

(vii) the engagement team's experience with the business and the industry in which the entity operates and with reporting on prospective financial information.

—— Space to write important points for revision ——

2019 - May [2] (a) CA Dabu has been appointed as an auditor of M/s MAP Technocraft Ltd. to conduct statutory audit. While conducting audit, he came across some difficulties which the management could not explain to him properly and, therefore, he decided to take services of Mr. Jay, an engineering consultant. Mr. Jay performed his work and submitted details to CA Dabu. State the specific procedure which CA Dabu should follow to evaluate the adequacy of work performed by Mr. Jay. (5 marks)

Answer:

- As per SA 620. Using the work of an Auditor's Expert, the auditor shall evaluate the adequacy of the auditors's expert's work for the auditor's purposes, including.
  - (a) The relevance and reasonableness of that expert's finding and conclusions and their consistency with other audit evidence.
  - (b) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and.
  - (c) If that expert's work involves the use of source data that is significant to that expert's work, the relevance completeness and accuracy of that source data.

- If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall.
  (a) Agree with that expert on the nature and extent of further work to be performed by that expert, or.
  (b) Perform further audit procedures appropriate to the circumstances.

—— Space to write important points for revision ——

2019 - Nov [1] {C} (a) Mr. L while conducting the audit of ABC Ltd., observed that a substantial amount is recognized in respect of obsolescence of inventory and warranty obligation in the financial statements. Mr. L wants to obtain written representation from the management to determine whether the assumptions and estimates used are reasonable. Guide Mr. L with reference to the relevant Standard on Auditing. (5 marks)

Answer:

SA 580 'written representations' discusses the use of written representations Depending on the nature, materiality and extent of estimation uncertainty, written representations about accounting estimates recognised or disclosed in the financial statements may include representations:

(i) About the appropriateness of the measurement processes, including related assumptions and mode is, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.

(ii) That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.

(iii) That disclosure related to accounting estimates are complete and appropriate under the applicable financial reporting framework.

(iv) That no Subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements.

- **Here,** Mr. L while conducting the audit of ABC Ltd. observed that a substantial amount is recognized in respect of obsolescence of inventory and warranty obligation in the financial statement. Mr. L is guided with the above mentioned points for the purpose of obtaining written representation from the management to determine whether the assumptions and estimates used are reasonable.

—— Space to write important points for revision ——

2019 - Nov [1] {C} (b) LMP Associates, Chartered Accountants, conducting the audit of PQR Ltd., a listed Company for the year ended 31st March, 2019 is concerned with the auditor's responsibilities relating to other information, both financial and non-financial, included in the Company's annual report. While regarding other information, LMP Associates considers whether there is a material inconsistency between other information and the financial statements. As a basis for the consideration the auditor shall evaluate their consistency, compare selected amounts or other items in the other information with such amounts or other items in the financial statements. Guide LMP Associates with examples of 'Amounts" or "other items" that may be included in the "other information" with reference to SA 720. (5 marks)

Answer:

SA 720, The Auditor's Responsibility in Relation to other Information provides following examples of amounts and other items that may be included in other information. This list is not intended to be exhaustive.

Amounts :

- Items in a summary of key financial results, such as net income, earnings per share, dividends, sales and other operating revenues and purchases and operating expenses.
- Selected operating data, such as income from continuing operations by major operating area, or sales by geographical segment or product line.
- Special items, such as asset dispositions, litigation provisions, asset impairments, tax adjustments, environmental remediation provisions, and restructuring and reorganization expenses.

- Liquidity and capital resource information such as cash, cash equivalents and marketable securities; dividends and debt, capital lease and minority interest obligations.
- Capital expenditures by segment or division.
- Amounts involved in, and related financial effects of, off balance sheet arrangements.
- Amounts involved in guarantees, contractual obligations, legal or environmental claims, and other contingencies.
- Financial measures or ratios, such as gross margin, return on average capital employed, return on average shareholders's equity, current ratio, interest coverage ratio and debt ratio. Some of these may be directly reconcilation to the financial statements.

Other Items:

- Explanations of critical accounting estimates and related assumptions
- Identification of related parties and descriptions of transactions with them.
- Articulation of the entity's policies or approach to manage commodity, foreign exchange or interest rate risks, such as through the use of forward contracts, interest rate swaps, or other financial instruments.
- Descriptions of the nature of off-balance sheet arrangements.
- Descriptions of gaurantees, indemnifications, contractual obligations, litigation or environmental liability cases and other contingencies, including management's quantative assessments of the entity's related exposures.
- Descriptions of changes in legal or regulatory requirements, such as new tax or environmental regulations, that have materially impacted the entity's operations or fiscal position, or will have a material impact on the entity's future financial prospects.
- Management's quantitative assessments of the impacts of new financial reporting standards that have come into effect during the period, or will come into effect in the following period, on the entity's financial results, financial position and cash flows.
- General descriptions of the business environment and outlook.
- Overview of strategy.

- Descriptions of trends in market prices of key commodities or raw materials.
- Contrasts of supply, demand and regulatory circumstances between geographic regions.
- Explanations of specific factors influencing the entity's profitability in specific segments.

—— Space to write important points for revision ——

2019 - Nov [1] {C} (c) MB & Associates is a partnership firm of Chartered Accountants which was established seven years back. The firm is getting new clients and has also been offered new engagement services with existing clients. The firm is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client. The firm is looking to work with only select clients to adhere to the Quality Control Standards. Guide MB & Associates about the matters to be considered with regard to the integrity of a client, as per the requirements of SQC 1. (4 marks)

Answer:

MB & Associates is concerned about obtaining such information as it considers necessary in the circumstances before accepting an engagement with a new client and acceptance of a new engagement with an existing client.

The firm is looking to work with only selected clients to adhere to the Quality Control Standards. As per the requirements of SQC1, following matters to be considered with regard to the integrity of a client :

(i) The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.

(ii) The nature of the client's operations, including its business practices.

(iii) 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.

(iv) Whether the client is aggressively concerned with maintaining the firms's fees as low as possible.
(v) Indications of an appropriate limitation in the scope of work.
(vi) Indications that the client might be involved in money laundering or other criminal activities.
(vii) The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.
- The extent of knowledge a firm will have regarding the integrity of a client will generally grow within the context of an ongoing relationship with that client.

Space to write important points for revision

2019 - Nov [5] (c) Mr. X has been appointed as an auditor of M/s ABC Ltd., Mr. X wants to be satisfied about the sufficiency and appropriateness of 'Opening Balances' to ensure that they are free from misstatements. Lay down the audit procedure, Mr. X should follow, in the initial audit engagement of M/s ABC Ltd. Also suggest the approach to be followed regarding mention in the audit report if Mr. X is not satisfied about the correctness of 'Opening Balances'? (4 marks)

Answer:

As per SA 510, Initial Audit Engagements - Opening Balances, the auditor shall obtain sufficient appropriate audit evidence about whether the opening balances contain misstatements that materially affect the current period's financial statements by:

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

(ii) Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or

(iii) Performing specific audit procedures to obtain evidence regarding the opening balances.

In this case, Mr. X shall require to perform above mentioned audit procedures if he wants to be satisfied about the sufficiency and appropriateness of balances to ensure that they are free from misstatements.

If Mr. X after following above procedures is not satisfied with the correctness of opening balances he shall perform such additional audit procedures as are appropriate in the circumstances to determine the effect on the current period's financial statements.

If the auditor concludes that such misstatements exist in the current period's financial statements, he shall communicate the misstatements with the appropriate level of management and those charged with governance in accordance with SA 450.

—— Space to write important points for revision ——

2020 - Nov [1] {C} (a) Moon Ltd. is a dealer in electronic appliances. The Company has a centralised warehouse at the outskirts of Mumbai. The Auditors of the company M/s JK Associates normally attend the physical verification of stocks carried out by the Management at the end of the financial year. However, on account of certain disturbances in the region, the physical inventory counting could not be carried out at the year end. The stock taking is decided to be done by management at some other date subsequently, after a month.

In the light of the above facts:

Enumerate the audit procedures to be considered by M/s JK Associates, if physical inventory counting is conducted at a date other than the date of the financial statements with reference to the relevant Standard on Auditing.

(5 marks)

(b) You are the auditor of PQR Ltd. which is in the business of supplying food products to various airline companies operating aircrafts in domestic circle only. As per terms of agreement with airlines, the company need to stock various non- perishable food items for coming one month (average holding of inventory to the tune of INR 75 Crores). Also the payment terms have been settled and the company receives payment in 45 days after the supply of goods. Everything was going-on well till the end of March 2020 when pandemic Covid hit the world and everything came to a standstill. Aviation sector was hit hard and there were no flights from April 2020 onwards. Consequently, the business of PQR Ltd. also got severely affected and the scheduled supplies of goods to airlines also were not made. Also, the liquidity position of airline companies got hit and the scheduled payments were also not received on due dates. As the auditor of PQR Ltd. what audit procedures would you perform to ensure that all subsequent events are considered, so that financial statements for the year ended 31.03.2020 represent true and fair view ? (5 marks)

(c) GS & Co., Chartered Accountants, have been appointed Statutory Auditors of MAP Ltd. for the F.Y. 2019-20. The audit team has completed the audit and is in the process of preparing audit report. Management of the company has also prepared draft annual report. Audit in-charge was going through the draft annual report and observed that the company has included an item in its Annual Report indicating downward trend in market prices of key commodities/raw material as compared to previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction. Audit Manager discussed this issue with partner of the firm who in reply said that auditors are not covered with such disclosures made by the management in its annual report, it being the responsibility of the management.

Do you think that the partner is correct in his approach on this issue.

Discuss with reference to relevant Standard on Auditing the Auditor's duties with regard to reporting. (4 marks)

Answer:

(a) As per SA 501 "Audit Evidence- Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.

For practical reasons, the physical inventory counting may be conducted at a date, or dates, other than the date of the financial statements. This may be done irrespective of whether management determines inventory quantities by an annual physical inventory counting or maintains a perpetual inventory system. In either case, the effectiveness of the design, implementation and maintenance of controls over changes in inventory determines whether the conduct of physical inventory counting at a date, or dates, other than the date of the financial statements is appropriate for audit purposes.

If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor, JK Associates, shall perform the following procedures:

(a) Attendance at physical inventory counting, unless impracticable, to:
   - (i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
   - (ii) Observe the performance of management's count procedures;
   - (iii) Inspect the inventory; and
   - (iv) Perform test counts; and

(b) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

In addition to above, auditor shall also perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded.

Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date, or dates, and the final inventory records are properly recorded include:

1. Whether the perpetual inventory records are properly adjusted.
2. Reliability of the entity's perpetual inventory records.
3. Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records.

(b) As per SA 560 "Subsequent Events", the auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required in above paragraph so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto.

Being the auditor of PQR Ltd, to ensure that all subsequent events are considered so that financial statements for the year ending 31.03.2020 represent true and fair view, the auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:

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

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

(c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.

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

When, as a result of the procedures performed as required above, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

(c) As per SA 720, "The Auditor's Responsibility in Relation to Other Information", Descriptions of trends in market prices of key commodities or raw materials is an example of amounts or other Items that may be Included in the other information.

The auditor's discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management's statements in the other information. Based on management's further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

Auditor's duties with regard to reporting in the given case are given hereunder:

As per SA 720, "The Auditor's Responsibility in Relation to Other Information", i f the auditor concludes that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management:

(i) Agrees to make the correction, the auditor shall determine that the correction has been made; or

(ii) Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made.

Contention of the partner of the firm that auditors are not concerned with such disclosures made by the management in its annual report, is incorrect.

—— Space to write important points for revision ——

2020 - Nov [2] (a) Mr. X, while conducting audit of PQR Ltd, comes across certain transactions which according to him are significant transactions with related parties and identified to be outside the entity's normal course of business. Guide Mr. X with examples of such transactions and to understand the nature of significant transactions outside the entity's normal course of business. (5 marks)

Answer:

As per SA 550 "Related Parties", examples of transactions outside the entity's normalcourse of business may include:

1. Complex equity transactions, such as corporate restructurings or acquisitions.
2. Transactions with offshore entities in jurisdictions with weak corporate laws.
3. The leasing of premises or the rendering of management services by the entity to another party if no consideration is exchanged.
4. Sales transactions with unusually large discounts or returns.
5. Transactions with circular arrangements, for example, sales with a commitment to repurchase.
6. Transactions under contracts whose terms are changed before expiry.

—— Space to write important points for revision ——

2021 - Jan [1] {C} (a) M/s NK & Co., Chartered Accountants were appointed as Statutory Auditors of Fresh Juice Limited for the F.Y. 2019-2020. The previous year's audit was conducted by M/s. LP & Associates. After the audit was completed and report submitted, it was found that closing balances of last financial year i.e., 2018-19 were incorrectly brought forward. It was found that M/s NK & Co. did not apply any audit procedures to ensure that correct opening balances have been brought forward to the current period.

Accordingly, a complaint was filed against NK & Co. in relation to this matter. You are required to inform what policies are required to be implemented by NK & Co. for dealing with such complaints and allegations as required by Standard on Quality Control (SQC). (5 marks)

Answer:

(a) As per Standard on Quality Control (SQC) 1 **"Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements".**

(i) The firm should establish policies and procedures designed to provide it with reasonable assurance that it deals appropriately with:

(a) Complaints and allegations that the work performed by the firm fails to comply with professional standards and regulatory and legal requirements; and

(b) Allegations of non-compliance with the firm's system of quality control.

(ii) Complaints and allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.

(iii) As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.

(iv) The firm investigates such complaints and allegations in accordance with established policies and procedures. The investigation is supervised by a partner with sufficient and appropriate experience and authority within the firm but who is not otherwise involved in the engagement, and includes involving legal counsel as necessary. Small firms and sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations and the responses to them are documented.

(v) Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies and procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action.

Space to write important points for revision

2021 - Jan [1] {C} (b) GHK Associates, Chartered Accountants, conducting the audit of PBS Ltd., a listed company for the year ended 31.03.2020 is concerned with the presentation and disclosure of segment information included in Company's Annual Report. GHK Associates want to ensure that methods adopted by management for determining segment information have resulted in disclosure in accordance with the applicable financial reporting framework. Guide GHK Associates with 'Examples of Matters' that may be relevant when obtaining an understanding of the methods used by the management with reference to the relevant Standards on Auditing.

(5 marks)

Answer:

(b) As per SA 501- "Audit Evidence-Specific Considerations for Selected Items", example of matters that may be relevant when obtaining an understanding of the methods used by management in determining segment information and whether such methods are likely to result in disclosure in accordance with the applicable financial reporting framework include:

(i) Sales, transfers and charges between segments, and elimination of inter-segment amounts.

(ii) Comparisons with budgets and other expected results, for example, operating profits as a percentage of sales.

(iii) The allocation of assets and costs among segments.

(iv) Consistency with prior periods, and the adequacy of the disclosures with respect to inconsistencies.

2021 - July [2] (b) Milk Ltd. is engaged in the business of manufacturing and distribution of various milk products like cheese, curd, paneer, etc. Government made certain changes in rules and regulations relating to this sector, consequently management decided to go for expansion. Management was looking for some financial investor, who can fund some part of the proposed expansion. Mr. X is interested in the venture and appoints you to act as an advisor to the proposed investment in the business of Milk Ltd. You have to investigate the audited financial statements and ensure that the valuation of shares of the company on the basis of audited financial statements is appropriate. What process will be used for checking and whether you can put reliance on already audited statement of accounts? (5 marks)

Answer:

Process used for checking and reliance on already audited statement of accounts:

1. If the statements of account produced before the investigator were not audited by a qualified accountant, then there arises a duty to get the figures in the accounts properly checked and verified.
   However, when the accounts have been specially prepared by a professional accountant, he could accept them as correct relying on the principle of liability to third parties.
2. Nevertheless, it would be prudent to see first that such accounts were prepared with objectivity and that no bias has crept in to give advantage to the person on whose behalf these were prepared.

Whether the investigator can put reliance on the already audited statement of account

If the investigation has been launched because of some doubt in the audited statement of account, no question of reliance on the audited statement of account arises. However, if the investigator has been requested to establish value of a business or a share or the amount of goodwill payable by an incoming partner, ordinarily the investigator would be entitled to put reliance on audited materials made available to him unless, in the course of his test verification, he finds the audit to have been carried on very casually or unless his terms of appointment clearly require to test everything afresh.

2021 - Dec [1] {C} (a) M/s Kumar & Co., Chartered Accountants were appointed as statutory auditors of PC limited for the financial year 2020-21. During the course of audit, one of the partners CA. Kumar observed that there is misappropriation of assets in the form of theft of entity's inventory and is perpetrated by employees in relatively small and immaterial amounts. CA. Kumar is concerned with the existence of certain circumstances for increasing the susceptibility of assets to misappropriation.
Guide CA. Kumar with respect to Risk factors related to misstatements arising from misappropriation of assets with reference to relevant Standard on Auditing. (5 marks)

2021 - Dec [1] {C} (b) In the course of audit of Tech limited you observed that processing of accounting data was given to a third party on account of certain considerations like cost reduction, own computer working to full capacity. Tech Limited used a service organisation to record transactions and process related data. As an auditor, what would be your considerations regarding the nature and extent of activities undertaken by service organisation so as to determine whether those activities are relevant to the audit and, if so, to assess their effect on audit risk.
Discuss with reference to relevant Standard on Auditing. (5 marks)

Similarly Asked Questions

No.	Category	Question	Marks	Frequency
1.	Descriptive	JY & Co. is appointed as auditor of Breeze Ltd. JY & Co. seeks your guidance for reviewing the records and documentation of the company regarding 'related party transactions in the normal course of business'. Describe the steps to be followed. 2012 - May [4] (a), 2012 - Nov [5] (b), 2015 - Nov [2] (d)	8, 8, 4	3 Times

2.	Descriptive	ENP Ltd. engaged an actuary to ascertain its employee cost, gratuity and leave encashment liabilities. As an auditor of ENP Ltd., you would like to use the report of the actuary as an audit evidence. How would you evaluate the work of the actuary? 2011 - May [3] (b), 2016 - May [2] (a)	8, 4	2 Times
3.	Practical	Practical Questions of- 2011 - May [1] (a), 2013 - Nov [1] (b)	4, 5	2 Times
4.	Practical	Practical Questions of - 2009 - May [1] (a), 2014 - Nov [4] (b)	5, 4	2 Times
5.	Practical	Practical Questions of - 2008 - Nov [1] (d), 2015 - May [1] (d)	5, 5	2 Times
6.	Descriptive	Explain briefly the duties and responsibilities of an auditor in case of material misstatement resulting from management fraud. 09 - Nov [4] (c), 17 - May [4] (a)	6, 6	2 Times

Table Showing Marks of Compulsory Questions

Year	17 M	17 N	18 M	18 N	19 M	19 N	20 N	21 J	21 J	21 D
Descriptive										
Practical		5	5	15	5	14	14	10		10
Total		5	5	15	5	14	14	10		10

Star Rating

On the basis of Maximum marks from a chapter ☆☆

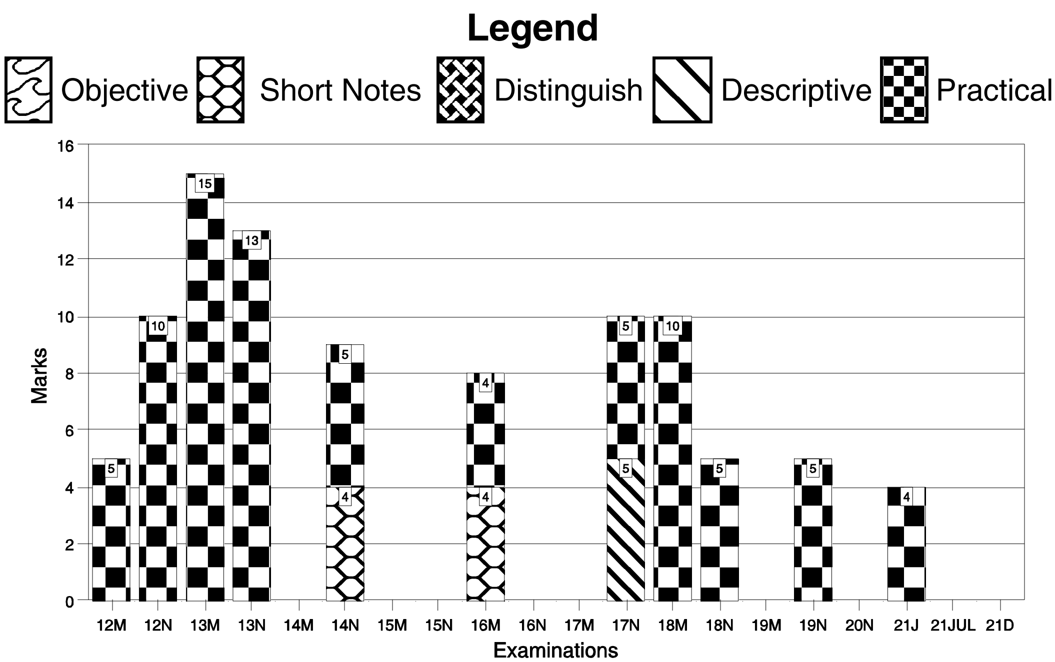
On the basis of Questions included every year from a chapter ☆

On the basis of Compulsory questions from a chapter ☆☆☆☆

CHAPTER	
1B	**Accounting Standards**

THIS CHAPTER COMPRISES OF
☞ Accounting Standards issued by ICAI.

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions



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SHORT NOTES

2014 - Nov [7] Write short note on the following:
(d) Intangible Asset vs. Intangible Item. (4 marks)

Answer:

1. **Intangible Asset**
   - An Intangible Asset is an identifiable non - monetary asset without physical substance held for use in the production or supplying of goods or services for rentals to others or for administrative purpose.
   - So main features of identifiable, non - monetary asset And without physical substance.
   - Intangible assets must have the characteristics of an assets i.e. Future economic benefits and Reliability measured.
   - Shown in Balance Sheet.
2. **Intangible Item**
   - An Intangible item is an identifiable non - monetary item without physical substance held for use in the production or supplying of goods or services for rentals to others or for administrative purpose.
   - So, intangible items are those items which does not have the following characteristics i.e. Future economic benefits and Reliable measured.
   - Provided as expenditure in Statement of P&L.

—— Space to write important points for revision ——

2016 - May [7] Write short note on the following:
(a) Deferred Taxation. (4 marks)

Answer:

Deferred Taxation:

AS-22, Accounting for Taxes on Income, prescribes the accounting treatment for taxes on income the amount of taxable income for a period and that of shown in profit & loss account are seldom the same. Taxable income is calculated in accordance with taxable laws whose requirement regarding computation of taxable income differ from the accounting policies applied to determine accounting income these differences are called ‘permanent differences' or 'timing differences'. 'Permanent differences' are differences which originate in one period and do not reverse subsequently. Timing differences are those differences which originate in one period and capable of reversal in one or more subsequent periods. The standard requires that deferred tax should be recognised for all timing differences, subject to the consideration of prudence in respect of deferred tax assets.

—— Space to write important points for revision ——

DESCRIPTIVE QUESTIONS

2017 - Nov [6] (c) What is 'Other Comprehensive Income' as per Ind-AS? What are its components? (5 marks)

Answer:

Other Comprehensive Income:

- Other Comprehensive Income comprises items of income and expenses (including reclassification adjustments) that are not recognised in profit or loss as required or permitted by other Ind ASs.
- The standard requires an entity to disclose reclassification adjustments and income tax relating to each components of other comprehensive income.

  Reclassification adjustments are the amounts reclassified to profit or loss in the current period that were previously recognised in other comprehensive income.

Components of other Comprehensive Income:

- The other comprehensive income section shall present line items for amounts for the period of:
  (a) items of other comprehensive income (excluding amounts in paragraph (b)), classified by nature and grouped into those that, in accordance with other Ind AS:
    (i) will not be reclassified subsequently to profit or loss; and
    (ii) will be reclassified subsequently to profit or loss when specific conditions are met.

(b) the share of the other comprehensive income of associates and joint ventures accounted for using the equity method, separated into the share of items that in accordance with other Ind ASs.'

(i) will not be reclassified subsequently to profit or loss; and

(ii) will be reclassified subsequently to profit or loss when specific conditions are met.

—— Space to write important points for revision ——

PRACTICAL QUESTIONS

2009 - May [5] (b) X Ltd. did not follow the applicable Accounting Standard for disclosing Earnings Per Share (EPS) in the financial statements. The fact of such non-disclosure was however, mentioned in the notes forming part of accounts. As the statutory auditor of X Ltd., how would you report in the above case? (5 marks)

Answer :

Disclosure of EPS is required for all companies as per **AS 20 "Earnings per Share"**. If the disclosures required by AS 20 are not made, it is the duty of the auditor to qualify in his report "Whether Accounting Standards under the clause as notified u/s 211(3C) have been followed?". Mere disclosure by company in notes does not absolve him of his duty.

The same is however not a qualification to affect the "True & Fair" position of financial results of the company.

—— Space to write important points for revision ——

2009 - Nov [1] Comment on the following :

(b) XYZ Limited received a grant of ₹ 25 lakhs under the Government's Subsidy Scheme, for acquiring an imported machinery for setting up new plant. The entire grant received is credited to Profit and Loss Account. (5 marks)

Answer :

According to **AS 12, "Accounting for Government Grants"** where grant is received for the acquisition of a specific fixed asset, the same cannot be credited to Profit and Loss Account since it fails to match revenue with the cost.

Treatment in Financial Statements:

Grants for Acquiring Assets:

1. Government grants related to specific fixed assets (PPE) should be presented in the balance sheet by showing the grant as a deduction from the gross value of the assets concerned in arriving at their book value.
2. Where the grant related to a specific fixed asset equals the whole, or virtually the whole, of the cost of the asset, the asset should be shown in the balance sheet at a nominal value.
3. Alternatively, "government grants related to depreciable fixed assets (PPE) may be treated as deferred income which should be recognised in the profit and loss statement on a systematic and rational basis over the useful life of the asset, i.e., such grants should be allocated to income over the periods and in the proportions in which depreciation on those assets is charged.
4. Grants related to non-depreciable assets should be credited to capital reserve under this method. However, if a grant related to a non-depreciable asset requires the fulfilment of certain obligations, the grant should be credited to income over the same period over which the cost of meeting such obligations is charged to income.
5. The deferred income balance should be separately disclosed in the financial statements.

Therefore, the statutory auditor would have to qualify audit report appropriately that the income has been overstated to the extent of the amount of grant net of proportionate credit that would have been worked out.

Space to write important points for revision

2010 - May [1] Comment on the following :

(a) T Ltd. an Indian company, subject to Indian Income tax Act, 1961, discloses advance Income-tax paid (Current tax asset) and provision for Income-tax (Current tax liability), separately in Balance Sheet for the year ended 31.3.2010., i.e., it do not offset the amount. (5 marks)

Answer:

As per **AS-22 - Accounting for Taxes on Income**, an enterprise should offset assets and liabilities representing current tax if the enterprise:

(i) has a legally enforceable right to set off the recognized amounts and

(ii) intends to settle the asset and liability on a net basis.

An enterprise will normally have a legally enforceable right to set off an asset and liability representing current tax when they relate to income taxes levied under the same governing taxation laws and the taxation law permit the enterprise to make or receive a single net payment.

Present Case:

Since T Ltd is an Indian Company, and as per Income Tax Act, 1961, such set off is allowed which is legally enforceable. Thus, in view of Provisions of AS 22 and Income Tax Laws, T Ltd. should off set advance tax paid against provision for income tax and show only the net amount in the balance sheet.

—— Space to write important points for revision ——

2010 - May [1] Comment on the following :

(d) F Limited includes in the Schedule of Inventory, those items of PPE which have not been in active use and held for disposal, as inventory item. (5 marks)

Answer:

AS-10 "Property, Plant and Equipment", requires that the items of PPE that have been retired from active use and are held for disposal be stated at the lower of their carrying amount and net realizable value. Any write down in this regard should be recognised immediately in the statement of profit and loss.

As per **AS-2 "Valuation of Inventories"**, "inventories" are assets "held for sale in the ordinary course of business, in the process of production for such sale; or in the form of materials or supplies to be consumed in the production process or in the rendering of services.", whereas, the sale of fixed assets cannot be treated as sale arising from the ordinary course of business.

Present Case:

Thus, F Ltd.'s inclusion of PPE not in active use and held for disposal, as inventory item in the schedule of inventory is not in line with the requirements of AS-10 and AS-2. Such fixed assets should be stated at lower of their carrying amount and net realizable value and any write down in this regard should be recognised immediately in the statement of profit and loss.

—— Space to write important points for revision ——

2010 - Nov [1] {C} Comment on the following :

(a) A Co. Ltd. has not included in the Balance Sheet as on 31-03-2010 a sum of ₹ 1.50 crores being amount in the arrears of salaries and wages payable to the staff for the last 2 years as a result of successful negotiations which were going on during the last 18 months and concluded on 30-04-2010. The auditor wants to sign the said Balance Sheet and give the audit report on 31-05-2010. The auditor came to know the result of the negotiations on 15-05-2010. (5 marks)

Answer :

This case requires attention to SA 560 "Subsequent Events", AS 4 "Contingencies and Events occurring after the Balance Sheet Date" and AS 29 "Provisions, Contingent liabilities and Contingent Assets".

As per AS 4 "Contingencies and Events occurring after the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

Similarly **as per AS 29 "Provisions, Contingent liabilities and Contingent Assets",** future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that will occur.

Present Case:

The amount of ₹ 1.50 crores is a material amount and it is the result of an event, which has occurred after the Balance Sheet date. The facts have become known to the auditor before the date of issue of the Audit Report and Financial Statements.

The auditor has to perform the procedure to obtain sufficient, appropriate evidence covering the period from the date of the financial statements i.e. 31-3-2010 to the date of Auditors Report i.e. 31-05-2010. It will be observed that as a result of long pending negotiations a sum of ₹ 1.50 crores representing arrears of salaries of the year 2008-09 and 2009-10 have not been included in the financial statements. It is quite clear that the obligation requires provision for outstanding expenses as per AS 4 and AS 29.

As per SA 560 "Subsequent Events", the auditor should assure 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.

So the auditor should request the management to adjust the sum of ₹ 1.50 crores by making provision for expenses. If the management does not accept the request the auditor should qualify the audit report.

—— Space to write important points for revision ——

2010 - Nov [1] {C} Comment on the following :

(b) B Co. Ltd. is engaged in the business of developing mass scale housing projects including development of small commercial complexes. The flats/commercial spaces are booked by the public and are allotted by way of allotment letter to each allottee. Major construction activities pertaining to buildings are undertaken after allotment is over. After completing the construction, possession of flats/commercial spaces is given to allottees by executing legal document. The CEO of the B. Co. Ltd. says that AS 7 is not applicable to the company. (5 marks)

Answer:

The contention of the CEO of B Co. Ltd. is **correct.**

AS 7 "Construction Contract", should be applied in accounting for construction contracts in the financial statements of contractors.

The activity of the B Co. Ltd. is not that of a contractor.

The company is developing projects on its own account as a commercial venture and is in the nature of production activity and not that of a contractor. Therefore AS 7 will not be applicable to B Co. Ltd. For the purpose of recognition of Revenue and valuation of inventories B Co. Ltd. should follow the principles contained in AS 9 "Revenue recognition" and AS 2 " Valuation of Inventories".

—— Space to write important points for revision ——

2010 - Nov [1] {C} Comment on the following :

(c) In the notes to accounts of C Co. Ltd. as on 31-03-2010 Note no. 11 states that 'Certain machinery items are lying at customs warehouses and company has paid ₹ 900 lakhs up to 30-06-2009 as detention charges, out of which a sum of ₹ 580 lakhs is written back during the year 2009-10 based on settlement with the concerned authorities in respect of a major spares of machinery. For the remaining machinery items negotiations are pending and a provision of ₹ 44 lakhs is made. As such total amount of ₹ 364 lakhs paid/provided on account of detention charges have been capitalized and included in the Fixed Assets/Capital work in progress. The management is of the view that these expenses are directly attributable to the acquisition of the related Fixed Asset.'

(5 marks)

Answer:

As per **AS 10 "Property, Plant and Equipment"**, the cost of an item of PPE comprise its purchase price, including import duties and other non-refundable taxes or levies and any directly attributable cost of bringing the asset to its working condition for its intended use.

Generally, detention charges represent an abnormal expenditure, as these expenditures are not directly attributable to the cost of asset.

The auditor will qualify the report appropriately in the paragraph before stating that the balance sheet gives true and fair view and the profit and loss account shows true and fair profit of the year ending on 31-3-2010. The qualification will be as follows:

"Attention is invited to Note no. 11 regarding Capitalization of detention charges of ₹ 364 lakhs during the year and on account of delays in respect of clearing from custom warehouses for certain machinery items". In our opinion the detention charges are not directly attributable to the acquisition of related fixed assets. The said amount of ₹ 364 lakhs should have been written off in the Profit and Loss account. Had these expenses been so written off the profit for the year would have been lower by ₹ 364 lakhs and Reserves & Surplus as well as Fixed Assets/Capital WIP would have been lower by ₹ 364 lakhs."

—— Space to write important points for revision ——

2010 - Nov [1] {C} Comment on the following :

(d) During the course of audit of D Co. Ltd. you as an auditor have observed that Inter Corporate deposit of ₹ 50 lakhs has been overdue. The D Co. Ltd. have disclosed this in the notes to accounts note No. 15 in schedule no. 21 stating that '₹ 50 lakhs is overdue from XYZ Co. Ltd. and the said company is in the process of liquidation. The management is taking steps to appoint the liquidator.' (5 marks)

Answer:

As per **AS 4 "Contingencies and Events occurring after the Balance Sheet Date"**, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

Present Case:

In the instant case, it appears from the note no. 15 that the overdue of outstanding inter corporate deposit may not be realisable in full. The company is in the process of liquidation, makes it clear that on the balance sheet date, the amount of deposit is not safe and is not likely to be realised.

Therefore as per AS 4 provision for the loss is required in the accounts. Hence the auditor should qualify the Audit Report.

—— Space to write important points for revision ——

2011 - Nov [1] {C} Comment on the following :

(b) MRE Ltd. provided ₹ 25 lakhs for Inventory obsolescence in 2009-10. In the subsequent years, it was determined that 50% of such stock was usable. The Board of Directors wants to adjust the same through prior period adjustment. (5 marks)

Answer :

Prior Period Adjustment :

As per **AS 5**, prior period items are income or expenses which arise in the current period as a result of errors or omissions in the preparation of the financial statements of one or more prior periods. The write- back of provision made in respect of inventories in the earlier year does not constitute prior period adjustment since it neither constitutes error nor omission but it merely involves making estimates based on prevailing circumstances when financial statements were being prepared. It is a mere estimate process involving judgement based on the latest information available.

An estimate may be revised if changes occur regarding the circumstances on which the estimate was based, or as a result of new information, more experience or subsequent developments. The revision of the estimate, does not bring the adjustment within the definitions of an extraordinary item or a prior period item.

Further, as per SA 540, the auditor shall review the outcome of accounting estimates included in the prior period financial statements or where applicable, their subsequent re-estimation for the purpose of the current period.

Present case:

MRE Ltd. provided ₹ 25 lakhs for inventory obsolescence in 2009-10. In the subsequent year due to change in circumstances, it was determined that 50% of such stock was usable. Revision of such an estimate does not bring the resulting amount of ₹ 12.5 lakhs within the definition of a prior period item or extraordinary item. The amount involved is however, material and requires separate disclosure to understand the financial position and performance of an enterprise. Hence, adjustment in the value of the inventory through prior period item would not be proper.

Space to write important points for revision

2011 - Nov [1] {C} Comment on the following :

(c) SRS Ltd. has drawn the financial statement as on 31-3-11 and presented to you alongwith additional information :

Balance Sheet of SRS Ltd. as on 31-3-11

Liabilities	**Amt.**	**Assets**	**Amt.**
Share capital	50,00,000	PPE	
Reserves & Surplus		Gross block	1,00,00,000
Profit and Loss A/c	4,00,000	*Less :* Depreciation	
Secured Loans	75,00,000	Investments	Nil
Current Liabilities and provisions :		Current Assets:	
		Loans & Advances	
Creditors for trade	3,00,000	Debtors	25,00,000
Advance received	3,00,000	Advance Paid	10,00,000
	1,35,00,000		1,35,00,000

Additional Information :

(a) Entire pre-operative expenses of ₹ 7,00,000/- was charged to Profit and Loss Account whereas for the purpose of Income Tax, only what is allowable is claimed.

(b) Depreciation as per Books- ₹ 35,00,000/-
Depreciation as per Income tax- ₹ 50,00,000/-

(c) Losses to be carried forward as per Income Tax Act - ₹ 16,00,000/-

(d) Donation disallowed while computing tax - ₹ 50,000/-

Considering the additional information, Can you certify that the company has complied with the Accounting Standards and issue an unqualified report?

(6 marks)

Answer:

Compliance with the Accounting Standards : As per **AS 26 "Intangible Assets"**, when an expenditure is incurred to provide future economic benefits to an enterprise, but no intangible asset or other asset is acquired or created that can be recognised, then such an expenditure is recognised as an expense when it is incurred.

Therefore, expenditures for commencing new operations or launching new products or process (pre-operating costs) should be shown as an expense in the year of incurrence as no asset is created.

Further, as per AS 22, tax expense for the period, comprising current tax and deferred tax, should be included in the determination of the net profit or loss for the period. Deferred Tax is the tax effect of timing difference. Hence deferred tax should be recognised for all the timing differences, however, permanent differences do not result in deferred tax assets (DTA) or deferred tax liabilities (DTL). Thus, Tax Expense = Current Tax + Deferred Tax.

Present Case:

Point (a) of additional information complies with AS 26 hence no qualification is required in view of AS 26. But at the same time it leads to timing difference which will require the creation of DTA/DTL as per AS 22.

Similarly, point (b) and (c) also lead to timing differences which creates DTA/DTL.

Creation of DTA/DTL due to such timing differences needs to be reported in the Financial Statements.

However, point (d) is a situation of permanent difference as per AS 22. Hence no DTA/DTL is required to be accounted for.

In the given balance sheet no tax expense has been provided for. Accordingly, audit report should be qualified in view of non compliance of AS 22.

Also, presentations of PPE are not in compliance with disclosure requirement of AS 10. Hence, it cannot be certified that the company has complied with all the Accounting Standards.

—— Space to write important points for revision ——

2011 - Nov [3] (c) An infrastructure company has constructed a mall and entered into agreement with tenants towards licence fees (monthly rental) and variable licence fees, a percentage on the turnover of the tenant (on an annual basis). Chief Finance Officer wants to account/recognize licence fee as income for 12 months during current year under audit and variable licence fees as income during next year, since invoice is raised in the subsequent year. As an auditor, how would you deal and state in the statement of Accounting policies? (6 marks)

Answer :

Revenue Recognition :

AS 9 is mainly concerned with the timing of recognition of revenue in the statements of profit and loss of an enterprises. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction. However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

As per accrual concept of fundamental accounting assumptions given in AS 1, revenue should be recognised as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate.

Present Case:

In the given case, monthly rental towards licence fees and variable licence fees as a percentage on the turnover of the tenant though on annual basis is the income related to common financial year. Hence, recognition of the fees as revenue cannot be deferred simply because the invoice is raised in subsequent period. Therefore, it should be recognised in the financial year of accrual.

Hence, the contention of the CFO is not in accordance with the provisions of AS 9 and the auditor may qualify the report indicating the understatement of income/profit and that the P/L Account does not exhibit a true and fair view of the profit or loss.

—— Space to write important points for revision ——

2011 - Nov [5] (c) ABC Private Ltd, has granted loan of ₹ 20 crores to XYZ Ltd. a sister concern and it remains outstanding at the year end. How would you report the fact? (4 marks)

Answer :

Reporting of "Loan to Related Party":

As per **AS 18 "Related Party Disclosures"**, related party transaction means a transfer of resources or obligations between related parties, regardless of whether or not a price is charged.

According to this AS, in the case of related party transactions, the reporting enterprise should disclose the following:

1. the name of the transacting related party;
2. a description of the relationship between the parties;
3. a description of the nature of transactions;
4. volume of the transactions either as an amount or as an appropriate proportion;
5. any other elements of the related party transactions necessary for an understanding of the financial statements;
6. the amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and
7. amounts written off or written back in the period in respect of debts due from or to related parties."

Present Case:

In the instant case, ABC Pvt. Ltd. has granted a loan of ₹ 20 crores to XYZ Ltd., a sister concern and it remains outstanding at the year end. The case is squarely covered by AS 18.

Further, SA 550 on "Related Parties", also prescribes the auditor's responsibilities and audit procedures regarding related party transactions. Auditor should insist to make proper disclosure as per the AS and if management refuses, the auditor shall have to modify his report.

—— Space to write important points for revision ——

2012 - May [1] {C} (a) A Ltd. is a manufacturer of readymade garments. It sells its products to franchisees located across the country. Readymade garment industry is subject to change in trends of fashion and as such, some of the goods are returned and A Ltd. accepts them back as sales returns. On the basis of past trends such returns are estimated to be at 20% of the sales of any year. For the financial year 2011-12, A Ltd. had accounted for the actual sales return made upto 31st March 2012 but has not reversed the possible expected return that are likely to happen after 31st March 2012, in respect of the sale made for the FY 11-12. Mr. X the auditor of A Ltd. wants this to be considered in the accounts for the year ended on 31st March 2012 but the company is of the opinion that although there is a probability of some goods being returned by the franchisees, there is no significant uncertainty regarding the amount of consideration that will be derived from the sale of goods, since the goods are not in the possession of the company and risk and rewards of ownership still lie with the franchisees and the company cannot record sales returns in its books of account in respect of goods that are likely to be received after the date of balance sheet. Comment.

(5 marks)

Answer:

Revenue Recognition :

AS 9 is mainly concerned with the timing of recognition of revenue in the statements of profit and loss of an enterprises. The amount of revenue arising on a transaction is usually determined by agreement between the parties involved in the transaction.

However, when uncertainties exist regarding the determination of the amount, or its associated costs, these uncertainties may influence the timing of revenue recognition.

As per accrual concept of fundamental accounting assumptions given in AS1, revenue should be recognised as and when it is accrued i.e. recorded in the financial statements of the periods to which they relate.

In the given case, A Ltd. is a manufacturer of readymade garments and sells its products to franchisees located across the country. Due to change in trends of fashion etc. sold goods are being returned and A Ltd. accepts them back as sales returns. On the basis of past trends such returns are estimated as 20% of the sales of any year.

Thus, the company is bearing the risk of sales return and therefore, the company should not recognize the revenue to the extent of 20% of its sales. The company may disclose suitable revenue recognition policy in its financial statements separately. In the absence of the above, the auditor must qualify his report.

2012 - Nov [1] {C} As a statutory auditor of a company, comment on the following:

(a) A fire broke out on 15th May, 2012, in which material worth ₹ 50 lakhs which was lying in stock since 1st March, 2012 was totally destroyed. The financial statements of the company have not been adopted till the date of fire. The management of the company argues that since the loss occurred in the year 2012-13, no provision for the loss needs to be made in the financial statements for 2011-12. (5 marks)

Answer:

Event Occurring after Balance Sheet Date

According to SA 560 on Subsequent Events, the auditor shall ensure 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.

As per **AS 4 "Contingencies and Events occurring after the Balance Sheet Date"**, adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date.

Present Case:

Fire broke out on 15th May 2012 i.e. after the close of the accounting year. Moreover it does not relate to conditions existing at Balance Sheet date. Thus it will have no effect on items appearing at the balance sheet date. Thus, the management's argument of no provision for the loss needs to be made in the financial statement for 2011-12 is correct. However the auditor is required to ensure the proper disclosure of the above mentioned event.

—— Space to write important points for revision ——

2012 - Nov [1] {C} As a statutory auditor of a company, comment on the following:

(d) The accounting policy on Revenue Recognition for a company engaged in manufacture and sale of chemical products was stated as "Revenue is recognized only when it can be reliably measured and it is reasonable to expect ultimate collection." (5 marks)

Answer :

Revenue Recognition:

According to **AS 9, Revenue Recognition**, in a transaction involving the sale of goods, performance should be regarded as being achieved when the following conditions have been fulfilled:

1. the seller of goods has transferred to the buyer the property in the goods for a price or all significant risks and rewards of ownership have been transferred to the buyer and the seller retains no effective control of the goods transferred to a degree usually associated with ownership; and
2. no significant uncertainty exists regarding the amount of the consideration that will be derived from the sale of the goods.

According to AS 1, Accounting Policy on Revenue Recognition, Revenue is recognised only when it can be reliably measured and it is reasonable to expect ultimate collection.

Present Case

The company has made disclosure in the accounting policy on recognition of revenue as per AS 1. The contention is not wrong. However, it should also cover the aspect of transfer of risk and reward for the purpose of revenue recognition as per AS 9.

—— Space to write important points for revision ——

2013 - May [1] {C} (b) Z Ltd. changed its employee remuneration policy from 1st of April 2012 to provide for 12% contribution to provident fund on leave encashment also. As per the leave encashment policy the employees can either utilize or encash it. As at 31st March 13 the company obtained an actuarial valuation for leave encashment liability. However it did not provide for 12% PF contribution on it. The auditor of the company wants it to be provided but the management replied that as and when the employees availed leave encashment, the provident fund contribution was made. The company further contends that this is the correct treatment as it is not sure whether the employees will avail leave encashment or utilize It. Comment.

[Modified] (5 marks)

Answer:

According to **AS-15 on "Employee Benefits"**, an enterprise should recognize the expected cost of short-term employee benefits in the form of compensated absences in the case of accumulating compensated absences, when the employees render services that increases their entitlement to future compensated absences.

The compensated absence are accumulating in nature because the company obtained actuarial valuation for leave encashment. An enterprise should therefore measure the expected cost of accumulating compensated absences as the additional amount that the enterprise expects to pay as a result of the unused entitlement that has accumulated at that balance sheet date.

Present Case:

In the present case, Z Ltd. will accumulate the amount of leave encashment benefits as it is the liability of the company to provide 12% PF on the amount of leave encashment. Thus, the contention of the auditor is correct that full provision should be provided by the company.

—— Space to write important points for revision ——

2013 - May [1] {C} (c) T Ltd. commenced its manufacturing activities from 1st April 2012. In the course of production the company generated certain by - products. As at 31st March 13 the company did not value the by-products considering the value as insignificant. The auditor of the company is of the opinion that the by-products are inventory of the company and it should be valued and brought into books of account . Comment.

[Modified] (5 marks)

Answer:

According to **AS-2 on "Valuation of Inventories"**, a production process may result in more than one product being produced simultaneously, when joint products are produced or when there is a main product and by-products. If the cost of conversion of each produced are not separable, they are allocated on a rational and consistent basis.

Many of the by-products as well as scrap or waste materials are immaterial. They are usually measured at net realizable value and this value is deducted from the cost of the main product. In the present case, as the value of the by-products is insignificant, the realizable value of by products should be ascertained and it should be deducted from the cost of the main product.

As per **AS - 2,** Inventories are those assets.

(a) which are held for sale in the ordinary course of business
(b) in the process of production for such sale
(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

As the stock of by-products is a resource controlled by T Ltd., it is an asset and it is inventory because it is held for sale in the ordinary course of business.

Thus in the present case of T Ltd. should deduct the realizable value of its by products from the cost of production of main product.

—— Space to write important points for revision ——

2013 - May [1] {C} (d) K Ltd. had 5 subsidiaries as at 31st March 2013 and the investments in subsidiaries are considered as long term and valued at cost. Two of the subsidiaries net worth eroded as at 31st March 13 and the prospects of their recovery are very bleak and the other three subsidiaries are doing exceptionally well. The company did not provide for the decline in the value of investments in two subsidiaries because the overall investment portfolio in subsidiaries did not suffer any decline as the other three subsidiaries are doing exceptionally well. Comment. **[Modified]** (5 marks)

Answer:

According to **AS-13 "Accounting for Investments"** Long-term investments are usually of individual importance to the investing enterprise. The carrying amount of long-term investments is therefore determined on an individual investment basis. Investments classified as long - term investments should be carried in the financial statements at cost. However, the provision for diminution shall be made to recognize a decline, other than temporary, in the value of investments, such reduction being determined and made for each investment individually.

Present case: K Ltd. should provide for the decline in the value of investments in two subsidiaries despite the fact that the overall investment portfolio in subsidiaries did not suffer any decline.

—— Space to write important points for revision ——

2013 - Nov [1] {C} (a) X Limited, a newly incorporated company in India commenced its business from April 1, 2012. The Company purchased fixed assets costing ₹ 4,000 lakhs on 01-04-2012 and the same was fully financed by foreign currency loan (U.S. Dollars) payable in three annual equal installments. Exchange rates were 1 Dollar = ₹ 40.00 and ₹ 42.50 as on 01-04-2012 and 31-03-2013 respectively. The company worked out foreign exchange loss as per AS 11 at ₹ 250 Lakhs and expensed the entire amount in the profit and loss account.

The Managing Director of the company was worried about this heavy revenue loss and asked the accountant not to follow AS 11 issued by the ICAI for this particular transaction. The Accountant of the company, followed the instruction of the Managing Director and removed exchange loss from the profit and loss account but then he added the entire exchange loss to the value of fixed asset and computed the depreciation thereon. As an Auditor of X Limited how you would deal with this particular transaction? (5 marks)

Answer:

According to Para 46A(1) of AS 11, "The Effects of Changes in Foreign Exchange Rates" inserted by Ministry of Corporate Affairs by way of notification, the exchange differences arising on reporting of long-term foreign currency monetary items in so far as they relate to the acquisition of a depreciable capital asset in respects of accounting periods commencing on or after the 1st April, 2011. Such exchange differences can be added to or deducted from the cost of the asset and shall be depreciated over the balance life of the asset, it can be accumulated in a "Foreign Currency Monetary item Translation Difference Account" over the balance period of such long term asset or liability, by recognition as income or expense in each of such periods.

Present Case:

Therefore, X Ltd. can adopt this option. However, the company should disclose the fact of such option and of the amount remaining to be amortized in the financial statements of the period in which such option is exercised and in every coming period so long as any exchange difference remains unamortized.

—— Space to write important points for revision ——

2013 - Nov [3] (a) Excellent Limited, a Company incorporated in India and listed with SEBI, has a scheme for payment of settlement allowance to retiring employees. Under the scheme, retiring employees are entitled to reimbursement of certain travel expenses for class they are entitled to as per company rules and regulations. Employees are also entitled to claim a lump-sum payment to cover expenses on food and stay during the travel. The Company also gives option to employees that they can claim a lump-sum amount equal to three months pay last drawn.

Excellent Limited have following accounting policies to record these travel expenses:

(i) Settlement allowance does not depend upon the length of service of employee. It is restricted to employee's eligibility under the travel rule of the company therefore all travel expenses fall under the category of defined contribution plans.

(ii) Since it is not related to the length of service of the employees, it is difficult to estimate reliably and there is no present obligation to pay employees as per AS 29 "Provisions, Contingent Liabilities and Contingent Assets", hence it is accounted for on claim basis.

You are statutory auditor of Excellent Limited. What would be your guidance to audit team? (4 marks)

Answer:

The present case falls under the category of defined benefit scheme under AS 15 "Employee Benefits". The said scheme encompasses cases where payment promised to be made to an employee at or near retirement presents significant difficulties in the determination of periodic charge to the statement of profit and loss. In estimating the obligation, assumptions may need to be made regarding future conditions and events, which are largely outside the company's control.

Thus:

1. Settlement allowance payable by the company is a defined retirement benefit, covered by AS 15.
2. A provision should be made every year in the accounts for the accruing liability on account of settlement allowance. The amount of provision should be calculated according to actuarial valuation.
3. Where, however, the amount of provision so determined is not material, the company can follow some other method of accounting for settlement allowances.

—— Space to write important points for revision ——

2013 - Nov [5] (a) X Ltd. is engaged in the business of newspaper and radio broadcasting. It operates through different brand names. During FY 12-13 it incurred substantial amounts on external trade, business communication and branding expenses by participation in various corporate social responsibility initiatives. The company expects to benefits by this expenditure by attracting new customers over a period of time and accordingly it has capitalized the same under brand development expenses and intends to amortize the same over the period in which it expects the benefits to flow. As the statutory auditor of the company do you concur? Give reasons. (4 marks)

Answer:

AS - 26 on "Intangible Assets", relates to expenditure on an intangible item should be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria.

In the above case, it incurred substantial amounts on external trade, business communication by participation in various corporate social responsibility initiatives. Here, no intangible asset or other asset is acquired or created that can be recognized.

Therefore the accounting treatment by the company to amortize the entire expenditure over the period in which it expects the benefits to flow is not correct and the same should be debited to the Profit & Loss Account.

—— Space to write important points for revision ——

2014 - Nov [1] {C} (a) In the Notes to Accounts of Z Co. Ltd. as on 31-03-2014 Note no. 10 states that certain machinery items are lying at customs warehouses and that the Company has paid ₹ 500 lakhs up to 30-06-2013 as detention charges, out of which a sum of ₹ 220 lakhs is written back during the year 2013-14 based on settlement with the concerned authorities in respect of a major spares of machinery. For the remaining machinery items, negotiations are pending and a provision of ₹ 48 lakhs has been made. As such a total amount of ₹ 328 lakhs paid/ provided on account of detention charges have been capitalized and included in the Fixed Assets/Capital work in progress. The Management is of the view that these expenses are directly attributable to the acquisition of the related Fixed Assets. As the auditor how would you respond to this? (5 marks)

Answer:

→ As per **AS 10 'Property, Plant and Equipment'**, the cost which is directly attributable to the acquisition or installation of the PPE should be capitalised.

→ In the present case company has paid detention charges. As detention charges are not directly attributable to the acquisition or installation of fixed asset.

→ Detention charges should be charged to P&L account and not capitalised.

→ So, accounting treatment given by the company is wrong. The auditor should qualify his report.

The qualification will be as follows:

"Attention is invited to Note no. 10 regarding Capitalization of detention charges of ₹ 328 lakhs during the year and on account of delays in respect of clearing from custom warehouses for certain machinery items. In our opinion the detention charges are not directly attributable to the acquisition of related PPE. The said amount of ₹ 328 lakhs should have been written off in the Statement of Profit and Loss. Had these expenses been so written off, the profits for the year would have been lower by ₹ 328 lakhs and Reserves & Surplus as well as PPE/Capital WIP would have been lower by ₹ 328 lakhs."

Space to write important points for revision

2016 - May [6] (a) K Ltd. changed its employee remuneration policy from 1st of April 2015 to provide for 12% contribution to provident fund on leave encashment also. The leave encashment policy provides that employees can either utilize or encash it. As at 31st March, 2016, the company obtained an actuarial valuation for leave encashment liability. However, it did not provide for 12% PF contribution on it. The auditor of the company wants it to be provided but the management replied that as and when the employees availed leave encashment, the provident fund contribution would be made. It is further contended that this treatment is correct as it is not sure whether employees will avail leave encashment or utilize it. Comment. (4 marks)

Answer:

As per part II of the AS-15 on "Employee Benefits" issued by the ICAI, an enterprise should recognise the expected cost of short-term employee benefits in the form of compensated absences in the case of accumulating compensated absences, when the employee render service that increases under their entitlement to future compensated absences.

Since the company obtained actuarial valuation for leave encashment, it is obvious that the compensated absences are accumulating in nature. An enterprise should measure the expected cost of accumulating compensated absences as the additional amount that it expects to pay as a result of unused entitlement that has accumulated at the balance sheet date.

Hence, auditors contention to full provision should be provided by the company is correct.

—— Space to write important points for revision ——

2017 - Nov [1] {C} (a) As an auditor of a company registered under section 8 of the Companies Act, 2013 you find that as per the notification of the Ministry of Corporate Affairs regarding applicability of Indian Accounting Standards (Ind-AS), the company has to prepare its financial statements for the year ended 31st March, 2017 under Ind-AS. The management of the company is however of the strong view that being a Section 8 company having charitable objects, Ind-AS cannot apply to the company. The financial statements are therefore prepared by the management under the earlier GAAP and a note for the same is given in the financial statements. How would you report on these financial statements? (5 marks)

Answer:

Provision:

Every company to which Ind AS apply, shall prepare its Financial Statement in accordance with Schedule III of the Companies Act, 2013 and comply with Accounting Standard as notified u/s 133 of the Companies Act, 2013. And there is no specific exemption for Sec. 8 companies from applicability of Ind AS.

Present Case:

The management of the company is under a strong view that Ind AS is not applicable to companies registered under Sec. 8 and therefore has prepared the financial statement under the earlier GAAP and not as per Ind AS.

Therefore, the auditor is required:

- to make a disclosure in the Audit Report of the non compliance of Sec. 133 of the Companies Act, 2013
- to modify his report as per SA 705.

—— Space to write important points for revision ——

2018 - May [1] {C} (b) The Property, Plant and Equipment of ABC Ltd. included ₹ 25.75 crores of earth removing machines of outdated technology which had been retired from active use and had been kept for disposal after knock down. These assets appeared at residual value and had been last inspected ten years back. As an Auditor, what may be your reporting concern as regards matters specified above? (5 marks)

Answer:

Disclosure in Audit Report:

The auditor is required to specifically include certain matters as per CARO, 2020 under Sec. 143 of the Companies Act, 2013.

According to Clause (i) (a) of CARO, 2020 the auditor has to comment.

(a) (i) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of Property, Plant and Equipment;

(ii) whether the company is maintaining proper records showing full particulars of intangible assets;

(b) whether these Property, Plant and Equipment have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

Hence, this fact needs to be disclosed in the Audit Report as per clause (i) (a) and (b) of Paragraph 3 of CARO 2020.

—— Space to write important points for revision ——

2018 - May [2] (a) As an Auditor give your comments for the following disclosures made by a Company which adopted Ind As for compilation of Financial Statements:

(i) In the Balance Sheet, the sub-head inventories contained an item "goods in transit" in which a consolidated amount aggregating the cost of raw materials in transit and loose tools billed on company but delivery not made to company had been specified.

(ii) Provision for doubtful debts of trade debtors was grouped in "Provisions" under current liabilities.

(iii) In Statement of Profit and Loss, prior period income was shown under "Other Income".

(iv) Sale proceeds of scrap incidental to manufacture were included in "Other Income".

(v) Payment towards a one time voluntary retirement scheme introduced during the year was included in "Employee Benefit Expense".

(5 marks)

Answer:

(i) Goods in Transit is required to be disclosed under head of inventories and the amount which is total of Cost of raw material and other items.

(ii) Provisions shall be required to be deduced from sundry debtors and not to be grouped in the provisions in balance sheet under current liabilities.

(iii) Other income shall be required to be mention in as prior period item head and such other income head.

(iv) Sale of scrap incidental to manufacture shall be required to be reduced from material not to be shown in other income.

(v) Payment toward a one time voluntary retirement scheme required to be shown in employee benefit expense which is correctly disclosed.

—— Space to write important points for revision ——

2018 - Nov [1] {C} (b) Amudhan & Co., are the Auditors of XYZ Company Ltd., for the year ended on 31/03/2018. The Audit Report for that year was signed by the Auditors on 04/05/2018. The Annual General Meeting was decided to be held during the month of August 2018. On 06/05/2018, the Company had received a communication from the Central Government that an amount of ₹ 5,800 crore kept pending on account of incentives pertaining to Financial Year 2017-18 had been approved and the amount would be paid to the Company before the end of May 2018. To a query to Chief Financial Officer of the Company by the Board, it was informed that this amount had not been recognised in the Audited Financial Statements in view of the same not being released before the close of the Financial Year and due to uncertainty of receipt. Now, having received the amount, the Board of Directors wished to include this amount in the Financial Statements of the Company for the Financial Year ended on 31/03/2018. On 08/05/2018, the Board amended the accounts, approved the same and requested the Auditor to consider this event and issue a fresh Audit Report on the Financial Statements for the year ended on 31/03/2018. Analyse the issues involved and give your views as to whether or not the Auditors could accede to the request of the Board of Directors. (5 marks)

Answer:

Provision:

This case requires attention to SA 560 "Subsequent Events" and AS 4 "Contingencies and Events occurring after the Balance Sheet Date".

As per AS 4 "Contingencies and Events occurring after the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern (i.e. the continuance of existence or substrum of the enterprise) is not appropriate.

AS 4 also requires disclosure of the non-adjusting event, in the report of the approving authority.

Further, as per SA 560 "Subsequent Events", the auditor should assure 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.

Present Case:

In the instant case, XYZ Company Ltd. received an amount of rupees 5,800 crore on account of incentives pertaining to year 2017-18 in the month of May 2018 i.e. after finalisation of financial statements and signing of audit report. Board of Directors of XYZ Ltd. amended the accounts, approved the same and requested the Amudhan & Co. (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2018.

After applying the conditions given in SA 560, Amudhan & Co. can issue new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

—— Space to write important points for revision ——

2019 - Nov [3] (a) As an auditor of a company registered under section 8 of the Companies Act, 2013 you find that as per the notification of the Ministry of Corporate Affairs regarding applicability of Indian According Standards (Ind-AS), the company has to prepare its financial statements for the year ended 31st March, 2019 under Ind-AS. The management of the company is however of the strong view that being a section 8 company having charitable objects, Ind-AS cannot apply to the company. The financial statements are therefore prepared by the management under the earlier GAAP and a note for the same is given in the financial statements. How would you report on these financial statement? (5 marks)

Answer:

Applicability of IND AS: Section 129(1) of the Companies Act, 2013, governs the requirements to be satisfied by financial statements. The provisions thereunder which should be complied with are:

- financial statements shall, give a true and fair view of the state of affairs of the company or companies as at the end of financial year, comply with the notified accounting standards under section 133 and be in such form or forms specified in Schedule III to the Companies Act, 2013 and
- the items contained in such financial statements shall be in accordance with the accounting standards.

Further, as per **section 133 of the Companies Act, 2013,** the Central Government has notified **Companies (Indian Accounting Standards) Rules, 2015 dated 16.02.2015** in exercise of the powers conferred by section 133. The said rules list the Indian Accounting Standards (IND AS) and the class of companies required to comply with the IND AS while preparation of their financial statements.

Here, it may be noted that the companies covered under Section 8 are required to comply the provisions of the Companies Act, 2013, unless and until any exemption is provided. Therefore, companies registered under section 8 are not exempted from the requirements of section 133 and 129 of the Companies Act, 2013.

- Section 8 Companies are also covered for the applicability of Ind AS. The Company shall require to prepare financial station as per Indian Accounting Standards as no exception is given to Section 8 Company.
- Here, view of the management regarding non-applicability of Ind As is not tenable.
- However, the Section 8 Company has prepared its financial Statements by using GAAP. It should be disclosed in Board's report.
- The Auditor of the Section 8 Company shall require to qualify its report as for non-compliance with Indian accounting standards.

2021 - Jan [5] (a) M/s. HK & Co. was appointed as an auditor of GSB Limited, a company operating its business in telecom sector. As per spectrum allocation agreement with Government, GSB Limited is required to pay certain percentage of its annual revenue as license fee. GSB Limited paid the license fee on its core business for last two years. At the end of third year, the communication was received from Government that it needs to pay agreed percentage on its total revenues and not only on core business revenues. Matter was disputed and went to court of law. On prudence basis, GSB Limited made a provision on estimated business in its books of accounts of agreed percentage on non-core business receipts also. The amount of provision was of such huge amount that the GSB Limited's profit and loss account for that quarter reflected loss due to that provision. How you as an auditor can evaluate this accounting estimate which involves significant risk and what if Management has not addressed the effects of estimation uncertainty on provision made? (4 marks)

Answer:

In the given case, HK & Co. was appointed as an auditor of GSB Ltd., operating in Telecom sector. GSB Ltd paid the license fee on its core business revenue whereas Govt required it to pay on non-core business receipts as well. Consequently, the amount of provision was of such a huge amount that GSB Ltd.'s profit and loss account reflected a loss due to that provision. As an auditor evaluation would be done as under:

For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of SA 330, the auditor shall evaluate the following:

(i) How management has considered alternative assumptions or outcomes, and why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.

(ii) Whether the significant assumptions used by management are reasonable.

(iii) Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action and its ability to do so.

(iv) If, in the auditor's judgment, management has not adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, develop a range with which to evaluate the reasonableness of the accounting estimate.

Space to write important points for revision

Similarly Asked Questions

No.	Category	Question	Marks	Frequency
1	Practical	Practical question of 13 - May [1] (b), 16 - May [6] (a)	5, 4	2 Times

Table Showing Marks of Compulsory Questions

Year	17 M	17 N	18 M	18 N	19 M	19 N	20 N	21 J	21 J	21 D
Practical		5	5	5						
Total		5	5	5						