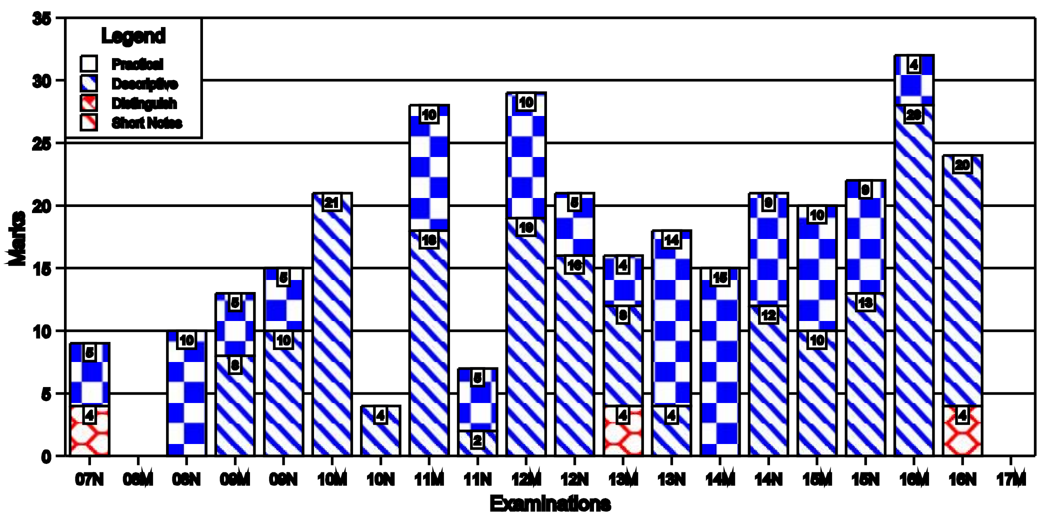
Star Rating

On the basis of Maximum marks from a chapter	☆☆☆☆
On the basis of Questions included every year from a chapter	Nil
On the basis of Compulsory questions from a chapter	☆☆☆☆

1(a) Auditing Standards, Statements & Guidance Notes

This Chapter Includes : Auditing and Assurance Standards Board – Scope and Functions; Framework of Standards and Guidance Notes on Related Services; Quality Control and Engagement Standards; Guidance Notes; Guidance Note(s) on Related Services; Authority Attached to the Documents issued by the Institute.

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



CA Final Gr. I

SHORT NOTES

2007 - Nov [8] Write short note on the following:
(f) Situations where external confirmations can be used. (4 marks)

Answer :

As per SA 505, external confirmations are the audit evidences obtained as a direct written response to the auditor from a third party (the confirming party) in paper form, or by electronic or other medium.

Situations where external confirmations can be used:

1. Bank balance from bankers
2. Account receivable balances
3. Stocks held by third parties
4. Property title deeds held by third parties
5. Investments purchased but delivery not taken
6. Loan from lenders
7. Account payable balance
8. Long outstanding share application money.

PRACTICAL QUESTIONS

2007 - Nov [1] {C} (c) As a Statutory Auditor, how would you deal with the following? For the year ended 31st March, 2007, a company has paid Minimum Alternative tax under Section 115 JB of the Income Tax Act, 1961. The company wants to disclose the same as an 'Asset' since the company is eligible to claim credit for the same. (5 marks)

Answer :

The concerned issue is discussed in the Guidance Note issued by ICAI on "Accounting for Credit available in respect of MAT under the IT Act, 1961".

As per para 6 of the said Guidance Note although MAT credit is not a deferred tax asset under AS 22, yet it give rise to expected future economic benefit in the form of adjustment of future income tax liability arising within the specified period.

The Framework for the Preparation and Presentation of Financial Statements, issued by the ICAI, defines the term ‘asset’ as follows:

“An asset is a resource controlled by the enterprise as a result of past events from which future economic benefits are expected to flow to the enterprise”.

MAT paid in a year in respect of which the credit is allowed during the specified period under the Income Tax Act is a resource controlled by the company as a result of past event, namely the payment of MAT. MAT credit has expected future economic benefits in the form of its adjustment against the discharge of the normal tax liability if the same arises during the specified period. Accordingly, MAT credit is an asset.

According to the framework, once an item meets the definition of the term ‘asset’, it has to meet the criteria for recognition of an asset so that it may be recognized as such in the financial statements. Para 88 of the Framework provides the following criteria for recognition of an asset: an asset is recognized in the balance sheet when it is probable that the future economic benefits associated with it will flow to the enterprise and the asset has a cost or value that can be measured reliably.

Thus, if the auditor is satisfied that the probability of the company to claim the said credit is high, it could recognize the same as an asset. As per Schedule III, in balance sheet it should be shown under the head “Long term Loans & Advances” as “MAT credit entitlement.

CA Final Gr. I (New Course)

SHORT NOTES

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

(c) Corresponding figures (4 marks)

Answer :

As per SA - 710 Comparative Information- Corresponding Figures and Comparative Financial statements, corresponding figures: 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.

2016 - Nov [7] Write short notes 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.

DESCRIPTIVE QUESTIONS

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.

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", 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.

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, *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 clients, 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'.

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.

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.

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.

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 Statement

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.

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.

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.

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.

SA- 200, "Basic Principles Governing an Audit", 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.

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.

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.

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.

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.

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:

Evaluation of Internal Audit Function:

The external auditor should as a part of his audit, carry out general evaluation of the internal audit function to determine the extent to which he can place reliance upon the work of the internal auditor.

As per **SA-610 "Using the work of Internal Auditors", the important aspects to be considered by external auditor are:**

1. **Organisational Status:** An important aspect is whether the audit is being carried out by outside agency or by departmental team. Another related aspect is level in the organisation to whom the report is addressed and whether he is free to communicate with the external auditor.
2. **Scope of Function:** Nature and depth of coverage of the internal audit and to what extent the management considers and where appropriate, act upon the recommendations of the internal auditor.
3. **Technical competence:** Internal audit work is performed by persons having adequate technical training and proficiency. Professional qualification and experience of the persons carrying out internal audit function also need to be considered.

4. **Due professional care:** It should be ascertained that the internal audit appears to be properly planned, supervised, reviewed and documented. Existence of proper internal audit manual, programmes and working papers will lead to the establishment of due professional care.

   The external auditor should document his evaluation and conclusion of all the above factors.

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:

The duties of an auditor with regard to reporting of transactions with related parties as required by Accounting Standard 18 are given in SA - 550 on Related Parties. As per SA-550 on "Related Parties" the auditor should review information provided by the management of the entity identifying the names of all known related parties. Since it is the management which is primarily responsible for identification of related parties, SA-550 requires that to identify names of all known related parties, **the auditor may carry out the following procedures:**

1. Review his working papers for previous years for names of known related parties;
2. Review the entity's procedures for identification of related parties;
3. Inquire as to affiliation of directors, key management personnel and offices with other entities, etc;
4. Review shareholder records to determine the names of principal shareholders or, if appropriate, obtain a list of principal shareholders from the share register;
5. Review memorandum and articles of association, minutes of the meetings of shareholders and the board of directors and its committees and other relevant statutory records such as the register of directors' interests;

6. Inquire of other auditors such as internal auditor, special auditors appointed under any statute, cost auditors, and concurrent auditors of the entity as to their knowledge of additional related parties and review the report of the predecessor auditors.
7. Review the entity's income tax returns and other information supplied to regulatory agencies; and
8. Review the joint venture and other relevant agreements entered into by the entity.

   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. Examples include-

   - Transactions which have abnormal terms of trade, such as, unusual prices, interest rates, guarantees, and repayment terms.
   - Transactions which lack an apparent logical business reason for their occurrence.
   - Transactions in which substance differs from form.
   - Transactions processed in an unusual manner.
   - High volume or significant transactions with certain customers or suppliers as compared with others.
   - Rendition of services without receipt or provision of management services at no charge.

     Finally, the auditor should also obtain a written representation from the management concerning the completeness of information provided regarding the identifications of related parties.

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).

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

- Matters that do not affect the auditor's opinion (Emphasis of matter)
- Matters that do affect the auditors opinions including qualified opinion, disclaimer of opinion or adverse opinion.

Matters that do not affect the Auditor's Opinion (Emphasis of matter)

1. In respect of matters that do not affect the auditor's opinion, the auditor should modify the report by adding a paragraph to highlight a matter.
2. The addition of such an emphasis of matter paragraph does not affect the auditor's opinion.
3. The paragraph would preferably be included preceding the opinion paragraph.

For example: Some uncertainty, the resolution of which is dependent on future events and which may significantly affect the financial statements and the same has already been incorporated by management in financial statement.

4. In such matters, the opinion paragraph would refer to the fact that auditor's opinion is not qualified in this respect.

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. 33

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 :

As per SA-450 "Evaluation of Misstatements Identified during the Audit", the following are the sources of misstatements arising from other than fraud -

1. Any inaccuracy in gathering or processing data from the financial statements that are prepared;
2. Any omission of an amount or disclosure;
3. Any incorrect accounting estimate arising from overlooking, or clear misrepresentation of facts; and
4. Any Judgement of management relating to accounting estimates that the auditor considers unreasonable or the selection and application of accounting policies that the auditor considers inappropriate.

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:

According to **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.

2013 - Nov [2] (d) Mr. X was appointed as the auditor of M/s Easygo 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:

According to **SA 320 on "Materiality in Planning and Performing an Audit",** 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:**

1. The elements of the financial statements (for e.g., assets, liabilities, equity, revenue, expenses).
2. 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.
3. The relative volatility of the benchmark.
4. Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused.

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, 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 [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.

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 Related Parties, in relation to related party transactions the Auditor shall ensure the following:

- Whether related parties are properly identified, accounted and disclosed as per financial reporting framework.
- Identifying fraud risk factors relating to related parties transactions.
- Ensuring that the financial statements are true and fair.

The auditor shall perform the following procedures in relation to the related party transaction :

1. Verify the internal controls in relation to related party transactions.
2. Understand the business rationale, terms of contract and accounting with respect to Related party transactions.
3. Compare the transactions of related parties with market rates, other transactions, etc.
4. Obtain expert opinion if need be.

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.

The auditor shall obtain a management representation that all the related party transactions are properly approved, accounted and disclosed in the financial statements and are executed at Arm's-Length price.

2015 - May [1] {C} (b) The financial statements of TC & Co. have been prepared by management of an entity in accordance with the financial reporting provisions of a contract (that is, a special purpose framework) to comply with provisions of the contract. Based on the contract, management does not have a choice of financial reporting frameworks. As an auditor what considerations would be undertaken while planning and performing audit? (5 marks)

Answer:

Considerations for Planning and Performing Audit in case of Special Purpose Framework:

As per SA 800 "Audits of Financial Statements Prepared in accordance with Special Purpose Frameworks", financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed.

While planning and performing audit of such special purpose framework based company, the auditor should consider below mentioned factors:

1. **Users' Needs:** The financial information needs of the intended users are a key factor in determining the acceptability of the Financial Reporting Framework applied in the preparation of special purpose financial statements.
2. **Standards Established by Organisations:** Where Financial Reporting Standards are established by an organization that is authorized or recognized to promulgate standards for special purpose financial statements, those standards will be presumed acceptable for that purpose, if the organization follows an established and transport process involving deliberation and consideration of the views of relevant stakeholders.

3. **Law/Regulation:** Where law(s) or regulation(s) prescribes the Financial Reporting Framework to be used by Management in the preparation of special purpose financial statements for a certain type of Entity, in the absence of indications to the contrary, such a Financial Reporting Framework is presumed acceptable for special purpose financial statements prepared by such Entity.
4. **Professional Judgement:** If the applicable Financial Reporting Framework encompasses the Financial Reporting provisions of a contract, the acceptability of the Financial Reporting Framework in the circumstances of the engagement is determined by considering whether the framework exhibits attributes normally exhibited by Acceptable Financial Reporting Frameworks. In the case of a special purpose framework, the relative importance to a particular engagement of each of the attributes normally exhibited by Acceptable Financial Reporting Frameworks is a matter of Professional Judgement.
5. Communication with those charged with governance in accordance with SAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility.

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:

Report on description and design of controls at a service organization (called as Type 1 Report)

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. The sub-service organisation may be a separate entity from the service organisation or may be related to the service organisation.

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.

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 & 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.

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. 33

2015 - Nov [6] (d) While compiling the accounts of Hope Ltd., you observed that a few accounting standards have not been followed and there have been omission of some information which was required to be followed in the current situation. How would you deal with this? (4 marks)

Answer:

According to **SRS 4410, Engagements to compile Financial Information**, an accountant would normally have to rely upon the management for information to compile the financial statements in compilation engagement. If it is observed that the Information supplied by the entity is incorrect, incomplete or otherwise unsatisfactory, the accountant should perform following procedures:

- Make enquiries to management to assess the reliability and completeness of the information provided.
- Assess internal controls prevailing in the entity.
- Verify any matters or Explanations.

If one or more Accounting Standards are not complied with, the same should so brought to the notice of the management and if the same is not rectified by the management, the accountant should include the same in notes to the Accounts.

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.

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”, 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.

2016 - May [1] {C} (c) The management of CSITA Ltd. has prepared its summary financial statements for the year 2015-16 to be provided to its investors. Consequently the company wants to appoint you for conducting audit of summary financial statements. What are the procedures that you will perform and consider necessary as the basis for forming an opinion on the summary financial statements? (5 marks)

Answer:

As per SA 810 "Engagement to Report on Summary Financial Statements", following procedure will be performed by auditors:

- Evaluate whether Summary Financial Statement (SFS) adequately disclose their summarised nature, identify Audited Financial Statements (AFS).
- When SFS are not accompanied by AFS, evaluate whether they describe clearly:
  - ➢ Laws & Regulation that specifies, AFS need not be made available to intended users of SFS.
  - ➢ From whom and where AFS are available.
- Evaluate whether SFS adequately disclose the applied criteria.
- Evaluate whether SFS are prepared in accordance with applied criteria.
- Whether SFS contain necessary information which is not misleading.
- Whether SFS agree with related information in AFS.
- Whether AFS are available to intended users without undue difficulty.

2016 - May [1] {C} (d) The financial statements of Ace Ltd. have been prepared by the management in accordance with special purpose frame work to meet the financial reporting provisions of a regulator. As an auditor, what considerations would be undertaken while planning and performing an audit in case of such special purpose frame work? (5 marks)

Answer:

Considerations for Planning and Performing Audit in case of Special Purpose Framework:

As per **SA 800 "Special Considerations-Audits of Financial Statements Prepared in accordance with Special Purpose Frameworks",** financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares.

In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed.

While planning and performing audit of such special purpose framework based company, the auditor should consider below mentioned factors:

1. To obtain an understanding of the entity's selection and application of accounting policies. In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements.
2. Compliance of all SAs relevant to audit, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement.
3. Application of some of the requirements of the SAs in an audit of special purpose financial statements may require special consideration by the auditor. For example, in SA 320, judgements about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. In the case of an audit of special purpose financial statements, however, those judgements are based on a consideration of the financial information needs of the intended users.
4. In the case of special purpose financial statements, such as those prepared in accordance with the requirements of a contract, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose financial statements.

5. Communication with those charged with governance in accordance with SAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility.

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. 31

2016 - May [3] (a) KG Ltd. wants to provide prospective Financial Information to its investors with information about future expectations of the company. You are engaged by KG Ltd. to examine the Projected Financial Information and give report thereon. What will you consider in assessing the presentation and disclosure of the prospective Financial Information and the underlying assumptions? (4 marks)

Answer:

Consideration for Assessing Presentation and Disclosure of Prospective Financial Information and Underlying Assumptions:

As per SAE 3400 “The Examination of Prospective Financial Information”, when assessing the presentation and disclosure of the prospective financial information and the underlying assumptions, in addition to the specific requirements of any relevant statutes, regulations as well as the relevant professional pronouncements, the auditor will need to consider whether:

1. the presentation of prospective financial information is informative and not misleading;
2. the accounting policies are clearly disclosed in the notes to the prospective financial information;
3. the assumptions are adequately disclosed in the notes to the prospective financial information. It needs to be clear whether assumptions represent

management's best-estimates or are hypothetical and, when assumptions are made in areas that are material and are subject to a high degree of uncertainty, this uncertainty and the resulting sensitivity of results needs to be adequately disclosed;

4. the date as of which the prospective financial information was prepared is disclosed. Management needs to confirm that the assumptions are appropriate as of this date, even though the underlying information may have been accumulated over a period of time;
5. the basis of establishing points in a range is clearly indicated and the range is not selected in a biased or misleading manner when results shown in the prospective financial information are expressed in terms of a range; and
6. there is any change in the accounting policy of the entity from that disclosed in the most recent historical financial statements and whether reason for the change and the effect of such change on the prospective financial information has been adequately disclosed.

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 "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.

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.

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.

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.

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 Additional Consideration for specific items the auditor should perform audit procedures, designed to obtain sufficient appropriate audit evidence during his attendance at physical inventory counting. SA 501 is additional guidance to that contained in SA 500. Audit Evidence with respect to certain specific financial statement amounts and other disclosures.

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.

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).

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 "Engagement to Compile Financial Information" 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 stock 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 our duty of 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.

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 identities of creditors 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.

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.

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.

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.

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.

The following indications *inter alia* have to be taken into consideration in determining the appropriateness of the going concern assumption:

1. Financial indications such as negative net worth, adverse key financial ratios, substantial operating losses, inability to pay creditors on due dates, etc.
2. Operating indications such as labour difficulties, loss of major market, etc.
3. Other indications include pending legal proceedings which may affect the concern adversely, sickness of entity under statutory definition, etc.

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.

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 section 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 (w.e.f. 1st April 2009), 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.

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. 58

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.

Persons Covered for Reporting on Fraud under Section 143(12) of the Companies Act, 2013 (Revised 2016)

Sec. 143(12) of the Companies Act, 2013 as amended, states, "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:

1. Provided that in case of fraud involving lesser than the specified amount, the auditor shall report the matter to the audit committee constituted under Sec. 177 or to the Board in other cases within such time and in such manner as may be prescribed.
2. 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.
3. The reporting requirement under Sec. 143(12) is for the statutory auditors of the company and also equally applies to the cost accountant in practice, conducting cost audit under Sec. 148 of the Act; and to the company secretary in practice, conducting secretarial audit under Sec. 204 of the Act.

   However, the provisions of Sec. 143(12) do not apply to other professionals who are rendering other services to the company.

   It may also be noted that internal auditors covered under Sec. 138 are not specified as persons who are required to report under Sec. 143(12).

   As per sub-rule (3) of Rule 12 of the Companies (Audit and Auditors) Rules, 2014, the provisions of sub-section (12) of Section 143 read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014 regarding reporting of frauds by the auditor shall also extend to a branch auditor appointed under Sec. 139 to the extent it relates to the concerned branch.

   It may be noted that Sec. 143(12) includes only fraud by officers or employees of the company and does not include fraud by third parties such as vendors and customers.

Reporting Under CARO 2016

The auditor is also required to report as per Clause (x) of paragraph 3 of CARO 2016, if there is any fraud on or by the company has been noticed during the year.

2013 - Nov [2] (c) C & Co., hired Mr. A, Chartered Accountant, to compile its financial statements for the interim period ending on 31st December 2012. Kindly assist Mr. A in drafting scope of engagement letter with specific focus on C & Co's responsibility. (4 marks)

Answer:

As per **SRS 4410 "Engagements to Compile Financial Information"**, the engagement letter to be issued by Mr. A should state the following as management's responsibility:

1. The accuracy and completeness of the information supplied to us, including maintenance of adequate accounting records and internal controls and selection and application of appropriate accounting policies.
2. Preparation and presentation of the financial statements of the entity, in accordance with the applicable laws and regulations, if any.
3. Safeguarding the assets of the entity and also establishing appropriate controls designed to prevent and detect fraud and other irregularities.
4. Ensuring that the activities of the entity are carried in accordance with applicable laws and regulations and that it institutes appropriate controls to prevent and detect any non-compliance.
5. Ensuring complete disclosure of all material and relevant information to the accountant.

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.

2014 - May [1] {C} (b) T & Co. wants to issue a prospectus, to provide potential investors with information about future expectations of the Company. You are hired by T & Co. to examine the projected financial statements and give report thereon. What things you will consider before accepting the audit engagement and what audit evidence will be obtained for reporting on projected financial statements? (5 marks)

Answer :

As per Standards on Auditing 3400, “the examination of prospective financial information”, Auditor is not in a position to express opinion as to whether the results shown in projected financial information will be achieved. He can provide only moderate assurance.

- Projected financial statements are highly subjective in nature and it's preparation requires the exercise of considerable judgement.
- Projected financial statements are prepared on the basis of:
  (a) hypothetical assumption about future event.
  (b) a mixture of best estimate and hypothetical assumptions.
- **In the present case T & Co.** wants to issue a prospectus. For that the auditor should consider following things:
  (a) Nature of company transaction whether the same can be projected or not.
  (b) Management's support for giving statement of responsibility.
  (c) Reliability of the financial statements etc.

  Audit evidence to be obtained for reporting on projected financial statements, such as:
  (a) Management's responsibility statement.
  (b) A reference to the purpose and for restricted distribution of projected financial statements.
  (c) Statement of negative assurance as to whether assumptions provide a reasonable basis for these statements.

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 confirmation"**.

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.

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 consideration 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.

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. 57

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.

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. 56

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.

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 forceable 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 forceable future.

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.

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. 32

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.

KZ - 1	Knowledge Zone
Scope of revision of Financial Statement	
As per Sec. 131(2) of the Companies Act, 2013 Where copies of the previous financial statement or report have been sent out to members or delivered to the Registrar or laid before the company in	

general meeting the revisions must be confined to -

1. the correction in respect of which the previous financial statement or report do not comply with the provisions of section 129 or 134 and
2. the making of any necessary consequential alteration.

KZ - 2 **Knowledge Zone**

Reporting of frauds by auditor and other matters as per Rule 13 of Companies (Audit & Auditors) Amendment Rules, 2015:

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 rupees one crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.
2. The auditor shall report the matter to the Central Government as under:
   (i) 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;
   (ii) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within fifteen days from the date of receipt of such reply or observations;
   (iii) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
   (iv) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with

Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;

(v) 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

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

3. In case of a fraud involving lesser than the amount specified in sub-rule(1), the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than two days of his knowledge of the fraud and he shall report the matter specifying the following:
   (i) Nature of Fraud with description;
   (ii) Approximate amount involved; and
   (iii) 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:
   (i) Nature of Fraud with description;
   (ii) Approximate Amount involved;
   (iii) Parties involved, if remedial action not taken; and
   (iv) Remedial actions taken.

KZ - 3 **Knowledge Zone**

Basic Principles Governing an Audit

SA 200 discusses the basic principles that govern an audit. Though the standard has been developed in the context of independent audit of financial information, the principles listed therein are also applicable to a large extent to other types of audit. The standard lays down the following basic principles:

1. **Integrity, objectivity and independence:** The auditor should be straightforward, honest and sincere in his approach to his professional work.

   He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude and both be and appear to be free of any interest which might be regarded, whatever its actual effect, as being incompatible with integrity and objectivity.

2. **Confidentiality:** The auditor should respect the confidentiality of information acquired in the course of his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose.

3. **Skills and competence:**

   (i) The audit should be performed and the report prepared with due professional care by persons who have adequate training, experience and competence in auditing.

   (ii) The auditor requires specialised skills and competence which are acquired through a combination of general education, technical knowledge obtained through study and formal courses concluded by a qualifying examination recognised for this purpose and practical experience under proper supervision. In addition, the auditor requires a continuing awareness of developments, including pronouncements of ICAI on accounting and auditing matters, and relevant regulations and statutory requirements.

4. **Work performed by others:**

   (i) When the auditor delegates work to assistants or uses work performed by other auditors and 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. In the case of any independent statutory appointment to perform the work on which the auditor has to rely in forming his opinion, such as in the case of the work of branch auditors appointed under the Companies Act, 2013, the auditor's report should expressly state the fact of such reliance.

   (ii) The auditor should carefully direct, supervise and review work delegate to assistants. The auditor should obtain reasonable assurance that work performed by other auditors or experts is adequate for his purpose.

5. **Documentation :** The auditor should document matters which are

important providing evidence that the audit was carried out in accordance with the basic principles.

6. Planning :

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

(ii) Plans should be made to cover, among other things :

(a) acquiring knowledge of the client's accounting system, policies and internal control procedures;

(b) establishing the expected degree of reliance to be placed on internal control;

(c) determining and programming the nature, timing, and extent of the audit procedures to be performed. and

(d) Co-ordinating the work to be performed.

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

7. Audit evidence :

(i) The auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions therefrom on which to base his opinion on the financial information.

(ii) Compliance procedures are tests designed to obtain reasonable assurance that those internal controls on which audit reliance is to be placed are in effect.

(iii) Substantive procedures are test designed to obtain evidence as to the completeness, accuracy and validity of the data produced by the accounting system.

They are of two types :

(i) tests of details of transactions and balances :

(ii) analysis of significant ratios and trends including the resulting enquiry of unusual fluctuations and items.

8. Accounting system and internal control :

(i) Management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business. The auditor should reasonably assure himself that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded. Internal controls normally contribute to such assurance.

(ii) The auditor should gain an understanding of the accounting system and related internal controls and should study and evaluate the operation of those internal controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

(iii) Where the auditor concludes that he can rely on certain internal controls his substantive procedures would normally be less extensive than would otherwise be required and may also differ as to their nature and timing.

9. Audit conclusion and reporting :

(i) The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of the business of the entity as the basis for the expression of his opinion on the financial information. This review and assessment involves forming an overall conclusion as to whether:

(a) the financial information has been prepared using acceptable accounting policies, which have been consistently applied.

(b) the financial information complies with relevant regulations and statutory requirements.

(c) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

(ii) The audit report should contain a clear written expression of opinion on the financial information and if the form or content of the report is laid down in or prescribed under any agreement or statute or regulation, the audit report should comply with such requirements. An unqualified opinion indicates the auditor's satisfaction in all material respects with the matter dealt with in paragraph (a) above or as may be laid down or prescribed under the relevant agreement or statute or regulation, as the case may be.

(iii) When a qualified opinion, adverse opinion or a disclaimer of opinion is to be given, or reservation of opinion on any matter is to be made, the audit report should state the reasons therefor.

KZ - 4 **Knowledge Zone**

An illustrative Format of Audit Report

SA-700 states that there may be circumstances when it is not practicable to quantify the effect of modification in the audit report accurately, the auditor may do so on the basis of estimates made by the management after carrying out such audit tests as are possible and clearly indicate the fact that the figures are based on management estimates. Ordinarily, this information would be set out in a separate paragraph preceding the opinion or disclaimer of opinion and may include a reference to a more extensive discussion, if any, in a note to the financial statements.

The following illustration of a qualification where quantification was not possible will explain the point.

(2) "No provision has been made in respect of product warranties outstanding at the year end. The amount of provision required in this behalf could not be ascertained."

In the above situation, the overall paragraph would appear as follows.

"We further report that, without considering item mentioned in paragraph (2) above, the effect of which could not be determined, had the observations made by us in paragraph (1) (not reproduced) and (2) above been considered, the profit for the year would have been ₹ 500.41 lacs (as against the reported figure of ₹ 596.07 lacs), reserves and surplus would have been ₹ 685.43 lacs (as against the reported figure of ₹ 781.09 lacs) and total fixed assets would have been ₹ 200.00 lacs (as against the reported figure of ₹ 229.05 lacs)".

KZ - 5 **Knowledge Zone**

Guidance Note on Reporting under section 143(3)(f) and (h) of the Companies Act, 2013:

This Guidance Note is intended to assist the auditors in discharging their duties in respect of clauses (f) and (h) of sub-section (3) of section 143 of the Act. Clause (f) of the said sub-section creates a requirement for the auditor to consider observations or comments of the auditor on financial transactions or matters which have an adverse effect on the functioning of the company. Such observations or comments would ordinarily lead to the modification of or an emphasis of matter in the auditor's report on financial statements. It may be noted that the matters that lead to modification in the auditor's report on financial statements are matters that give rise to a qualified opinion, adverse opinion or a disclaimer of opinion. Further, matters that lead to an emphasis of matter paragraphs are matters appropriately presented or disclosed in the financial statements that, in the auditor's judgement, are of such importance that they are fundamental to the users' understanding of the financial statements. If the matter leading to the modification of the auditor's opinion or an emphasis of matter in the auditor's report on financial statements is likely to have an adverse effect on the functioning of the company, the auditor is required to report such matter.

Under clause (h) of sub-section (3) of section 143 of the Act, the auditor is required to state whether any matter leading to a qualification, reservation or adverse remark, that is, effectively the modification of the auditor's report on financial statements, relates to the maintenance of accounts and other matters connected therewith.

KZ - 6 **Knowledge Zone**

General matters to be considered while taking up a new engagement

General Economic factors : General level of economic activity (for example, recession, growth)

1. The market and competition
2. Cyclical or seasonal activity

3. Government policies

The industry : important conditions affecting the client's business

1. The market and competition
2. Cyclical or seasonal activity
3. Changes in product technology
4. Business risk

The entity:

1. Management and ownership-important characteristics
2. Operating Management
3. The entity's business - products, markets, suppliers, expenses, operations
   (i) Nature of business (es) (for example manufacturing, wholesaler, financial services, import /exports)
   (ii) Location of production facilities, warehouses, offices,
   (iii) Employment (for example, by location, supply, wage levels, union contracts, pension commitments, Government regulation)
   (iv) Products or services and markets.
4. Financial performance-factors concerning the entity's financial condition and profitability.
5. Reporting environment-external influences which affect management in the preparation of the financial statements.
6. Legislation:
   (i) Regulatory environment and requirements
   (ii) Taxation both direct and indirect.

KZ - 7 **Knowledge Zone**

Main Source of obtaining Information about the client's business

The auditor can obtain information about client's business from the following sources :

1. The client's annual Reports to shareholders;
2. Minutes of meetings of shareholders, board of directors and important committees.

3. Internal financial management report for current and previous periods, including budgets, if any;
4. The previous year's audit working papers, and other relevant files,
5. Firm personnel responsible for non audit services to the client who may be able to provide information on matters that may affect the audit:
6. Discussions with the client;
7. The client's policy and procedures manual;
8. Relevant publications of the Institute of Chartered Accountants of India and other professional bodies, industry publication, trade Journals, magazines, newspapers or text books;
9. Consideration of the state of the economy and its effects on the client's business;
10. Visits to the client's premises and plant facilities by the management.

KZ - 8 **Knowledge Zone**

Reporting responsibility of an auditor in the context of non-compliance of Law and Regulation

The auditor should as soon as practicable, either communicate with the audit committee, the Board of Directors and senior management or obtain evidence that they are appropriately informed regarding non-compliance that comes to the auditors attention.

If in the auditor Judgment, the non compliance is believed to be intentional and/or material, the auditor should communicate the findings without delay.

If the auditor suspects that members of senior management, including members of the Board of Directors, are involved in non-compliance, the auditor should communicate the matter to the next higher level of authority at the entity, such as, the audit committee or Board of Directors, to the users of the auditors report or financial statements.

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

If the auditor is precluded by the entity from obtaining sufficient and appropriate audit evidence to evaluate whether non-compliance is, or is likely to have occurred that have or may have material impact on the financial statements, the auditor should express a qualified opinion or a disclaimer of opinion on the financial statements on the basis of a limitations on the scope of the audit.

If the auditor is unable to determine whether non compliance has occurred because of limitations imposed by the circumstances rather than by the entity, the auditor should consider the effect on the auditor's report.

The auditor's duty of confidentiality would ordinarily preclude reporting non compliance to third party. However, in certain circumstances, that duty of confidentiality is overridden by statement, law or by courts of laws.

KZ - 9 **Knowledge Zone**

SA 260: Communication with Those Charged with Governance

SA 260 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 27, "Communications of Audit Matters with those Charged with Governance" Issued by the Institute in 2003.

This Standard deals with the auditor's responsibility to communicate with those charged with governance in relation to an audit of financial statements. SA 260 also describes the requirements regarding communication with those charged with governance and regarding matter to be communicated and documentation required. This standard also spells out the distinction between the Management and those Charged with Governance.

Although this SA applies irrespective of an entity's governance structure or size, particular considerations apply where all of those charged with governance are Involved in managing an entity, and for listed entities. This SA does not establish requirements regarding the auditor's communication with an entity's management or owners unless they are also charged with a governance role.

Note: This SA is effective for audits of financial statements for periods beginning on or after April 1, 2017.

KZ - 10 **Knowledge Zone**

SA 570 Going Concern:

SA 570 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 16, "Going Concern" issued by the institute in 1998. The revised Standard is quite detailed in terms of auditor's responsibility in the audit of financial statements with respect to management's use of the going concern assumption in the preparation and presentation of the financial statements. SA 570 requires the auditor to inquire of management as to its knowledge of events or conditions beyond the period of management's assessment that may cast significant doubt on the entity's ability to continue as a going concern. SA 570 also deals with the requirements of risk assessment procedures and related activities, evaluating management's assessment, additional procedures, audit conclusions and reporting, use of going concern assumption etc. The standard also discusses the principles when mitigating factors are present *vis-a-vis* Going Concern of the enterprise.

Note: This SA is effective for audits of financial statements for periods beginning on or after April 1, 2017.

While examining the going concern assumption of an entity, important indications that should be evaluated and examined

SA 570 on "Going Concern", aims to establish standards on the auditor's responsibilities in the audit of financial statements regarding the appropriateness of the going concern assumption as a basis for the preparation of the financial statements.

The following are the financial indications to be considered :

1. Negative net worth or negative working capital.
2. Fixed-term borrowings approaching maturity without realistic prospects or renewal or repayment, or excessive reliance on short-term borrowings to finance long-term assets.

3. Adverse key financial ratios.
4. Substantial operating losses.
5. Substantial negative cash flows from operations.
6. Arrears or discontinuance of dividends.
7. Inability to pay creditors on due dates.
8. Difficulty in complying with the terms of loan agreements.
9. Change from credit to cash-on-delivery transactions with suppliers.
10. Inability to obtain financing for essential new product development or other essential investments.
11. Entering into a scheme of arrangement with creditors for reduction of liability.

Operating Indications :

1. Turnover and departure of key management personnel without replacement.
2. Loss of market, franchise, license or key supplier.
3. Labour difficulties or shortage of important supplies

Other indications :

1. Non-compliance with statutory requirements.
2. Legal cases with possibility of adverse judgement which could not be met.
3. Changes in legislations or government policy.
4. Sickness of the entity under any statutory definition.

KZ - 11 **Knowledge Zone**

SA 610: Using the work of Internal Auditors:

SA 610 is a revised version of the erstwhile Auditing and Assurance Standard (AAS) 7, “Relying Upon the Work of an Internal Auditor” issued by the Institute in 1989. The revised Standard deals with the external auditor’s responsibilities regarding the work of internal auditors. This SA also defines the terms “Internal audit function” and “Internal auditor”. SA 610 also deals with the aspects like determining whether and to what extent to use the work of the internal auditors, using specific work of the internal auditors and documentation.

Note: This SA is effective for audits of financial statements for periods beginning on or after April 1, 2016.

KZ - 12 **Knowledge Zone**

SA 701: Communicating Key Audit Matters in the Independent Auditor's Report:

This Standard on Auditing (SA) deals with the auditor's responsibility to communicate key audit matters in the auditor's report. It is intended to address both the auditor's judgement as to what to communicate in the auditor's report and the form and content of such communication. The purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements ("intended users") to assist them in understanding those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgement in the audited financial statements.

The communication of key audit matters in the auditor's report may also provide intended users a basis to further engage with management and those charged with governance about certain matters relating to the entity, the audited financial statements, or the audit that was performed.

Note: This SA is effective for audits of financial statements for periods beginning on or after April 1, 2017.

KZ - 13 **Knowledge Zone**

SA 705: Modifications to the Opinion in the Independent Auditor's Report:

This Standard on Auditing (SA) deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised), the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary. The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that are necessary when:

(a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Note: This SA is effective for audits of financial statements for periods beginning on or after April 1, 2017.

KZ - 14 **Knowledge Zone**

SA 706: Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report:

This Standard on Auditing (SA) deals with additional communication in the auditor's report when the auditor considers it necessary to draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; or draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibility or the auditor's report.

SA 701[1] establishes requirements and provides guidance when the auditor determines key audit matters and communicates them in the auditor's report. When the auditor includes a Key Audit Matters section in the auditor's report, this SA addresses the relationship between key audit matters and any additional communication in the auditor's report in accordance with this SA.

Note: This SA is effective for audits of financial statements for periods beginning on or after April 1, 2017.

KZ - 15 **Knowledge Zone**

SRE 2400: Engagements to Review Historical Financial Statements

This Standard on Review Engagements (SRE) deals with the practitioner's responsibilities when engaged to perform a review of historical financial statements, when the practitioner is not the auditor of the entity's financial statements; and the form and content of the practitioner's report on the financial statements.

The practitioner's objectives in a review of financial statements under this SRE are to obtain limited assurance, primarily by performing inquiry and analytical procedures, about whether the financial statements as a whole are free from material misstatement, thereby enabling the practitioner to express a conclusion on whether anything has come to the practitioner's attention that causes the practitioner to believe the financial statements are not prepared, in all material respects, in accordance with an applicable financial reporting framework; and report on the financial statements as a whole and communicate, as required by this SRE.

In all cases when limited assurance cannot be obtained and a qualified conclusion in the practitioner's report is insufficient in the circumstances, this SRE requires that the practitioner either disclaim a conclusion in the report issued for the engagement or, where appropriate, withdraw from the engagement if withdrawal is possible under applicable law of regulation.

Note: This SRE is effective for reviews of Financial Statements for periods beginning on or after April 1, 2016.

KZ - 16 **Knowledge Zone**

SAE 3420 - Assurance Engagements to Report on the Compilation of Pro Forma Financial Information Included in a Prospectus:

This Standard on Assurance Engagements (SAE) deals with reasonable assurance engagements undertaken by a practitioner to report on the responsible party's compilation of proforma financial information included in a prospectus. The SAE applies where: Such reporting is required by securities law or the regulation of the securities exchange ("relevant law or regulation") in the jurisdiction in which the prospectus is to be issued; or this reporting is generally accepted practice in such jurisdiction.

The purpose of proforma financial information included in a prospectus is solely to illustrate the impact of a significant event or transaction on unadjusted financial information of the entity as if the event had occurred or the transaction had been undertaken at an earlier date selected for purposes of the illustration. This is achieved by applying proforma adjustments to the unadjusted financial information. Proforma financial information does not represent the entity's actual financial position, financial performance, or cash flows.

Note: This SAE is effective for assurance reports dated on or after April 1, 2016.

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

Table Showing Marks of Compulsory Questions

Year	12 N	13 M	13 N	14 M	14 N	15 M	15 N	16 M	16 N	17 M
Descriptive					5	10	5	20	20	
Practical	5		10	15	5	10	5			
Total	5		10	15	10	20	10	20	20	

Star Rating

On the basis of Maximum marks from a chapter ☆☆

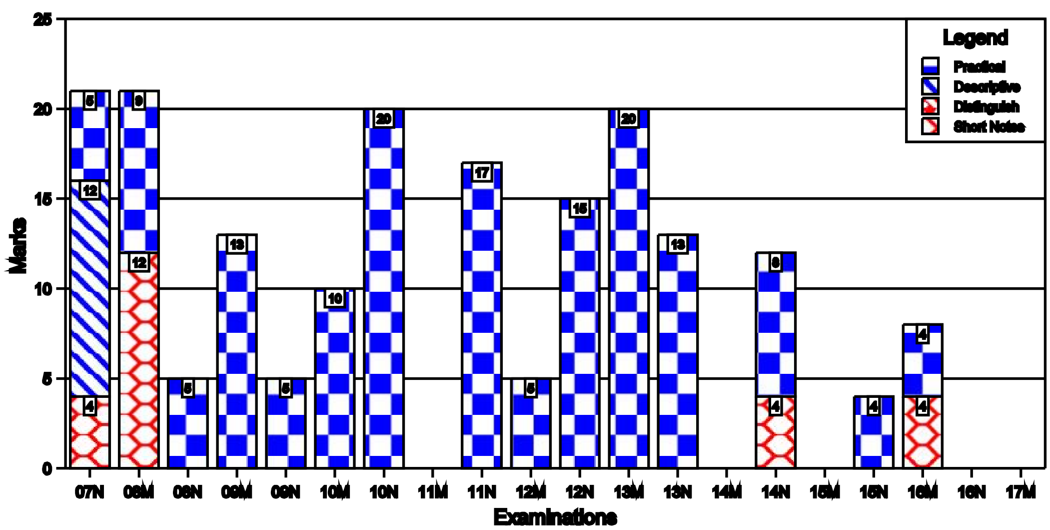
On the basis of Questions included every year from a chapter ☆

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

1(b) Accounting Standards & Schedule III

This Chapter Includes : Accounting Standards and Schedule III of Companies Act, 2013.

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



CA Final Gr. I

SHORT NOTES

2007 - Nov [8] Write short note on the following:

(c) Purchase method of Accounting for amalgamations. (4 marks)

Answer :

Purchase Method of Accounting for Amalgamation: As per AS 14 on Accounting for Amalgamations, there are two main methods of accounting for amalgamations

(i) The pooling of interests method; (ii) The purchase method.

Under the purchase method in preparing the transferee company's financial statements, the assets and liabilities of the transferor company should be incorporated at their existing carrying amounts or, alternatively, the consideration should be allocated to individual identifiable assets and liabilities on the basis of their fair values at the date of amalgamation.

The reserves (whether capital or revenue or arising on revaluation) of the transferor company, other than the statutory reserves, should not be included in the financial statements of the transferee company.

Any excess of the amount of the consideration over the value of the net assets of the transferor company acquired by the transferee company should be recognised in the transferee company's financial statements as goodwill arising on amalgamation.

If the amount of the consideration is lower than the value of the net assets acquired, the difference should be treated as Capital Reserve. The goodwill arising on amalgamation should be amortised to income on a systematic basis over its useful life.

The amortization period should not exceed 5 years unless a somewhat longer period can be justified.

Where the requirements of the relevant statute for recording the statutory reserves in the books of the transferee company are complied with, statutory reserves of the transferor company should be recorded in the financial statements of the transferee company. The corresponding debit should be given to a suitable account head (e.g., 'Amalgamation Adjustment Account') which should be disclosed as a part of 'miscellaneous expenditure' or other similar category in the balance sheet. When the identity of the statutory reserves is no longer required to be maintained, both the reserves and the aforesaid account should be reversed.

2008 - May [8] Write short note on the following :

(b) Price/Earnings (P/E) ratio (4 marks)

Answer :

Price/Earning Ratio:

The pre-issue price/earning ratio should be calculated by using the following formula:

Issue price per share/ EPS × 100

The issue price per share which is to be used for computing this ratio (and not the market price per share which is normally used for computation of the price/earning ratio).

Accordingly, for this purpose issue price per share is required to be used. However, P/E ratio of the company base on issue price is to be compared with the industry P/E ratio, the auditor should check that the market price should be the market price for the industry prevailing within one month prior to the date of auditor's report or as close thereto as possible.

2008 - May [8] Write short note on the following :

(d) Normal Capacity for the purpose of Inventory Valuation (4 marks)

Answer:

Normal capacity for Inventory Valuation:

As per **AS 2**, allocations of fixed production overheads for the purpose of their inclusion in the costs of conversion is based on the normal capacity of the production facilities.

Normal capacity is the production expected to be achieved on an average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. Due to this, the fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. In periods of high production, these overheads allocated are decreased so that inventories are not measured above cost.

2008 - May [8] Write short note on the following :

(e) Integral Foreign Operations (4 marks)

Answer:

Integral Foreign Operations:

As per **AS 11**, there are foreign operations, the activities of which are an integral part of the reporting enterprise. This is important since the method used to translate financial results of a foreign operation depends on the way in which it is financed and operates in relation to the reporting enterprise.

A foreign operation that is integral to the operation of the reporting enterprise carries on its business as if it were an extension of the reporting enterprise's operations. In such cases, change in exchange rates between the reporting currency and the currency in the country of foreign operations has an almost immediate effect on the reporting enterprise's cash flow from operations. Therefore, the change in the exchange rates affects the individual monetary items held by the foreign operation rather than the net investment in that operation.

DESCRIPTIVE QUESTIONS

2007 - Nov [1] {C} As a Statutory Auditor, how would you deal with the following?

(b) A company capitalises interest on borrowings incurred for holding investments by adding the same to the cost of investment every year.

(4 marks)

Answer:

Investments are assets held by an enterprise for earning income by way of dividends interest, an rentals, for capital appreciation, or for other benefits to the investing enterprise.

As per AS-13 "Accounting for Investment" cost of investments includes acquisition charges such as brokerage, fees and duties.

As per AS 16 "Borrowing Costs", Borrowing costs should be recognised as an expense in the period in which they are incurred. A qualifying asset is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Assets that are ready for their intended use or sale when acquired are not qualifying assets. Therefore such investment is not a qualifying asset, therefore interest cost of holding investments cannot be capitalized.

The decision of the Directors to capitalize the interest on borrowings is not proper. So the Auditor should qualify his report and state the financial effect of deviation from A.S.

2007 - Nov [4] (b) What is the meaning of "Small and Medium sized Company" as per the Companies (Accounting Standards) Rules, 2006? (8 marks)

Answer :

In exercise of the powers conferred by Sec. 469 of the Companies Act, 2013, read with Sec. 129 and Sec. 132 of the said Act, the Central Government, in consultation with National Advisory Committee on Accounting Standards, made the Companies (Accounting Standards) Rules, 2006.

As per these rules "Small and Medium Sized Company" (SMC) means, a company:

1. whose equity or debt securities are not listed or are not in the process of listing on any stock exchange, whether in India or outside India;
2. which is not a bank, financial institution or an insurance company;
3. whose turnover (excluding other income) does not exceed rupees fifty crore in the immediately preceding accounting year;
4. which does not have borrowings (including public deposits) in excess of rupees ten crore at any time during the immediately preceding accounting year; and
5. Which is not a holding or subsidiary company of a company which is not a small and medium-sized company.

Explanation: For the purposes of this, a company shall qualify as a Small and Medium Sized Company, if the conditions mentioned therein are satisfied as at the end of the relevant accounting period.

PRACTICAL QUESTIONS

2007 - Nov [1] {C} As a Statutory Auditor, how would you deal with the following?

(a) Z Ltd. provided, ₹ 5 lakhs for inventory obsolescence in the last year's accounts. In the subsequent year, it was determined that 50% of this stock was actually usable. The Company wants to adjust the same as a "Prior period adjustment." (5 marks)

Answer :

As per AS 5 "Net Profit or Loss for the period, Prior Period items and Change in Accounting Policies", Prior period items are income or expenditure 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 circumstance when Financial Statements were being prepared.

An estimate may have to be revised -

(i) If changes occur in the circumstances on which the estimate was based or

(ii) as a result of new information, more experience or subsequent developments.

The revision of the estimate, by its nature, does not bring the adjustment within the definitions of an extraordinary item or a prior period item.

A change in an accounting estimate may affect the current period only or both the current period and future periods. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods, is recognised in future periods.

2008 - May [1] {C} As a Statutory Auditor, how would you deal with the following:

(b) V Ltd. sold 1 lakh vacuum pumps during the year 2006-07 with a condition to make good by repair/replacement any manufacturing defects reported within 6 months from the date of sale. Past experience in this regard showed that there were no replacements carried out, but minor/major repairs were necessitated to the extent of 10%/5% respectively of the units sold. The cost of such minor/major repairs would amount to ₹ 1,000/₹ 6,000 respectively. While finalizing the accounts for the year, the company does not reflect any provision in this regard.

(5 marks)

Answer :

Provisions: As per **AS-29, 'Provisions, Contingent Liabilities and Contingent Assets**, a provision is a liability which can be measured only by using a substantial degree of estimation.

As per AS-29, Provision should be recognised when:

1. An enterprise has a present obligation as a result of a past event.
2. It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and
3. A reliable estimate can be made of the amount of the obligation.

   If these conditions are not met, no provision should be recognised.

Present Case:

In the present case. V Ltd fulfils all the above conditions. The sale of pumps with a warranty obligation constitutes the present obligation as a result of past event. It is probable that some outflow will be involved in setting the warranty obligation, satisfy the second condition. As per the details based on past precedence reliable estimate can be made as under:

[6000 × (5% of 1,00,000)] + 1,000 × (10% of 1,00,000) = ₹ 400 lakhs

Thus, V Ltd as on 31.3.07 should make a provision for warranty obligation against sale of vacuum pumps to the extent of rupees 400 lakhs. The auditor should insist on such provision being created. If provision is not made he should qualify his audit report.

2008 - May [1] {C} As a Statutory Auditor, how would you deal with the following:

(c) XYZ Pvt. Ltd., manufacturing garments, has valued at the year end its closing stock of packed finished goods for which firm export contracts have been received, at realizable value inclusive of profit and export cash incentive. As at the year end, the ownership of the goods has not been transferred to the foreign buyers. (4 marks)

Answer:

Valuation of Inventories: AS 2 requires that inventories should be valued as lower of cost and Net realisable value(NRV). A departure from the general principle can be made if the AS is not applicable or having regard to the nature of industry.

AS 2 also states that (a) work in progress arising under construction contracts, including directly related service contracts (b) work in progress arising in the ordinary course of business of service providers;(c) shares, debentures and other financial instruments held as stock-in-trade; and(d) producers' inventories of livestock, agricultural and forest products are measured as NRV Based on established practices.

Present Case:

In the given case the sale is assumed under a forward contract but the goods are not of a nature covered by the above exceptions Taking into account the facts the closing stock of finished goods should have been valued at cost, as it is lower than the realisable value (as it includes profit). Further, export cash incentives should not be included for valuation purposes.

The policy adopted by the company for valuing its closing stock of inventory of finished goods on selling price plus export incentives is not correct. The statutory auditor should give a qualified report.

CA Final Gr. I (New Course)

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.

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.

PRACTICAL QUESTIONS

2008 - Nov [1] {C} Comment on the following :
(a) X Ltd., paid ₹ 25 lakhs as advance to Y Ltd. towards the purchase of a printing machinery on 15.1.08 with delivery instructions to deliver the same in the last week of June 08. Further on 2.2.08 X Ltd. purchased two diesel generator sets from Y Ltd. for ₹ 30 lakhs on 90 days Credit term. In the accounts for 2007-08, X Ltd. intends to adjust the advance

paid against Credit purchase and show the net amount of ₹ 5 lakhs as due from them. As the statutory auditor, how would you deal with this? (5 marks)

Answer :

According to the requirement of Schedule III to the Companies Act, 2013 and the existing accounting practice, advance amount paid by X Ltd. to the supplier of machinery to be used in the project, should be grouped under the sub head 'Capital Work in Progress' under the head Fixed Asset.

If the advance is for purchase of other machinery, it should be grouped under a separate head. 'Advance Payment for Capital Expenditure' and should be disclosed under Other Non Current Asset.

Present Case:

Thus the proposition of X Ltd. to show the net balance in the personal account of Y Ltd., is not correct. Such proposal will cancel the two material items in the balance sheet

1. Expenditure towards capital asset and
2. Other current liability for purchase of the generator set.

Therefore the auditor should advise X Ltd., to show these two items separately. If X Ltd., does not accept the advice, the auditor should qualify his report with suitable qualification of amount involved.

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 :

SA 620 using the work of an Auditor's Expert, states that while using the work of an expert, auditor should consider the materiality of the item, nature and complexity of the item, the other audit evidence available and professional qualifications, experience and reputation in the field of the concerned expert.

The auditor should ensure that the expert has used appropriate source data, has made consistent assumptions, has applied correct methods and that results of expert's work are in line with auditor's overall knowledge of the business and match with results of his audit procedures. The auditor should also ensure that substance of expert's findings is properly reflected in the financial information.

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:

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".

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.

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.

As per AS 12, such grants should be presented in the balance sheet showing the grant as a deduction from the gross value of the asset concerned (in arriving at its book value). Alternatively, the grants related to a depreciable fixed asset may be treated as deferred income which should be recognised in the profit and loss account on a systematic and rational basis over the useful life of the asset. By crediting the entire amount of grant to profit and loss account, the company has treated it as a revenue income which is not in accordance with the requirements of the accounting standard.

Therefore, the statutory auditor would have to qualify 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.

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.

2010 - May [1] Comment on the following :

(d) F Limited includes in the Schedule of Inventory, those items of Fixed assets 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 fixed assets that have been retired from active use and are held for disposal be stated at the lower of their net book value and net realizable value and are shown separately in the financial statements.

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 fixed assets 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 net book value and net realizable value and are shown separately in financial statements.

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.

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".

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 fixed asset 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."

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.

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.

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	Fixed Assets	
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.

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 Fixed Assets 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.

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.

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.

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

(c) For the year ended 31st March, 2012, the financial statements of A Pvt. Ltd. were adopted on 31st July, 2012. At this meeting, the directors proposed a dividend for the year 2011-12 of 25% on the equity share capital amounting to ₹ 10 lakhs. No entry was passed for the proposed dividend in the books of the company, since in the view of the directors the same was not required as per Schedule III. (5 marks)

Answer:

Provision for Proposed Dividend in the Revised Schedule III

The Schedule III requires disclosure of amounts of dividends proposed to be distributed to equity and preference shareholders for the period and the related amount per share to be disclosed separately in the notes. This makes the provision for proposed dividend a non-adjusting event.

Present Case

In the instant case, director of A Pvt. Ltd. proposed the dividend on equity share capital @ 25%, for which no entry has been passed in the books of the company. Contention of the directors for non provision as per Schedule III is correct as statutory compliance has been changed.

Therefore, amount of proposed dividend should be disclosed by means of a note in the accounts.

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.

2013 - May [1] {C} (a) The Balance Sheet of G Ltd. as at 31st March 13 is as under. Comment on the presentation in terms of Schedule III of Companies Act, 2013

Heading	Note No.	31st March 13	31st March 12
Equity & Liabilities			
Share Capital	1	x x x	x x x
Reserves & Surplus	2	0	0
Employee stock option outstanding	3	x x x	x x x
Share application money refundable	4	x x x	x x x
Non-Current Liabilities			
Deferred tax liability (Arising from Indian Income Tax)	5	x x x	x x x
Current Liabilities			
Trade Payables	6	x x x	x x x
Total		x x x	x x x
Assets		x x x x	x x x x
Non-Current Assets			
Fixed Assets - Tangible	7	x x x	x x x
CWIP (including capital advances)	8	x x x	x x x
Current Assets			
Trade Receivables	9	x x x	x x x
Deferred Tax Asset (Arising from Indian Income Tax)	10	x x x	x x x
P & L Debit balance		x x x	x x x
Total		x x x x	x x x x

[Modified] (5 marks)

Answer :

As per the Schedule - III, of the Companies Act, 2013, the errors are :

1. Share Capital & Reserve & Surplus are to be shown under the heading "Shareholders' funds", while preparing the balance sheet.
2. Reserve & Surplus is showing zero balance, which is not correct. Debit balance of Statement of Profit & Loss should be shown as a negative figure under the head 'Surplus'. The balance of 'Reserve and Surplus', after adjusting negative balance of surplus shall be shown under the head 'Reserve and Surplus' even if the resulting figure is in the negative.
3. Employees Stock Option outstanding should be disclosed under the heading "Reserve and Surplus".
4. Share application money refundable shall be shown under the sub-heading "Other Current Liabilities".
5. Deferred Tax Assets and Deferred Tax Liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown.
6. The CWIP shall be shown under Fixed Assets as Capital Work in Progress. The amount of capital advances included in CWIP shall be disclosed under the sub-heading "Long term loans and advances" under the heading Non-Current Assets.
7. Deferred Tax Assets shall be shown under Non-Current Assets. It should be net balance of Deferred Tax Assets after adjusting the balance of Deferred Tax Liability.

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.

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.

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.

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 new 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.

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.

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.

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 fixed cost 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 fixed assets. 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 Fixed Assets/Capital WIP would have been lower by ₹ 328 lakhs."

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 Statement",** 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.*

2015 - Nov [5] (d) M/s IT Limited has prepared the financial statements for the year 2014-15 and mentioned in the significant accounting policies that depreciation on tangible fixed assets is provided on the straight line method over the useful lives of the assets as estimated by the management. The company has ignored the useful lives of assets mentioned in Schedule II of the Companies Act, 2013. As statutory auditor of the company how would you deal with this? (4 marks)

Answer:

Providing Depreciation ignoring Schedule II to the Companies Act, 2013: Sec. 129 of the Companies Act, 2013, requires that the financial statements shall give a true and fair view of the state of affairs of the company and are in compliance with Accounting Standards.

Further, as per Schedule II to the Companies Act, 2013 on 'Useful Lives to Compute Depreciation', the useful life of an asset shall not ordinarily be different from the useful life specified therein.

However, if such a company uses a useful life of the asset which is different from the above limits, it shall disclose the justification for the same in its financial statement.

In the given case, M/s IT Limited has mentioned in the significant accounting policies that the depreciation on tangible fixed assets is provided on the straight line method over the useful lives of the assets as estimated by the management and ignored the useful lives of the assets as provided under Schedule II to the Companies Act, 2013.

Therefore, the statutory auditor of the company should ensure that the management has disclosed the justification for consideration of different useful life of the assets from that as indicated under Schedule II. If the justification has not been provided then the auditor of the company shall suggest the management for the same and if management refuses, the auditor should qualify his report accordingly.

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.

KZ - 1	Knowledge Zone

Amendments in Schedule III to the Companies Act, 2013

The MCA vide Notification dt. 6th April, 2016 has notified amendments in Schedule III of the Companies Act, 2013.

These amendments indicates the revised instructions for preparation of financial statements (i.e. Balance Sheet, P&L A/c, Notes to Accounts, etc.) by the entities those who have to comply with Accounting Standards (AS) or Indian Accounting Standards (Ind AS).

In exercise of the powers conferred by sub section (1) of Sec. 467 of the Companies Act, 2013 (18 of 2013), the Central Government hereby makes the following amendments to Schedule III of the said Act with effect from the date of publication of this notification in the Official Gazette, namely:-

- In the Companies Act, 2013 (hereinafter referred to as the Principal Act) in Schedule III, for the heading "General instructions for preparation of Balance Sheet and Statements of Profit and Loss of a Company" the following shall be substituted, namely:

"Division I

Financial Statements for a company whose Financial Statements are required to comply with the Companies (Accounting Standards) Rules, 2006.

General Instructions for Preparation of Balance Sheet and Statement of Profit and Loss of a Company."

- In the Principal Act, in Schedule III, at the end, the following shall be inserted, namely:

"Division II

Financial Statements for a company whose financial statements are drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015.

General Instructions for Preparation of Financial Statements of a Company required to comply with Ind AS

1. Every company to which Indian Accounting Standards apply, shall prepare its financial statements in accordance with this Schedule or with such modification as may be required under certain circumstances.
2. Where compliance with the requirements of the Act including Indian Accounting Standards (except the option of presenting assets and liabilities in the order of liquidity as provided by the relevant Ind AS) as applicable to the companies require any change in treatment or disclosure including addition, amendment, substitution or deletion in the head or sub-head or any changes *inter se*, in the financial statements or statements forming part thereof, the same shall be made and the requirements under this Schedule shall stand modified accordingly.
3. The disclosure requirements specified in this Schedule are in addition to and not in substitution of the disclosure requirements specified in the Indian Accounting Standards. Additional disclosures specified in the Indian Accounting Standards shall be made in the Notes or by way of additional statement or statements unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act, 2013 shall be made in the Notes in addition to the requirements set out in this Schedule.

4. (i) Notes shall contain information in addition to that presented in the Financial Statements and shall provide where required:
   - (a) narrative descriptions or disaggregations of items recognised in those statements; and
   - (b) information about items that do not qualify for recognition in those statements.

   (ii) Each item on the face of the Balance Sheet, Statement of Changes in Equity and Statement of Profit and Loss shall be cross-referenced to any related information in the Notes. In preparing the Financial Statements including the Notes, a balance shall be maintained between providing excessive detail that may not assist users of Financial Statements and not providing important information as a result of too much aggregation.

5. Depending upon the turnover of the company, the figures appearing in the Financial Statements shall be rounded off as below:

Turnover

Turnover	Rounding off
(i) less than one hundred crore rupees	To the nearest hundreds, thousands, lakhs or millions, or decimals thereof.
(ii) one hundred crore rupees or more	To the nearest, lakhs, millions or crores, or decimals thereof.

Once a unit of measurement is used, it should be used uniformly in the Financial Statements.

6. Financial Statements shall contain the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statements including Notes except in the case of first Financial Statements laid before the company after incorporation.
7. Financial Statements shall disclose all ‘material’ items, i.e., the items if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size or nature of the item or a combination of both, to be judged in the particular circumstances.
8. For the purpose of this Schedule, the terms used herein shall have the

same meanings assigned to them in Indian Accounting Standards.

9. Where any Act or Regulation requires specific disclosures to be made in the standalone financial statements of a company, the said disclosures shall be made in addition to those required under this Schedule.

Note:

This Schedule sets out the minimum requirements for disclosure on the face of the Financial Statements, i.e., Balance Sheet, Statements of Changes in Equity for the period, the Statement of Profit and Loss for the period (The term 'Statement of Profit and Loss' has the same meaning as 'Profit and Loss Account') and Notes. Cash flow statement shall be prepared, where applicable, in accordance with the requirements of the relevant Indian Accounting Standard.

Line items, sub-line items and sub-totals shall be presented as an addition or substitution on the face of the Financial Statements when such presentation is relevant to an understanding of the company's financial position or performance or to cater to industry or sector-specific disclosure requirements or when required for compliance with the amendments to the Companies Act, 2013 or under the Indian Accounting Standards.

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	12 N	13 M	13 N	14 M	14 N	15 M	15 N	16 M	16 N	17 M
Practical	15	20	5		5					
Total	15	20	5		5					