

Solution [MCQs 2M each]

Ques.	Ans.	Description
1	(d)	Auditor should express qualified/disclaimer of opinion in his audit report as no evidence regarding going concern assessment of management.
2	(b)	The auditor should request confirmation from third party as to the quantities and condition of the inventory held with them or perform inspection or other audit procedures as appropriate.
3	(c)	Cash loss of 2.95 Cr
4	(d)	(i), (ii) and (iii) [SA 510]
5	C	When auditors conclude reason for management's refusal to allow to send the confirmation to the debtors is unreasonable and auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures → Auditor shall communicate the matter with TCWG and also determine the implications for the Audit and Auditor's opinion in accordance with SA 705.
6	D	Joint auditor with different opinion can issue separate report with reference to other report using OM Para.
7	B	When auditor finds a material misstatement which has not been accurately accounted or presented or disclosed in the financial statement of current year, he should express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705(Revised).
8	B	The employee benefit expenses shown in the books were <u>actually incurred</u> during the relevant period → Occurrence The expenses in respect of <u>all personnel</u> were accounted for → Completeness The expense recognised during <u>year 2022-23</u> related to this year only → Cut-off
9	C	Dividend declared after year end is disclosed in the notes to accounts of that year. No provision is created.
10	A	Checking allowance for debtors is testing valuation assertion.
11	C	Short term crop loan overdue for 1 crop season is not treated as NPA. Also income on govt guaranteed advance recognised on realisation basis.
12	D	50% of 7 Lakhs i.e. ₹3.5 L guaranteed by state govt treated as NPA.
13	B	Since law prescribes in sufficient detail the terms of the audit engagement, the auditor need not record them in a written agreement except for the fact that law or regulation applies and also seek written agreement from management that it acknowledges and understands that it has responsibility for the preparation of financial statements.
14	B	The practicing CA shall perform work in accordance with Standards on Related Services and SQC 1.
15	B	CA Akaay is conducting preliminary engagement activities.

Descriptive Answers

Answer 1

(a) In the given situation, a huge fire had broken out in one of plants of company on 26th June, 2024 destroying substantial part of machinery and work-in-process resulting in loss of ₹ 10 crores. The auditor has yet to sign audit report.

Before signing audit report, he should perform following audit procedures to obtain sufficient appropriate audit evidence that all such events have been identified and are appropriately reflected in financial statements: -

- **Inquiry of management** whether any subsequent events have occurred
- **Reading minutes of the meetings** of owners, management that have been held after date of financial statements and inquiring about matters discussed at such meetings for which minutes are not available
- Reading entity's latest **subsequent interim financial statements**
- **Obtaining Written representations** from management in accordance with SA 580

The situation is an example of subsequent event occurring between date of financial statements and date of audit report **requiring disclosure in financial statements**. The auditor has a responsibility to obtain sufficient appropriate audit evidence whether such an event requiring disclosure in financial statements is appropriately reflected in financial statements.

(b) While recognizing that exceptions may exist, the following guiding principles about the reliability of audit evidence may be useful:

- The reliability of audit evidence is increased when it is obtained from **independent sources outside the entity**.
- The reliability of audit evidence that is **generated internally** is increased when the related **controls**, including those over its preparation and maintenance, imposed by the entity **are effective**.
- Audit evidence obtained **directly by the auditor** (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- Audit evidence in **documentary form**, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- Audit evidence provided by **original documents** is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

(c) The person conducting this task should take care to ensure that financial statements would not mislead anybody. This he can do honestly by satisfying himself that:

- i) the accounts have been **drawn up with reference to entries** in the books of account;
- ii) the entries in the books of account are adequately **supported by sufficient and appropriate evidence**;
- iii) **none of the entries in the books of account has been omitted** in the process of compilation and nothing which is not in the books of account has found place in the statements;
- iv) the information conveyed by the statements is **clear and unambiguous**;
- v) the financial statement amounts are properly classified, described and disclosed in **conformity with accounting standards**; and
- vi) the statement of accounts **present a true and fair picture** of the operational results and of the assets and liabilities.

(d) As per clause (xviii) of Para 3, CARO 2020, auditor required to report whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

CA T, the auditor of SDA Limited resigned due to non-recording of various material transactions. The auditor would be required to report the same in CARO, 2020 as per Clause (xviii) of Paragraph 3 of CARO, 2020.

Hence, the auditor would be required to report as per Clause (xviii) of Paragraph 3 of CARO 2020 for the year 2023-24.

Answer 2

(a) Matters the auditor may consider in determining the extent of test of controls include the following:

1. The **frequency** of the performance of the control by the entity during the period.
2. The **length of time** during the audit period that the auditor is relying on the operating effectiveness of the control.
3. The **expected rate of deviation** from a control.
4. The **relevance and reliability of the audit evidence** to be obtained regarding the operating effectiveness of the control at the assertion level.
5. The **extent to which audit evidence is obtained from tests of other controls** related to the assertion.

(b) The value of intangible assets may diminish due to efflux of time, use and/ or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period. Unless this cost in the form of amortization is charged to the accounts, the profit or loss would not be correctly ascertained and the values of intangible asset would be shown at higher amounts.

The auditor should:

- ✓ Verify that the entity has **charged amortization** on all intangible assets;
- ✓ Verify that the amortization method used **reflects the pattern** in which the **asset's future economic benefits are expected to be consumed** by the entity.
- ✓ Auditor should also verify whether the management has done an **impairment assessment** to determine whether an intangible asset is impaired. For this purpose, the auditor needs to verify whether the entity has applied AS 28 - Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset, determining the recoverable amount of the asset to determine impairment loss, if any.

(c) **Disclosure in case of Benami Properties held by the Company:** Where any proceedings have been initiated or pending against the company for holding any benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, the company shall disclose the following:

- a. **Details** of such property, including year of acquisition,
- b. **Amount** thereof,
- c. Details of **Beneficiaries**,
- d. If **property is not in the books**, then the fact shall be stated with reasons,
- e. Where there are **proceedings** against the company under this law **as an abettor** of the transaction **or as the transferor**, then the details shall be provided,
- f. **Nature of proceedings**, status of same and company's view on same.

(d) The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:

- The **size and complexity** of the entity.
- The **area of the audit**.
- The **assessed risks of material misstatement** (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work).
- **Capabilities and competence of the individual team members** performing the audit work.

Answer 3

(a) Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit.

The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when:

- Assessing risks of material misstatement of the financial statements;
- Determining materiality in accordance with SA 320;
- Considering the appropriateness of the selection and application of accounting policies;
- Identifying areas where special audit consideration may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions;
- Developing expectations for use when performing analytical procedures;
- Evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and of management's oral and written representations.

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

Examples of such changes include:

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

(c) In a banking environment, there exist documentary evidence containing observations/comments on advances which can be useful to the statutory branch auditor in performing an effective audit.

CA Amrish, the auditor should take into account the adverse comments, if any, on advances appearing in the following:-

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

(d) The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:

- i) Size of the organisation under audit.
- ii) State of the internal control.
- iii) Adequacy and reliability of books and records.
- iv) Tolerable error range.
- v) Degree of the desired confidence.

Answer 4

(a) Few examples are listed as under: -

- Volume of transactions which may determine whether it is more efficient for the auditor to rely on internal control

- Significant **industry developments** such as changes in industry regulations and new reporting requirements.
- Significant **changes in the financial reporting framework**, such as changes in accounting standards.
- **Other significant relevant developments**, such as changes in the legal environment affecting the entity.

(b) Attributes to be preferred for vouching other expenses:

While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes:

- Whether the expenditure pertained to **current period** under audit;
- Whether the expenditure **qualified as a revenue** and not capital expenditure;
- Whether the expenditure had a **valid supporting documents** like travel tickets, insurance policy, third party invoice etc.;
- Whether the expenditure has been **classified under the correct expense head**;
- Whether the expenditure was **authorised** as per the delegation of authority matrix;
- Whether the expenditure was in **relation to the entity's business** and not a personal expenditure.

(c) The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion".

Opinion Section of the Auditor's report shall also:

- Identify the **entity** whose financial statements have been audited;
- State that the **financial statements have been audited**;
- Identify the **title of each statement** that comprises the financial statements;
- Refer to the **summary of significant accounting policies** and other explanatory information; and
- Specify the **date or period** covered by each financial statement comprising the financial statements.

(d) LLP's are required to maintain books of accounts which shall contain

- Particulars of all **sums of money received and expended** by the LLP and the matters in respect of which the receipt and expenditure takes place,
- A record of the **assets and liabilities** of the LLP,
- Statements of costs of goods purchased**, inventories, work-in-progress, finished goods and costs of goods sold,
- Any other particulars** which the partners may decide.

Answer 5

(a)

Name of Concern : Narrow Industries

Financial Year : 20XX-XX

Prepared by : Name of person with date

Reviewed by : Name of person with date

Approved by : Name of person with date

S No.	Nature of procedure	Extent of check	Basis of sample	Done by
a)	Vouch few sales invoices of paper from purchase records of concern.			
b)	Trace these invoices into account books of concern.			
c)	Verify few invoices with e-way bills generated on the e-way bill portal.			
d)	Trace few sales invoices into the stock records to ensure that sold quantities have been reduced from stocks.			
e)	Trace also few sales invoices into accounts of buyers			

(b) CA Diljeet, having doubts about fictitious sales being recorded by Happy Home Ltd would ensure that revenue is not overstated by performing following audit procedures:

- Check whether a **single sales invoice is recorded twice** or a **cancelled sales** invoice could also be **recorded**.
- **Test check few invoices** with their relevant entries in sales journal.
- **Obtain confirmation** from few customers to ensure genuineness of sales transaction
- Whether any **fictitious customers** and sales have been recorded.
- Whether any **shipments were done without the consent and agreement of the customer**, especially at the year end to inflate the sales figure
- Whether **unearned revenue recorded as earned**.
- Whether any **substantial uncertainty** exists about collectability
- Whether **customer obligations are contingent** on other actions (financing, resale etc.)

(c) Understanding of the Company's Automated Environment: Given below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment

- **Information systems** being used (one or more application systems and what they are)
- their **purpose** (financial and non-financial)
- **Location** of IT systems - local vs global
- **Architecture** (desktop based, client-server, web application, cloud based)
- **Version** (functions and risks could vary in different versions of same application)
- **Interfaces** within systems (in case multiple systems exist)
- **In-house vs Packaged**
- **Outsourced activities** (IT maintenance and support)
- **Key persons** (CIO, CISO, Administrators)

(d) Audit Engagement letter includes: -

1. The **objective and scope** of the audit of the financial statements
2. The **responsibilities** of the **auditor**
3. The responsibilities of **management**
4. Identification of the **applicable financial reporting framework** for the preparation of the financial statements and
5. Reference to the **expected form and content of any reports** to be issued by the auditor and a statement that there may be **circumstances** in which a **report may differ from its expected form and content**.

If law or regulation prescribes in sufficient detail the terms of the audit engagement, the auditor need not record them in a written agreement, except for the fact that such law or regulation applies, and that management acknowledges and understands its responsibilities.

Answer 6

(a) The provision for advances falling in D1 category is required @ 25% of secured portion and 100% of unsecured portion.

Therefore, provision in above case is arrived as under: -

Outstanding balance as on 31.3.23	₹ 60 lakhs
Less: Value of security	₹ 50 lakhs
Unsecured portion	₹ 10 lakhs

Therefore, outstanding balance of ₹60 lakhs is secured to the tune of ₹50 lakhs and balance ₹ 10 lakhs is unsecured.

Provision calculation

25% of secured part i.e., 25% of ₹50 lakhs	₹ 12.5 lakhs
100% of unsecured part i.e., 100% of ₹10 lakhs	₹ 10 lakhs
Required provision	₹ 22.5 lakhs

Therefore, provision made by branch is not proper. It should have made provision of ₹22.5 lakhs instead of ₹ 7.50 lakhs.

OR

Examples of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process, for example:
 - ✓ General monitoring controls (such as oversight of management).
 - ✓ Controls over the prevention and detection of fraud.
 - ✓ Controls over the selection and application of significant accounting policies.
 - ✓ Controls over significant transactions with related parties.
 - ✓ Controls over significant transactions outside the entity's normal course of business.
 - ✓ Controls over the period-end financial reporting process (such as controls over non-recurring journal entries).
- The cause and frequency of the exceptions detected as a result of the deficiencies in the controls.

(b) The firm is providing free hospitality to engagement team members including engagement partner. In such circumstances, fundamental principles governing professional ethics are violated. Such acts of free hospitality are capable of impairing objectivity of auditor.

The situation given in the question signifies that auditors have formed relationships with client where they may end up being too sympathetic to the client's interests.

Due to free hospitality enjoyed by engagement team members, they may take a sympathetic view to issues which may have arisen during course of audit. In this way, familiarity threats are created in the situation.

(c) If management refuses to allow the auditor to send a confirmation request, CA Popat should deal in this regard in the manner prescribed in SA 505 explained hereunder:

- a. Inquire as to management's reasons for the refusal and seek audit evidence as to their validity and reasonableness;
- b. 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
- c. 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 charged with governance in accordance with SA 260.

The auditor shall also determine the implications for the audit and the auditor's opinion in accordance with SA 705.

(d) Following points merit consideration while auditing the element of ROOM SALES during the audit of a Hotel:-

1. The charge for room sales is normally **posted to guest bills by the receptionist/ front office** or in the case of large hotels by the night auditor.
2. The source of these entries is the **guest register** and audit tests should be carried out to ensure that the correct numbers of guests are charged for the correct period.
3. Any **difference between the charged rates used on the guests' bills and the standard room rate** should be investigated to ensure that they have been properly authorised.
4. In many hotels, the **housekeeper prepares a daily report** of the rooms which were occupied the previous night and the number of beds kept in each room. This report tends not to be permanently retained and the auditor should ensure that a sufficient number of reports are available for him to test both with the guest register and with the individual guest's bill.
5. Ensure **compliance with the provisions of FEMA and RBI** if receipts are in foreign currency. Ensure application of proper Conversion rate.
6. Special emphasis to be laid on **receipts through Credit Cards**.
7. The auditor should ensure that **proper valuation of occupancy-in-progress** at the balance sheet date is made and included in the accounts.

