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FOR CA INTERMEDIATE EXAM PREPARATION

CA Intermediate 2024 Suggested Answers · Paper 5 Auditing and Ethics

EXAM	YEAR	TYPE
CA Intermediate	2024	Suggested Answers

SUBJECT	DATE
Paper 5 Auditing and Ethics	September 2024

PAPER – 5: AUDITING AND ETHICS

PART I

Case Scenario 1

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

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

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

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

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

The Board of Directors want CA B to certify the debtors to be sent to the bank without checking. CA B agrees, as most of the professional income of BPP & 4 Co. LLP comes from GHB Ltd. They have undue dependence on the fees from GHB Ltd. hence; they are concerned about losing the engagement.

SUGGESTED ANSWER **INTERMEDIATE EXAMINATION: SEPTEMBER 2024**

Based on the above facts, answer the following Q. Nos. 1 to 5.

1. *Since it became impracticable for CA B, on 31 March, 2024, to attend physical inventory counting at the warehouse and also became impossible to perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and conditions of inventory, CA B shall:*

   (A) Take Management Representation regarding the existence and valuation of inventory and mention in Emphasis of Matter paragraph.

   (B) Rely on GHB Ltd.'s perpetual inventory records as audit evidence and express unmodified opinion.

   (C) Omit altogether the audit procedure of physical inventory counting from the audit programme because of impracticability.

   (D) Modify the opinion in the auditor's report in accordance with SA 705 as a result of the scope limitation.

2. *Which assertion concerning the bifurcation of employee expenses into various heads is being verified by CA B?*

   (A) Occurrence

   (B) Measurement

   (C) Completeness

   (D) Disclosures

3. *With reference to reporting on the internal financial controls system under the Companies Act, 2013, which of the following does not fall within the nature of responsibility of GHB Ltd?*

   (A) In accordance with the terms of reference specified in writing by the Board, act of every audit committee to include evaluation of internal financial controls and risk management systems.

   (B) Directors' responsibility statement to state that the Directors had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.

   (C) Board of Directors have to appoint an expert to state that the internal financial controls of the company are commensurate with the size and nature of its business.

(D) *In terms of code for Independent Directors, independent directors to get themselves satisfied that financial controls and systems of risk management are robust and defensible.*

4. *Due to tight deadlines, CA B has insufficient time to properly perform or complete the relevant duties and he has to sign off clean audit report. Which fundamental principle governing professional ethics is disregarded by him ?*

(A) *Professional competence and due care*

(B) *Professional behaviour*

(C) *Integrity*

(D) *Objectivity*

5. *Undue dependence on the fees from GHB Ltd. creates which threat of independence for the auditors?*

(A) *Intimidation threat*

(B) *Familiarity threat*

(C) *Self-interest threat*

(D) *Advocacy threat*

Case Scenario 2

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

M/s KRISH & Co. is appointed as the joint auditor along with M/s. PK. and Associates and M/s. RS and Associates for the audit of a large manufacturing company for the financial year 2023-24. CA K is in charge of this audit. They have divided their audit areas and have also identified the common audit areas, which will be applicable to all the joint auditors. While forming the opinion, CA K had a different opinion whereas, the other two audit firms shared the same opinion. Both of them contended that as they were forming a majority, M/s KRISH & Co. will have to agree with their opinion.

CA R is conducting the statutory audit of PAWAN Ltd. He observed that, during the year, the company has issued shares at premium and has transferred the amount

received as premium to securities premium account. He wants to ensure that PAWAN Ltd. has utilised the amount available in the securities premium amount for the purposes permitted under the Companies Act, 2013.

Registrar of Co-operative Societies has appointed M/s KRISH & Co. as the statutory auditor of NAND Co-operative Society for the financial year 2023-24. CA I is looking after the audit of the said registered society. During the year, in terms of Section 34 of the Cooperative Societies Act, with the sanction of the Registrar, Society has contributed for charitable purposes as defined in section 2 of the Charitable Endowments Act, 1890. CA I is ensuring whether requirements, as regards contribution made, have been complied with.

All the engagement partners and the audit team of M/s KRISH & Co. have deliberations and discussions every week through google meet to review the progress of their respective assignments. During last such meet, CA SH, the managing partner, briefed to the team about the form, content, and extent of audit documentation in terms of SA 230, while citing examples of records to be excluded as well as to be included as a part of audit documentation.

Based on the above facts, answer the following Q. Nos. 6 to 9.

6. *In case of difference of opinion between the joint auditors, what course of action can M/s. KRISH & Co. take while issuing the audit report?*

   (A) They will have to agree with the opinion formed by the majority of auditors.

   (B) They will have to agree with the opinion formed by the majority auditors, but they can mention their view in the Emphasis of Matter Paragraph.

   (C) They can add a separate audit opinion paragraph in the common audit report.

   (D) They can issue a separate audit report and the audit reports issued by the joint auditors shall make a reference to each other's audit report.

7. *The securities premium account of PAWAN Ltd. cannot be applied for which of the following purposes ?*

   (A) In writing off the debit balance in the Profit & Loss account.

   (B) In writing off the expenses of, or the commission paid or discount allowed on any issue of equity shares of the company.

(C) *For the purchase of its own shares or other securities under section 68.*

(D) *In paying up unissued equity shares of the company to be issued to the members of the company as fully paid bonus shares.*

8. *CA I, who is in charge of audit of NAND Co-operative Society, wants to ensure that the society has contributed for charitable purposes within the limits prescribed. How much is the society allowed to contribute for charitable purposes ?*

(A) *contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund.*

(B) *contribute an amount at the appropriate rate as per class of the society.*

(C) *contribute an amount not exceeding 20% of the net profits remaining after the compulsory transfer to the reserve fund.*

(D) *contribute annually at prescribed percentage of the profits as approved by the General body of the society.*

9. *Which of the following need not be included by the audit team as a part of audit documentation during handling of their respective assignments?*

(A) *Significant and specific contracts and agreements.*

(B) *Draft audit engagement letter.*

(C) *Summaries of significant matters.*

(D) *Checklists.*

Case Scenario 3

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

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

indicators that cast a significant doubt on the company's ability to continue as a going concern.

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

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

Based on the above facts, answer the following Q. Nos. 10 to 12.

10. *Financial events or conditions that may cast significant doubt on the entity's ability to continue as a going concern does not include*

    (A) Inability to comply with the terms of loan agreements.

    (B) Inability to pay creditors on due dates.

    (C) Shortage of important supplies.

    (D) Substantial operating losses.

11. *Which kind of audit report will the auditor issue, if the use of going concern basis of accounting is appropriate, but a material uncertainty exists and adequate disclosure of the material uncertainty is made in the financial statements by the management?*

    (A) Adverse opinion

    (B) Disclaimer of opinion

    (C) Unmodified opinion

    (D) Qualified opinion

12. *If the auditor is of the opinion that the written representations are not reliable, what kind of audit opinion should be issued by him?*

    (A) Disclaimer of opinion

SUGGESTED ANSWER

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(B) *Adverse opinion*

(C) *Unmodified opinion and mention the facts in Other Matters Paragraph*

(D) *Unmodified opinion and mention the facts in Emphasis of Matter Paragraph*

13. *M/s DEF & Associates have been appointed as the statutory auditor of JKL Ltd. for the first time for the financial year 2024-25. The engagement partner, CA D, is briefing his engagement team about the need of Engagement Standards and Quality Control Standards in the areas of financial statement audits and in other types of assurance services. Out of the following which one point is not correct about why standards are needed?*

(A) *Standards equip professional accountants with professional knowledge & Skill.*

(B) *Standards ensure audit quality.*

(C) *Standards promote uniformity as audit of financial statements is carried out following these Standards.*

(D) *Standards ensure carrying out of audit against established benchmarks at par with local practices.*

14. *RDB & Co. have been appointed as statutory auditors of INA Group of Hotels. This is the first time the firm is auditing an industry in food & beverage. The engagement partner, CA R, and other key members of the engagement team have undertaken the activity of development of an audit plan of INA Hotels after thorough understanding the Hotel's business and its environment. As per SA 300, description of which of the following matters is not a part of developing an audit plan?*

(A) *The nature, timing and extent of planned risk assessment procedure.*

(B) *The nature, timing and extent of planned further audit procedures at assertion level.*

(C) *The nature, timing and extent of resources necessary to perform the engagement.*

(D) *Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.*

SUGGESTED ANSWER INTERMEDIATE EXAMINATION: SEPTEMBER 2024

15. *The Board of Directors of a company wanted the auditor to certify Export sales during the year for submitting to the authorities. The auditor also signed the Confirmation letters to be sent to various debtors and creditors for confirming their balances as on 31.03.2024.*

UDIN is required to be generated by the auditor for:

(A) Export sales during the year certificate only.

(B) Confirmation letters only.

(C) Both Export sales during the year certificate and Confirmation letters.

(D) No UDIN is required to be generated.

Answer Key

MCQ No.	Correct Option
1.	(D)
2.	(D)
3.	(C)
4.	(A)
5.	(C)
6.	(D)
7.	(A)
8.	(A)
9.	(B)
10.	(C)
11.	(C)
12.	(A)
13.	(D)
14.	(C)
15.	(A)

PAPER – 5: AUDITING AND ETHICS

Part II

*Question No.**1** is compulsory.*

*Attempt any **four** questions from the remaining **five** questions.*

Question 1

(a) CA Rashmi is the auditor of ABC Ltd. for the financial year ending 31/03/2024. The audit report for the year was signed by her on 19/04/2024.

On 25/4/2024, the company received a communication from the Central Government that an incentive amount of ₹ 5 crores pertaining to financial year 2023-24 was approved. It was paid to the company before the end of April 2024. The financial statements of the company were not yet issued to the shareholders.

The Board of Directors wished to include the incentive amount in the financial statements and requested the auditor to issue a fresh audit report for the year ended 31/03/2024.

Analyze the issue involved and give an overview of the auditor's responsibility in such a situation. ***(4 Marks)***

(b) Auditors cannot normally examine all the information available to them as it would be impracticable to do so and using audit sampling will produce valid conclusions. Samples should be selected in such a manner that it is representative of the population from which the sample is being selected.

Which sample selection method is used in the following two cases? Identify and explain them briefly.

(i) Auditor divided the trade receivables in three groups: balances above ₹ 20 lakhs, balances between ₹ 10 lakhs to ₹ 20 lakhs and balances below ₹ 10 lakhs. He selected different percentages of items from each group.

(ii) Auditor uses the sample of 50 consecutive cheques to test whether the cheques are signed by authorized signatories, rather than picking 50 single cheques throughout the year. ***(4 Marks)***

(c) *PD & Co., Chartered Accountants, were appointed as the statutory auditors of MR Limited for the financial year 2023-24. MR Limited included the following clause in the appointment letter to the auditors: "The Auditor shall be responsible for detecting the frauds that may happen in the company during the financial year 2023-24."*

The auditor objected to inclusion of such a clause in the appointment letter. Discuss in the light of scope of audit. ***(3 Marks)***

(d) *M/s. PQ Limited has a turnover of ₹ 807 crores during the financial year 2023-24. It has outstanding dues towards Goods and Services Tax (GST) of ₹ 10 lakhs since June 2023. When enquired by the auditor, the company's management informed him that they have filed an objection letter for the said demand with the GST Authorities, however, no response is received from the GST Department. State the reporting responsibility of the auditor under paragraph 3, clause (vii) of the Companies Auditor's Report Order, 2020 [CARO, 2020].* ***(3 Marks)***

Answer

(a) Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued: As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report.

However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall

(i) Discuss the matter with management and, where appropriate, those charged with governance.

(ii) Determine whether the financial statements need amendment and, if so,

(iii) Inquire how management intends to address the matter in the financial statements.

If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment.

Further, the auditor shall extend the audit procedures and provide a new auditor's report on the amended financial statements. However, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

In the instant case, ABC Ltd. received an amount of ₹ 5 crore on account of incentives pertaining to year 2023-24 in the month of April 2024 i.e. after finalisation of financial statements and signing of audit report but before the issuance of Financial Statements to stakeholders. The Board of Directors of ABC Ltd. wished to amend the financial statements and requested the CA. Rashmi (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2024.

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

(b) Sample Selections Methods:

(i) Stratified Sampling method involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and proportionate of items are selected from each of these stratum. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgment.

In the given case, Auditor divided the trade receivables in three groups i.e. balances above ₹ 20 lakhs, balances between ₹ 10 lakhs to 20 lakhs and balances below ₹ 10 lakhs and he selected different percentages of items from each group will be considered as Stratified Sampling.

(ii) **Block Sampling:** This method involves selection of a block(s) of contiguous items from within the population. Usually, a range of continuous transaction shall have similar characteristics, therefore, selection of a group at one time will not give a reasonable basis for opinion on the overall population as different types of transactions and unusual transactions may not be covered in the group taken all at once.

In the given case, the auditor uses the sample of 50 consecutive cheques to test whether the cheques are signed by authorized

signatories, rather than picking 50 single cheques throughout the year is Block Selection Method.

(c) Scope of Audit in detection of Fraud: In conducting audit of financial statements objectives of auditor, in accordance with SA 200, "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing" is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.

An audit is not an official investigation into alleged wrongdoing. The auditor does not have any specific legal powers of search or recording statements of witness on oath which may be necessary for carrying out an official investigation.

Audit is distinct from investigation. Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.

The scope of audit is general and broad whereas scope of investigation is specific and narrow.

Thus, inclusion of such a clause in the engagement letter is uncalled for and outside the scope of audit.

(d) Reporting responsibility of the auditor under paragraph 3 of CARO, 2020: The auditor is required to report as per clause (vii) (a) of Paragraph 3 of CARO, 2020 that whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

Further, the auditor is also required to report as per Clause (vii) (b) of Paragraph 3 of CARO, 2020, where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts

involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute).

Question 2

(a) CA B, was the auditor of Star Limited. He wanted to ensure that the company had correctly reconciled its bank accounts and also wanted to understand whether and how far the internal control system was operating in the company. What kind of test of control was CA B performing? What are the other procedures that can be applied while undertaking test of controls?

(4 Marks)

(b) Alfa Limited has availed bank overdraft facility from a nationalized bank. The company received balance confirmation certificate for bank overdraft balance as on 31.03.2024 from the bank.

Particulars	***Amount (₹)***
Bank overdraft balance as per Bank Certificate	*25,66,200/-*
Bank overdraft balance as per Ledger	*26,45,300/-*

How will you vouch/verify borrowings from Bank taken by Alfa Limited?

(4 Marks)

(c) Schedule III of the Companies Act, 2013 prescribes disclosure of certain ratios as a part of Additional Regulatory Information. Mention any 3 ratios that should be disclosed along with the Rules relating to disclosure of these ratios.

(3 Marks)

(d) The engagement partner, of a firm of auditors, is explaining to his audit team, undergoing practical training, the inter relationship between audit strategy and audit plan. Discuss the points which the engagement partner will explain to his team in this regard. ***(3 Marks)***

Answer

(a) Inquiries of Management and Others Within the Entity: After assimilating the internal control system, the auditor needs to examine whether and how far the same is actually in operation. Test of controls are performed to obtain audit evidence about the effectiveness of the: -

(i) Design of the accounting and internal control system

(ii) Operation of the internal control throughout the period

In the given case, CA B was performing Re-performance. It involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control, for example, reconciliation of bank accounts, to ensure they were correctly performed by the entity.

Other procedures that can be applied while undertaking test of controls are:

- Inspection of documents supporting transactions and other events to gain audit evidence that internal controls have operated properly, for example, verifying that a transaction has been authorised.
- Inquiries about, and observation of, internal controls which leave no audit trail, for example, determining who actually performs each function and not merely who is supposed to perform it.
- Testing of internal control operating on specific computerised applications or over the overall information technology function, for example, access or program change controls.

(b) Vouching /Verification of borrowings from Bank: The auditor is required to roll out and obtain independent balance confirmations in respect of all the borrowings from the lender (banks/ financial institutions etc.) and perform the following:

- Ascertain that the confirmation asks for all information likely to be relevant to the tests of debt and related interest balances (e.g., applicable interest rates, due dates, collateral and security interests).
- Send reminders for non-replies.
- Compare the balances as per the confirmations obtained to the books of the accounts. Ask for reconciliations, if there are any differences and test the supporting documents for the reconciling items on a test check basis.
- Reconcile the balances in the overdrafts or loan accounts with that shown in the pass book(s) and confirm the last-mentioned balance by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.

- Obtain independent balance confirmation from the bank showing balances, particulars of securities deposited with the bank as security for the loans or of the charge created on an asset and confirm that the same has been correctly disclosed and duly registered with Registrar of Companies and recorded in the Register of charges.
- Verify the authority under which the loan or draft has been raised. In the case of a company, only the Board of Directors is authorised to raise a loan or borrow from a bank.
- Confirm, in the case of a company, that the restraint contained in Section 180 of the Companies Act, 2013 as regards the maximum amount of loan that the company can raise has not been contravened.
- Ascertain the purpose for which loan has been raised and the manner in which it has been utilised and that this has not prejudicially affected the entity.

(c) Disclosure of Ratios as a part of Additional Regulatory Information as per Schedule III of the Companies Act 2013 and its Rules relating to disclosure are:

(1) Current Ratio,

(2) Debt-Equity Ratio,

(3) Debt Service Coverage Ratio,

(4) Return on Equity Ratio,

(5) Inventory turnover ratio,

(6) Trade Receivables turnover ratio,

(7) Trade payables turnover ratio,

(8) Net capital turnover ratio,

(9) Net profit ratio,

(10) Return on Capital employed,

(11) Return on investment.

Rules relating to disclosures of Ratios: The company shall explain the items included in the numerator and denominator for computing the above ratios.

Further explanation shall be provided for any change in the ratio by more than 25% as compared to the preceding year.

(d) Relationship between audit strategy and audit plan

- Audit strategy sets the broad overall approach to the audit whereas audit plan addresses the various matters identified in the overall audit strategy.
- Audit strategy determines scope, timing and direction of audit. Audit plan describes how strategy is going to be implemented.
- The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.
- Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.
- The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes but are closely inter-related since changes in one may result in consequential changes to the other.

Question 3

(a) CA Amit is the auditor of LMN Ltd. While conducting the audit, he wanted to analyze the different components of internal control of the company. Identify and explain which component of internal control he is trying to understand in the following two cases: -

(i) Whether controls in LMN Ltd. are operating as intended and they are modified as appropriate for change in conditions.

(ii) Whether there exists proper segregation of duties in the company and the person responsible for recording a transaction is different from the person authorizing it. ***(4 Marks)***

(b) M/s. PK & Company, Chartered Accountants, are the statutory auditors of JC Limited. CA Tarun, partner of M/s. PK & Company, was entrusted to supervise

and verify the inventory items as on 31.03.2024. During the process of verification, a large chunk of draft inventory sheets were accumulated and then a final inventory sheet was prepared. The audit assistant has kept all these drafts and the final inventory sheet in the audit file. Is the approach of the audit assistant correct? Which papers/ documents may not be included in the audit documentation? ***(4 Marks)***

(c) K Ltd. is availing cash credit limit of ₹ 25 crores from LMN Bank Ltd. The drawing power of the company range between ₹ 22 crores and ₹ 25 crores during the year 2023-24. The limit availed by the company remained less than ₹ 20 crores during all the days of the financial year 2023-24. The company has not deposited any amount in the cash credit account and there are no other credits to this account during the last two quarters. How will this account be classified in the books of LMN Bank Ltd. as on 31-03-2024? Explain. ***(3 Marks)***

(d) You are the statutory auditor of NP Ltd. Looking at the huge size of similar transactions, you directed your team members to use statistical sampling. One of the team members, Mr. Q, wants to select samples based upon his personal experience & knowledge as he is not aware of statistical sampling. You are required to explain to Mr. Q why the use of statistical sampling method is more scientific and appropriate. ***(3 Marks)***

Answer

(a) (i) In this case, CA. Amit is trying to understand that whether controls in the LMN Ltd. are operating as intended and they are modified as appropriate for change in conditions: He is gaining the understanding of the Monitoring of controls component of internal control. Monitoring of controls is a process to assess the effectiveness of internal control performance over time. It helps in assessing the effectiveness of controls on a timely basis and taking necessary remedial actions. It includes considering whether controls are operating as intended and that they are modified as appropriate for change in conditions.

(ii) In the given situation, CA Amit is trying to understand that whether there exists a proper system of segregation of duties in the company and the person responsible for recording a transaction is different from the person authorising it. He is gaining an understanding of internal

control of the company. In particular, he is understanding "control activities". When a person recording a transaction is different from one authorizing it, he gains confidence that there exists a system for preventing misstatements. It helps him in gaining insight into the internal control system of the company.

(b) In the given case, the audit assistant has kept a large chunk of draft inventory sheets and the final inventory sheet in the audit file which is not correct as the auditor is not required to document draft inventory sheets. Auditor should ensure that only final inventory sheets will form part of the audit documentation. Thus, approach of the audit assistant of filing draft and final inventory sheet is not correct.

As per SA 230, "Audit documentation", audit documentation may be recorded on paper or on electronic or other media.

The auditor need not include in audit documentation:

- superseded drafts of working papers and financial statements,
- notes that reflect incomplete or preliminary thinking,
- previous copies of documents corrected for typographical or other errors, and
- duplicates of documents.

(c) An account should be treated as 'out of order' if: -

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

In the given case, K Ltd. is availing cash credit limit of ₹ 25 crores from LMN Bank Ltd and the drawing power of the company range between ₹ 22 crores and ₹ 25 crores during the year 2023-24. The limit availed by K Ltd. remained less than ₹ 20 crores during all the days of the financial year 2023-

24 and the company has not deposited any amount in the cash credit account and there are no other credits to this account during the last two quarters.

Thus, account should be treated as out of order in the books of LMN Bank Ltd. as the outstanding balance in the principal operating account (₹ 20 crore) is less than the sanctioned limit/drawing power (₹ 22 cores and ₹ 25 crores), but there are no credits continuously for 90 days as on the date of Balance Sheet.

(d) Statistical sampling: Statistical sampling is an approach to sampling that has the random selection of the sample units and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.

Statistical Sampling is more scientific and appropriate as:

- Audit testing done through this approach is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.
- Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.
- There is no personal bias of the auditor in case of statistical sampling. Since it is scientific, the results of samples can be evaluated and projected on the whole population in a more reliable manner.

In larger organisations, with huge transactions, statistical sampling is always recommended as it is unbiased, and the samples selected are not prejudged.

Question 4

(a) EFG Ltd. has appointed M/s. MN & Co., Chartered Accountants, as the statutory auditors for the year 2024-25. CA N, the engagement partner, completed his risk assessment procedure. However, he is concerned about the management of human resources to be employed to conduct the audit. For this purpose, he wants to establish an overall audit strategy for setting the

scope, timing and direction of the audit. Describe how the process of establishment of overall audit strategy will assist him in managing deployment of his human resources for various audit areas. ***(4 Marks)***

(b) *JB Limited has invested huge sums of money on establishment of new Property, Plant and Equipment during the year under audit. They have incurred an amount of ₹ 5,70,000/- on dismantling of an old plant, which had become obsolete, so that a new plant can be set up at the existing location. The Auditor is in the process of verifying the cost incurred towards addition to Property, Plant and Equipment. What should be the accounting treatment of the amount spent on dismantling of old plant in the financial statements? Which elements of cost should be considered for valuing Property, Plant and Equipment?* ***(4 Marks)***

(c) *CA Ayush has recently qualified and has joined a CA Firm. On going through various audit reports, he observed that different phrases were used to express an unmodified opinion on the financial statements. On enquiring with a senior, he got to know that all those phrases can be regarded as being equivalent. Which phrases are appropriate and which phrases are inappropriate while drafting an unmodified opinion?* ***(3 Marks)***

(d) *You have been appointed as an auditor of Co-operative society. During the course of audit, you have noticed some serious irregularities in the working of the society. Enumerate those special matters for reporting to the Registrar.* ***(3 Marks)***

Answer

(a) Establishing the overall audit strategy- Assistance for the auditor : Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan. The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as: -

(i) The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high-risk areas or the involvement of experts on complex matters

(ii) The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas

(iii) When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates

(iv) How such resources are managed, directed and supervised, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews.

(b) In the given situation, JB Limited has invested huge sums of money on establishment of new Property, Plant and Equipment and incurred an amount of ₹ 5,70,000 on dismantling of old plant which had become obsolete so that new plant can be set up at the existing location. An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost. The costs of dismantling, removing the item and restoring the site on which it is located referred to as decommissioning will form part of the new Property, Plant and Equipment.

Elements of Cost: The cost of an item of property, plant and equipment comprises:

(i) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(ii) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(iii) the initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as decommissioning, restoration and similar liabilities', the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

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(c) Appropriate and Inappropriate Phrases while drafting an Unmodified Opinion: When expressing an unmodified opinion on financial statements, the auditor's opinion shall, unless otherwise required by law or regulation, use one of the following phrases, which are regarded as being equivalent:

(i) In our opinion, the accompanying financial statements **present fairly, in all material respects**, [...] in accordance with [the applicable financial reporting framework]; or

(ii) In our opinion, the accompanying financial statements **give a true and fair view of** [...] in accordance with [the applicable financial reporting framework].

The phrases "present fairly, in all material respects," and "give a true and fair view" are regarded as being equivalent.

Inappropriate Phrases: When the auditor expresses an unmodified opinion, it is not appropriate to use phrases such as "with the foregoing explanation" or "subject to" in relation to the opinion, as these suggest a conditional opinion or a weakening or modification of opinion.

(d) Special report to the Registrar: During the course of audit, if the auditor notices that there are some serious irregularities in the working of the society he may report these special matters to the Registrar, drawing his specific attention to the points. The Registrar on receipt of such a special report may take necessary action against the society. In the following cases, for instance, a special report may become necessary:

(i) Personal profiteering by members of managing committee in transactions of the society, which are ultimately detrimental to the interest of the society.

(ii) Detection of fraud relating to expenses, purchases, property and stores of the society.

(iii) Specific examples of mis-management. Decisions of management against co-operative principles.

(iv) In the case of urban co-operative banks, disproportionate advances to vested interest groups, such as relatives of management, and deliberate negligence about the recovery thereof. Cases of reckless advancing, where the management is negligent about taking adequate

security and proper safeguards for judging the credit worthiness of the party.

Question 5

(a) *M/s. PP & Co, a firm of Chartered Accountants, has been auditing the books of accounts of KALI Ltd. for the past 3 years. The company has recently made some major changes in its business policies. While planning to start the audit for the 4th year i.e. for financial year 2024-25, the audit manager of the firm, as per the routine practice, handed over the previous years' audit programme as it is to the audit team with the instructions to adhere unfailingly to the said audit programme. Evaluate the decision of the audit manager with reference to the use of audit programme.* ***(4 Marks)***

(b) *The management of D. Ltd. have engaged an actuary-expert to ascertain actuarial valuation of gratuity for provision to be made in the accounts. As an auditor of D. Ltd., you plan to use the report of the said expert as audit evidence for ascertaining appropriate valuation of provisions. As an auditor, what will you do to evaluate the competence, capabilities, objectivity and an understanding of the work of the actuary-expert who has carried out actuarial valuation of gratuity?* ***(4 Marks)***

(c) *Z and Associates are the auditors of Realton Ltd., an export oriented unit, which specializes in manufacturing oil extraction plants. Since many complex processes are involved, they are digitizing their operations. They are restructuring their business models which are driven by technology. Since most of the operations of the company are automated, Z and Associates are planning to do Digital Audit. Explain the use of digital technology in the conduct of an audit.* ***(3 Marks)***

(d) *Mr. J is an articled clerk with a big Chartered Accountants' firm. He is a part of the engagement team which is conducting the audit of a company for the first time. They are assigned with the work of preparing the draft audit engagement letter. Mr. J is not sure how to go about with this work. Explain what is Audit Engagement Letter and what are its contents?* ***(3 Marks)***

Answer

(a) Review of the audit programme: There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions. Unless

this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an obsolete programme and, for this negligence, the whole audit may be held as negligently conducted and the auditor may have to face legal consequences.

The utility of the audit programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed.

Audit programme not only lists the tasks to be carried out but also contains a few relevant instructions, like the extent of checking, the sampling plan, etc. So long as the programme is not officially changed by the principal, every assistant deputed on the job should unfailingly carry out the detailed work according to the instructions governing the work. Many persons believe that this brings an element of rigidity in the audit programme. This is not true provided the periodic review is undertaken to keep the programme as up-to-date as possible and by encouraging the assistants on the job to observe all salient features of the various accounting functions of the client.

In the given situation, Ms. PP & Co., a firm of Chartered Accountants has been auditing the books of accounts of KALI Ltd. for the past 3 years and the Company has recently made major changes in its business policies, therefore, it is very essential to review the audit programme. Thus, contention of the audit manager to adhere with the instructions of following the same audit programme as per routine practice is not correct.

(b) As per SA 500, "Audit Evidence", issued by ICAI, when using the work of a management's expert as audit evidence the auditor should evaluate the competence, capabilities and objectivity of that expert that:

- Whether the expert is employed by the entity or is an outside party.
- Whether the expert is independent in respect of the entity.
- Auditor's previous experience of the work of the expert.
- Knowledge of the expert, his qualification, membership of a professional body or industry association, etc.

The auditor should also obtain an understanding of the work of that expert that:

- Whether the auditor has expertise to evaluate the work of the expert.
- Evaluating the assumptions and methods used by the management.
- Evaluating the nature of internal or external data used by the expert.

(c) Use of Digital Technology in the conduct of an audit: Entities are embracing digitization as part of their operations to keep pace with changing times. New technologies are helping companies revamp their operations and rethink the way business is conducted. Companies are restructuring their business models driven by technology. Automation is key to digitization.

In such a business environment, use of digital technology is being made by auditors right from planning to expression of final opinion.

- Auditors are making use of artificial intelligence, data analytics and other latest technologies to help understand business processes in a better way.
- By using such tools, auditors can conduct audits in a better way and devote more attention to areas requiring greater focus.
- Digital audit is helping auditors to better identify risks making use of technology.

(d) Audit Engagement Letter: The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement are recorded in a letter or other the suitable form of written agreement. Such an agreement is known as Audit Engagement Letter. The audit engagement letter is sent by the auditor to his client. It is in the interest of both the auditor and the client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent.

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.

Question 6

(a) You are the auditor of Plus Bank Limited. The bank has made following provisions for the year ended on 31.03.2024:

Particulars	***Amount (₹ in crores)***
Provision for Bad Debts	*66*
Provision for Sub-standard Assets	*78*
Provision for Expenses	*24*
Provision for Income Tax	*55*

You are in the process of verifying the provisions and contingencies of the bank. What audit approach and procedures will you adopt to verify the above? ***(4 Marks)***

OR

(a) CA Vasu was appointed as the statutory auditor of M/s. Pizza Limited for the financial year 2023-24. While reviewing the internal controls, he observed that the company has entered into many transactions with firms in which the directors are interested. The company's specified procedure was by-passed in such transactions. CA Vasu considered it as a significant deficiency in internal control over related party transactions. He communicated this deficiency to Those Charged With Governance (TCWG) as under, "Controls over significant transactions with related parties are weak." In view of the above, please explain:

(i) What is meant by deficiency in internal control?

(ii) As per SA 265, whether the significant deficiency communicated by CA Vasu to TCWG is appropriate? Explain. ***(4 Marks)***

(b) CA P is a professional accountant in service. In terms of employment and professional relationships with employer he has to be alert to the possibility of inadvertent disclosure of any information outside the employing organization. However, in view of disclosure required by law, CAP had to divulge the information and documents as evidence in course of legal proceedings. Whether CA P has violated any fundamental principle governing professional ethics in this case? Explain. ***(4 Marks)***

(c) During the audit of accounts for the year ended 31.03.2024, the auditor of FD Limited wanted confirmation from a Trade Receivable, which was outstanding for more than six months, amounting to ₹ 4,25,000/-. The auditor sent a Confirmation letter to the party requesting them to respond directly to him, whether or not they agree with the amount outstanding from them.

That trade receivable confirmed to the auditor of FD Limited, that they were required to pay an amount of ₹4,20,000 to FD Limited as per their books of accounts.

State and explain the type of Confirmation Request sent by the auditor and the course of action that he should take on the confirmation received from the trade receivable. ***(3 Marks)***

(d) P Financial Services Ltd. (PFSL) is a leasing & hire purchase company. You, as an auditor of PFSL, are in the process of examining finance lease agreements executed by them for equipment given on lease. Which points shall be noted by you while examining a particular finance lease agreement entered into by PFSL in respect of a leasing transaction? ***(3 Marks)***

Answer

(a) For audit of provisions and contingencies the auditor should:

- ensure that the compliances for various regulatory requirements for provisioning as contained in the various circulars have been fulfilled.
- obtain an understanding as to how the bank computes provision on standard assets and non-performing assets. It will primarily include checking the basis of classification of loans and receivables into

standard, sub-standard, doubtful, loss and non-performing assets. The auditor may verify the loan classification on a sample basis.

- obtain the detailed break up of standard loans, non-performing loans and agree the outstanding balances with the general ledger.
- obtain the tax provision computation from the bank's management and verify the nature of items debited and credited to profit and loss account to ascertain that the same are appropriately considered in the tax provision computation.
- examine the other provisions for expenses vis-a-vis the circumstances warranting the provisioning and the adequacy of the same by discussing and obtaining the explanations from the bank's management.

Or

(a) (i) **Meaning of Deficiency in internal control:** This exists when -

(1) A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis or

(2) A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing.

(ii) As per SA 265, While pointing out significant deficiencies in internal control, auditor has not only to communicate significant deficiencies giving their description but also explain the potential effects and sufficient information to those charged with governance and management to understand context of communication.

Therefore, the above communication is not proper. Not only significant deficiency has to be communicated, it should also be explained to management the potential effects of transactions with firm in which the directors are interested. It should explain that such a significant deficiency can lead to misstatement of transactions with related party. Highlighting importance of such a control, it should be stated that responsibility be fixed for concerned persons for adhering to such an important control.

(b) Confidentiality principle requires a professional accountant to respect the confidentiality of information acquired as a result of professional or business relationships. Confidentiality serves the public interest because it facilitates the free flow of information from the professional accountant's client or employing organization to the accountant with the understanding that the information will not be disclosed to a third party.

However, such confidential information may be disclosed, for example, when it is required by law, when it is permitted by law and is authorised by the client or employer or there is a professional duty or right to disclose when not prohibited by law.

In the given situation, CA P, who is a professional accountant in service, and in terms of employment and professional relationships with the employer he is alert to the possibility of inadvertent disclosures of any information outside the employing organization. However, CA P had to divulge the information and documents as evidence in the course of legal proceedings and same was required by law. Therefore, CA. P will not be held responsible for violation of fundamental principle of "Confidentiality" governing professional ethics.

(c) **Positive confirmation request:** A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request or providing the requested information.

Exception – A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party. The exception needs to be assessed to the entire population after analyzing the reason for difference.

In the given situation, the auditor has sent the positive confirmation request for the amount of 4,25,000 to a trade receivable which was outstanding for more than 6 months, however, due to difference between information requested to be confirmed, or contained in the entity's records (i.e. 4,25,000), and information provided by the confirming party (i.e. 4,20,000) is forming situation of exception confirmation.

The auditor's evaluation, when taken into account with other audit procedures the auditor may have performed, may assist the auditor in concluding whether sufficient appropriate audit evidence has been

obtained or whether performing further audit procedures is necessary, as required by SA 330 in case a response is indicating an exception.

The company should be asked to investigate and reconcile the discrepancy indicated by the confirming party.

(d) The lease agreement should be examined, and the following points may be noted:

(i) the description of the lessor, the lessee, the equipment and the location where the equipment is to be installed. (The stipulation that the equipment shall not be removed from the described location except for repairs. For the sake of identification, the lessor may also require plates or markings to be attached to the equipment).

(ii) the amount of tenure of lease, dates of payment, late charges, deposits or advances etc. should be noted.

(iii) whether the equipment shall be returned to the lessor on termination of the agreement and the cost shall be borne by the lessee.

(iv) whether the agreement prohibits the lessee from subletting the equipment and authorises the lessor to do so.