

AEU2

Roll. No.

Total No. of Question -6

Maximum Marks : 70

Test Paper with Solutions

Auditing & Assurance

CA-Intermediate (May 2023) | Examination

PART-II

Instructions for the Candidates :

- The question paper comprises two **Part I and Part II**.
- Part I comprise Multiple Choice Question (MCQs).
- Part II comprises question which require descriptive type answers.
- Ensure that you receive the question paper relating to both the parts. If you have not received both, bring it to the notice of the invigilator.
- Answers to Question in Part I are to be marked on the OMR answer sheet only. Answer to questions in Part II are to be written on the descriptive type answer book. Answers to MCQs, if written in the descriptive type answer book, will not be evaluated.
- OMR answer sheet will be in English only for all candidates, including for Hindi medium candidates.
- **The bar coded sticker provided in the attendance register, is to be affixed only on the descriptive type answer book.**
- You will be allowed to leave the examination hall only after the conclusion of the exam. If you have completed the paper before time, remain in your seat till the conclusion of the exam.
- Duration of the examination is 3 hours. You will be required to submit (a) Part I of the question paper containing MCQs, (b) OMR answer sheet thereon and (c) the answer book in respect of descriptive type answer book to the invigilator before leaving the exam hall, after the conclusion of the exam.
- The invigilator will give you acknowledgement on Page 2 of the admit card, upon receipt of the above – mentioned items
- Candidate found copying or receiving or giving any help or defying instructions of the invigilators will be expelled from the examination and will also be liable for further punitive action.

General Instructions:

- ◆ Question paper comprises **6** questions. Answer Question No. **1** which is compulsory and any 4 out of the remaining **5** questions.
- Working notes should form part of the answer.
- Answers to the questions are to be given only in English except in the case of candidates who have opted for Hindi Medium. If a candidate has not opted for Hindi Medium, his/her answers in Hindi will not be evaluated.

Disclaimer Clause :

- These Solutions are prepared by the Expert Faculty Team of RESONANCE .
- Views and Answers provided may differ from ICAI due to difference in assumptions taken in support of the answers .
- In such case answers as provided by "ICAI" will be deemed as final .

PART– II

1. State with reasons whether the following statements are correct or incorrect. (7 x 2 = 14)
(Answer any seven)

1.(a) The "documentation of the overall audit strategy" is a record of the audit evidences considered necessary to properly plan the audit and to assign various audit functions to the engagement team.

Ans. Incorrect : As required by SA 300, the documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team and not a record of audit evidence considered necessary.

1. (b) Communicating key audit matters in the auditor's report is a separate opinion on individual matters.

Ans. Incorrect : As per SA 706 "Communicating Key Audit Matters in The Independent Auditor's Report" Key audit matters are those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period; and These matters were addressed in the context of the audit of the financial statements as a whole, and in forming the auditor's opinion thereon, and the auditor does not provide a separate opinion on these matters.

1.(c) Amortization represents systematic allocation of the depreciable amount of an item of Property, Plant and Equipment (PPE) over its useful life.

Ans. Incorrect : Depreciation represents systematic allocation of the depreciable value of an item of PPE over its useful life while amortisation represents systematic allocation of the depreciable amount of an intangible asset over its useful life.

1.(d) As per section 142 of Companies Act, 2013 the remuneration to the auditor shall also include any facility provided to him.

Ans. Correct : As per section 142 of the Companies Act 2013, the remuneration, in addition to the fee payable to an auditor, include the expenses, if any, incurred by the auditor in connection with the audit of the company and any facility extended to him but does not include any remuneration paid to him for any other service rendered by him at the request of the company.

1. (e) Appropriateness is the measure of the quantity of audit evidence.

Ans. Incorrect : As per SA 500, Appropriateness is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based.

1. (f) Analytical procedures are used in all stages of audit by experienced auditors.

Ans. Correct : As per SA 520 "Analytical Procedures" Experienced auditors use analytical procedures in all stages of the audit. Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase.

1. (g) In the case of Co-operative societies, contribution to Education fund is a charge on profits and not an appropriation.

Ans. Correct : Some of the State Acts provide that every society shall contribute annually towards the Education Fund of the State Federal Society, at the appropriate rate as per the class of the society. Contribution to Education Fund is a charge on profits and not an appropriation.

1.(h) If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered less complex and easy to audit compared to using an off-the-shelf accounting software.

Ans. Incorrect : If a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment

2.(a) While designing an audit sample, the auditor shall determine a sample size sufficient to reduce the sampling risk to an acceptably low level. In this context, explain sampling risk and non-sampling risk.

(4 Marks)

Ans. The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level. The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be. In this context 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. This risk will always be in existence when auditor uses sampling technique in conducting his audit.

Sampling risk can lead to two types of erroneous conclusions:

- (i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist 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. This is because of over reliance on the internal controls.
- (ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement 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. This is because of

under reliance on the test of controls and detailed substantive procedures performed by the auditor. Here risk of giving wrong opinion is minimum but it will lead to more detailed checking which is time consuming.

Non-Sampling Risk

The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

Sources of Non Sampling risk are: Human Mistakes, Misinterpreting the sample results, Applying audit procedures not appropriate to the objectives of audit, Relying on erroneous information e.g. erroneous confirmation

Non sampling risk can never be mathematically measured.

- 2. (b)** You are appointed as an auditor of Gama Ltd. Your audit assistant wants to understand the meaning of Audit Risk. Explain him the meaning of Audit Risk with example. Also guide him as to what is not included in Audit Risk.

(4 Marks)

Ans. Audit risk means the risk that the auditor gives an inappropriate audit opinion when the financial statement are materially misstated. Thus, it is the risk that the auditor may fail to express an appropriate opinion in an audit assignment.

Audit Risk could be simply understood as follows:

During the audit of a company if the financial statements of that company are misstated and those misstatements are material in nature, then there will be a risk that audit opinion given by the auditor regarding audit of that company would be incorrect. Then that risk will be known as Audit Risk.

Example : A company purchased a machinery worth ₹ 3 lacs during the year. Instead of capitalising, the company debited this in the statement of Profit & Loss as repair and maintenance expense. While auditing, the auditor did not report anything about this misstatement. Therefore the misstatement remained undetected and opinion given by the auditor would be inappropriate resulting in audit risk.

Audit risk is a function of the risks of material misstatement and detection risk

Further the risk of misstatement consists of two components, namely inherent risk & control risk.

What is not included in Audit Risk?

- (i) Audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant.
- (ii) Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

- 2. (c)** An auditor has to exercise professional judgement in determining materiality. Explain the factors that may affect the identification of an appropriate benchmark in determining materiality for the financial statements as whole. **(3 Marks)**

Ans. Determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements
Examples : Assets, liabilities, equity, revenue, expenses
- Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused
Example : For the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets.
- 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; The entity's ownership structure and the way it is financed
Example : If an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings;
- The relative volatility of the benchmark.

2. (d) While auditing in an automated environment how data analytics can be used in testing electronic records and data residing in IT systems using spread sheets and specialised audit tools ?

(3 Marks)

Ans. Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the following:

- Check completeness of data and population that is used in either test of controls or substantive audit tests.
- Selection of audit samples – random sampling, systematic sampling.
- Re-computation of balances – reconstruction of trial balance from transaction data.
- Reperformance of mathematical calculations – depreciation, bank interest calculation.
- Analysis of journal entries as required by SA 240.
- Fraud investigation.
- Evaluating impact of control deficiencies.

3. (a) CA P is the auditor of MN Ltd. While scrutinising the accounts of MN Ltd., he observed that the company had large volume of Trade payable outstanding in the Balance sheet as on 31st March, 2023 for which external confirmations are not available. CA P wants to send external confirmation request to selected Trade payables but management of MN Ltd. refused for the same. Discuss how CA P should deal in this regard as per relevant Standard on Auditing.

(4 Marks)

Ans. As required by SA 505 “External Confirmations” If management refuses to allow the auditor to send a confirmation request, the auditor shall:

- Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;
- 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
- 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 also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705.

Thus in the given case, if management of MN Ltd. refuses to allow the auditor, Mr. P to send external confirmations to the trade payables, he may decide his course of action in accordance of above discussed provisions.

- 3.(b)** Management of D Ltd. has issued shares at a discount to its creditors. Explain the provisions of the Companies Act, 2013 when shares are issued at a discount to creditors ? As an auditor what will be your concern of checking in such a case ?

(4 Marks)

Ans. According to Section 53 of the Companies Act, 2013,

(1) a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under Section 54 of the Companies Act, 2013.

(2) any share issued by a company at a discounted price shall be void.

(2A) Notwithstanding anything contained in sub- sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

- In the given question, management of D Ltd. has issued shares at a discount to its creditors. The auditor will check the circumstance under which such shares are issued at discount. If the shares issued at discount are in accordance with provisions of section 54, then it's a valid issue otherwise the issue of such shares will become void and the company and every office in default will be liable under this section.

- Further, auditor should also verify that whether the company has issued shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

- 3. (c)** X Ltd. is a hardware manufacturing company. At each and every stage of production processes large amount of scrap is generated in the factory and subsequently sold. As an auditor how will you vouch/ verify the sale of scrap ?

(3 Marks)

Ans. In a large manufacturing company, where at each and every stage of production process, large amount of scrap is generated and subsequently sold, an auditor can check in the following way :

- (i) Review the internal control as regards generation, storage and disposal of scrap.
- (ii) Check whether the organization is maintaining reasonable record for generation of scrap.
- (iii) Analyze the raw material used, production and generation pattern of scrap and compare the same with figures of earlier year.
- (iv) Check the rates at which scrap has been sold and compare the rate with previous year.
- (v) Vouch sales, with invoices raised, advertisement for tender, rate contract with scrap dealers.

- (vi) Ensure that there exists a proper control procedure to identify scrap and good units and they are not mixed up and sold as scrap.
- (vii) Make an overall assessment of the value of realization from scrap as to its reasonableness.

3.(d) CA Q, the auditor of XYZ Ltd, while conducting audit observes that the company has made various provisions in the books of account. What are the audit procedures that CA Q will follow to verify the existence, completeness, and valuation of the provisions made ?

(3 Marks)

Ans. While conducting audit of XYZ Ltd, CA Q, the auditor observe that the company has made various provisions in the books of accounts. He may verify the existence, completeness and valuation of the same in the following manner :

- Obtain a list of all provisions and compare them with balances in the ledger.
- Inspect the underlying agreements like agreement with customers to assess warranty commitments, any legal and other claims on the entity i.e. litigations.
- Obtain the underlying working and the basis for each of the provisions made, from the management and verify whether the same is complete and accurate.
- Wherever required, obtain expert's report, calculation and underlying working for the provision amount, example for warranty involving complex calculations, some entities get that valued through an actuary. In such a case, the auditor may request the management to share the actuarial valuation report and in case of any matter under legal dispute, the auditor should request for assessment made by a legal expert in relation to likelihood of a liability devolving on the entity i.e. whether probable or possible or remote as defined above. The auditor should then verify the underlying assumptions used by the expert with the data shared by the management.

4. (a) CA D has been appointed as an auditor of LMP Ltd. Before developing an overall audit plan, CA D wants to get an understanding and knowledge of the Client's business including applicable financial reporting framework. Guide CA D in understanding of the same with reference to the relevant Standard on Auditing.

(4 Marks)

Ans. SA 300 "Planning an audit of financial statement" deals with development of overall audit strategy and audit plan. Further plan should be based on the knowledge of client's business. It is one of the important principles in developing an overall audit plan. In fact without adequate knowledge of client's business, a proper audit is not possible. As per SA-315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and Its Environment", the auditor shall obtain an understanding of the following:

- (a) Relevant industry, regulatory and other external factors including the applicable financial reporting framework.
- (b) 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.
- (c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are

appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.

- (d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.
- (e) The measurement and review of the entity's financial performance.

In addition to the importance of knowledge of the client's business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations and to make judgements regarding the appropriateness of accounting policies and disclosures.

This would be helpful for CA D in understanding and getting knowledge of client's business including applicable financial reporting framework.

4. (b) ABC Ltd. is a public company, which has availed various loans and cash credit facilities from Banks and other financial institutions. The company has defaulted in repayments of such borrowings during the year under audit. What are the reporting requirements in this regard under the Companies (Auditor's Report) Order, 2020 ?

(4 Marks)

Ans. (a) In the given question, ABC Ltd. is a public company, which has availed various loans and cash credit facilities from banks and other financial institutions. The company has defaulted in repayment of such borrowings during the year under audit. Following are the reporting requirements regarding this under The Companies (Auditor's Report) Order, 2020 : Whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below:-

| Nature of borrowing, including debt securities | Name of lender | Amount not paid on due date | Whether principal or interest | No. of days delay or unpaid | Remarks, if any |
|--|---|-----------------------------|-------------------------------|-----------------------------|-----------------|
| | lender wise details to be provided in case of defaults to banks, financial institutions and Government. | | | | |

- (b) whether the company is a declared wilful defaulter by any bank or financial institution or other lender;
- (c) whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported;
- (d) whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated;
- (e) whether the company has taken any funds from any entity or person on account of or to meet the obligations of its subsidiaries, associates or joint ventures, if so, details thereof with nature of such transactions and the amount in each case;

- (f) whether the company has raised loans during the year on the pledge of securities held in its subsidiaries, joint ventures or associate companies, if so, give details thereof and also report if the company has defaulted in repayment of such loans raised;

4. (c) The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Explain the factors that are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures.

(3 Marks)

Ans. As required by SA 520 “Analytical Procedures” The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:

- (i) Source of the information available. For example, information may be more reliable when it is obtained from independent sources outside the entity;
- (ii) Comparability of the information available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products;
- (iii) Nature and relevance of the information available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved; and
- (iv) Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

4. (d) As a part of Risk assessment, the auditor shall determine whether any of the risks identified are in the auditor's judgement a significant risk. Mention any three guiding factors to judge as to which risks are significant risks ?

(3 Marks)

Ans. As per the requirement of SA 315 “Identifying & assessing the risk of material misstatement through understanding the entity & its environment” in exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

- (a) Whether the risk is a risk of fraud;
- (b) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;
- (c) The complexity of transactions;
- (d) Whether the risk involves significant transactions with related parties;
- (e) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- (f) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

5. (a) S Ltd., a large textile manufacturing company, due to heavy recession in the market was unable to collect amount of huge receivables in time and also holding large amounts of stock of raw materials and finished goods since last 9 months of the Financial Year 2022-23.

From your primary observations of audit evidences you feel that there is a material uncertainty exists about going concern.

How will you deal in your audit report ?

What will be the effect on your audit opinion in the following situations ?

- (i) If adequate disclosure of such material uncertainty is already made in the financial statements.
- (ii) If adequate disclosure of such material uncertainty is not made in the financial statements.

(4 Marks)

Ans.

Due to heavy recession, S Ltd was unable to collect huge amount of large receivables and also holding large amount of stock since last 9 months. As per auditor's observation it is a material uncertainty about going concern. The auditor should deal with the same in the following manner :
As required by SA 570 "Going Concern" The identification of a material uncertainty is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that a material uncertainty related to going concern exists alerts users to this circumstance.

- (1) Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements :
If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern."
- (2) Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements:
If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:
 - (a) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 (Revised); and
 - (b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

5. (b)

During the course of audit of PQR Ltd, the statutory auditor CA G 4 came across payments made to various creditors aggregating to Z 75 lakhs. On verifying the same it is found that the accounts manager had accounted for fake invoices of credit purchases for ! 25 lakhs in the books of account in the name of one bogus creditor Mr. X . Discuss the duties of auditor with reference to the provisions of Companies Act, 2013 and also the disclosure requirements in the Board's Report.

(4 Marks)

Ans.

As per sub-section (12) of section 143 of the Companies Act, 2013 further prescribes that in case of a fraud involving lesser than the specified amount [i.e. less than ₹ 1 crore], the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.

In this regard, sub-rule (3) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that in case of a fraud involving lesser than the amount specified in sub- rule (1) [i.e. less than ₹ 1 crore], the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:

- (a) Nature of Fraud with description;
- (b) Approximate amount involved; and
- (c) Parties involved.

Disclosure in the Board's Report: Sub-section (12) of section 143 of the Companies Act, 2013 furthermore prescribes that the companies, whose auditors have reported frauds under this sub-section (12) 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.

In this regard, sub-rule (4) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that the auditor is also required to disclose in the Board's Report the following details of each of the fraud reported to the Audit Committee or the Board under sub- rule (3) during the year:

- (a) Nature of Fraud with description;
- (b) Approximate Amount involved;
- (c) Parties involved, if remedial action not taken; and
- (d) Remedial actions taken.

In the given question, during the audit of PQR Ltd. the auditor CA G found a fake invoice of credit purchase for ₹ 25 lacs in the books of accounts in the name of a bogus creditor. Since the amount involved in the fraud is less than ₹ 1 crore, the auditor may take action in accordance with above discussed provisions.

OR

- 5. (b)** CA. Z, a Chartered Accountant is the Senior manager of a Multi-State co-operative society in Mumbai. He is proposed to be appointed as an auditor of the said Multi-State Co-operative society. Analyse the provisions of the Multi-State Co-operative Societies Act, 2002 and comment on validity of proposed appointment.

Ans. Section 72 of the Multi-State Co-operative Societies Act, 2002 states that a person who is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 can only be appointed as auditor of Multi-State co-operative society.

However the following persons are not eligible for appointment as auditors of a Multi- State co-operative society-

- (a) A body corporate.
- (b) An officer or employee of the Multi-State co-operative society.
- (c) A person who is a member or who is in the employment, of an officer or employee of the Multi-State co-operative society.
- (d) A person who is indebted to the Multi-State co-operative society or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the Multi-State co-operative society for an amount exceeding one thousand rupees.

If an auditor becomes subject, after his appointment, to any, of the disqualifications specified above, he shall be deemed to have vacated his office as such.

In the given question since CA Z, a chartered accountant is the senior manager of the multi state cooperative society, he is disqualified to be appointed as the auditor of the society. Therefore the proposed appointment is not a valid appointment.

- 5. (c)** Elucidate the circumstances when a modification to the Auditor's opinion is required. Also state the factors for making the decision regarding which type of modified opinion is appropriate.

(3 Marks)

Ans. As required by SA 705 "Modifications To The Opinion In The Independent Auditor's Report" The auditor shall modify the opinion in the auditor's report in the following circumstances:

- (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.

The decision regarding which type of modified opinion is appropriate depends upon:

- (a) The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated; and
- (b) The auditor's judgement about the pervasiveness of the effects or possible effects of the matter on the financial statements.

5. (d) Management is often in the best position to perpetrate fraud. As an auditor you are suspecting existence or suspicion of fraud from management. Give any three examples of "others within the entity" to whom direct inquiries can be made.

(3 Marks)

Ans. As required by SA 240 "the auditor's responsibilities relating to fraud in an audit of financial statements" if an auditor suspects existence of fraud, he may make direct enquiries from management & others within the entities.

Examples of others within the entity to whom the auditor may direct inquiries about the existence or suspicion of fraud include:

- Operating personnel not directly involved in the financial reporting process.
- Employees with different levels of authority.
- Employees involved in initiating, processing or recording complex or unusual transactions and those who supervise or monitor such employees.
- In-house legal counsel.
- Chief ethics officer or equivalent person.
- The person or persons charged with dealing with allegations of fraud.

6. (a) ATM Ltd. Is a public company, with a paid up capital of ₹ 12 crore. The company has made a turnover of ₹ 105 crore in the Financial Year 2021-22. The outstanding loan as on 31-03-2022 was ₹ 32 crore. Whether ATM Ltd. Is required to constitute an Audit Committee in the financial year 2022-23 ? Analyse the provisions of Companies Act, 2013 and give your comments.

(4 Marks)

Ans. As per the provisions of Section 177 of Companies Act 2013, in addition to listed public companies, following classes of companies shall constitute an Audit Committee -

- (i) all public companies with a paid up capital of ten crore rupees or more;
- (ii) all public companies having turnover of one hundred crore rupees or more;
- (iii) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation: The paid up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of last audited Financial Statements shall be taken into account for the purposes of this rule.

In the given question, ABC Ltd is a public company with a paid up capital of ₹ 12 crore, turnover during the financial year 21-22 of ₹ 105 crore and outstanding loan as on 31.03.2022 of ₹ 32 crore. Though the outstanding loans are less than ₹ 50 crore but since paid up capital and turnover both exceed the threshold limit, therefore the company is required to constitute an audit committee in the financial year 2022-23.

6. (b) SK & Co, a Chartered Accountant firm has been appointed an auditor of Metro Rail project in City A. Since the project is on large scale it involves a high volume of resources (financial, human and physical resources). The appointing authority C&AG requires an objective examination of the financial and operational performance of the Metro Rail project. Explain the nature and scope of audit that SK & Co will undertake.

(4 Marks)

Ans. SK & Co., chartered accountant firm has been appointed by CAG to conduct audit of metro rail project of a city. The project is large and involve high volume of resources. In accordance with the requirement of CAG, the should auditor should vouch/verify the project in the following manner :

Performance audit - The scope of audit has been extended to cover efficiency, economy and effectiveness audit or performance audit, or full scope audit:-

Efficiency audit looks into whether the various schemes/projects are executed and their operations conducted economically and whether they are yielding the results expected of them, i.e., the relationship between goods and services produced and resources used to produce them; and examination aimed to find out the extent to which operations are carried out in an economical and efficient manner.

Economy audit looks into whether government have acquired the financial, human and physical resources in an economical manner, and whether the sanctioning and spending authorities have observed economy.

Effectiveness audit is an appraisal of the performance of programmes, schemes, projects with reference to the overall targeted objectives as well as efficiency of the means adopted for the attainment of the objectives.

Efficiency-cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.

The procedure for conducting performance audit covers : identification of topic, preliminary study, planning , execution of audit, and reporting.

6. (c) A Ltd. has availed Cash Credit facilities against Stock and Book Debt, Term Loan for machineries and Bank Guarantee from Big Bank Ltd.

A Ltd. furnishes stock statements and age wise list of debtors to Big Bank Ltd. on regular basis. Concurrent Auditors of Big Bank Ltd. mentioned about wrong calculation of Drawing Power by the Bank Branch along with sanctioned limit, and balances overdrawn due to wrong calculation of Drawing Power (DP) in the monthly report.

Explain the meaning of drawing power and how it differs from sanctioned limit ? What is to be ensured while computing Drawing Power (DP) ?

(3 Marks)

Ans. In the given question, A Ltd. has taken Cash Credit facilities against stock and book debt, term loan for machineries and bank guarantee from Big Bank Ltd. Concurrent auditor mentioned in his report about wrong calculation of drawing power by the bank. In this context we can understand the meaning of drawing power and sanction limit as under:

- Drawing Power generally addressed as “DP” is an important concept for Cash Credit (CC) facility availed from banks and financial institutions. Drawing power is the limit up to which a firm or company can withdraw from the working capital limit sanctioned.
- The Sanctioned limit is the total exposure that a bank can take on a particular client for facilities like cash credit, overdraft, export packing credit, non-funded exposures etc. On the other hand, Drawing Power refers to the amount calculated based on primary security less margin as on a particular date.

- All accounts should be kept within both the drawing power and the sanctioned limit at all times.
- The accounts which exceed the sanctioned limit or drawing power or are against unapproved securities or are otherwise irregular should be brought to the notice of the Management/Head Office regularly.
- Banks should ensure that drawings in the working capital account are covered by the adequacy of the current assets.
- Drawing power is required to be arrived at based on current stock statement. The outstanding in the account based on drawing power calculated from stock statements older than three months is deemed as irregular.
- It needs to be ensured that the drawing power is calculated as per the extant guidelines formulated by the Board of Directors of the respective bank and agreed upon by the concerned statutory auditors.
- Special consideration should be given to proper reporting of sundry creditors for the purposes of calculating drawing power.

6. (d) CA B is appointed as the auditor of a Public Charitable Trust. Guide hint the focus area of attention relating to the vouching and verification of expenditure of charitable institution.

(3 Marks)

Ans. As an auditor of a public charitable trust, CA B should focus on the following areas relating to the vouching and verification of expenditure of charitable institution :

- (i) Vouching payment of grants, also verifying that the grants have been paid only for a charitable purpose or purposes falling within the purview of the objects for which the charitable institution has been set up and that no trustee, director or member of the Managing Committee has benefited there from either directly or indirectly.
- (ii) Verifying the schedules of securities held, as well as inventories of properties both movable and immovable by inspecting the securities and title deeds of property and by physical verification of the movable properties on a test- basis.
- (iii) Verifying the cash and bank payments.
- (iv) Ascertaining that any funds contributed for a special purpose have been utilised for the purpose.

Test Paper Analysis by Expert Faculty Member

Available on

YouTube Channel : Resonance clpd