

Mock Test Paper - Series II: November 2024

Date of Paper: 22nd November 2024

Time of Paper: 2 P.M. to 5 P.M.

INTERMEDIATE GROUP – II

PAPER – 5: AUDITING AND ETHICS

Time Allowed – 3 Hours

Maximum Marks – 100

PART I - Case Scenario based MCQs (30 Marks)

Write the most appropriate answer to each of the following multiple-choice questions by choosing one of the four options given. All MCQs are compulsory and carries 2 Marks each.

Case Scenario 1

While auditing ANJ Industries Private Limited, CA J has decided that it would be appropriate to examine 100% of the items comprising turnover of ₹ 30 crores as reflected in its financial statements. In this regard, he has designed tests of details for transactions forming part of company's turnover. The sales function is automated in the company's information system involving repetitive nature of calculations. Further, in respect of designing of tests of controls pertaining to turnover, he is in a fix.

While verifying turnover of the company, CA J ensures that all the sales are correctly recorded in the books of accounts based on the invoices and discounts have been properly adjusted. Similarly, in respect of verification of employee benefit expenses reflected in the financial statements, he ensured that TDS related adjustments are correctly reconciled and accounted for.

Ankush is an article assistant who has recently joined CA J for practical training. He is also part of the team assisting seniors. Although he has read about assertions, there remain several doubts about assertions in his mind. He noted down the following points about assertions as per his understanding: -

- (i) Assertions are the representations made by the auditors.
- (ii) Assertions are generally explicit and not implied.
- (iii) Verification of the assertions helps the auditor in finding out whether financial statements are in accordance with applicable financial reporting framework or not.

In normal course of business, the company also holds a part of goods as a consignee. While verifying assertions relating to inventories, he ensures that inventory held by the company as consignee of goods on behalf of third parties is excluded from inventories.

Based on the above facts, answer the following: -

1. Considering approach of CA J in respect of tests of details and tests of controls pertaining to sales, which of the following statement is most appropriate?
 - (a) The approach for both designing tests of details and tests of controls is proper.
 - (b) The approach for designing tests of details is proper. However, it is an unlikely approach for tests of controls.
 - (c) The approach for designing tests of controls is proper. However, it is an unlikely approach for tests of details.
 - (d) The approach for designing tests of details as well as tests of controls is not proper.
2. Which assertions are being verified by CA J for correctness of recording of sales on the basis of invoices (including adjustment of discounts) and TDS adjustments for employee benefit expenses respectively?
 - (a) Measurement, Measurement.
 - (b) Completeness, Measurement.
 - (c) Existence, Measurement.
 - (d) Measurement, Completeness.
3. Considering the view of Ankush, which of the following(s) is/are false?
 - (a) 1 and 2.
 - (b) 1,2 and 3.
 - (c) 1 only.
 - (d) 2 only.
4. As regards the matter of holding of certain inventories as consignee of goods, which type of assertion(s) is/are being verified by the auditor?
 - (a) Cut-off and Valuation.
 - (b) Completeness and Rights & Obligations.
 - (c) Completeness only.
 - (d) Rights & Obligations only.

Case Scenario 2

Revanth, Manohar and Piyush are planning to set up a new business for trading of electronic goods. They have heard in business circles that many entrepreneurs are setting up their organisations as Limited Liability Partnerships (LLPs). However, they lack knowledge about such legal structures. So, they decided to approach CA S for understanding the difference between a partnership firm, an LLP and a private company.

They also want to gain the knowledge of legal provisions regarding number of partners and the paperwork involved in forming an LLP. Further, they also have doubts regarding maintenance of books of accounts and the audit requirement for such organisations. Revanth, being cost conscious, specifically asks CA S regarding requirement of audit of LLPs. During the discussion, he shares that they are expecting a turnover of ₹ 5 crores in the first year of their business and funds amounting to ₹ 50 lakhs would be brought by partners as their contribution.

Manohar is concerned about the rules regarding the maintenance of accounts in software with an audit trail feature. He has a vague understanding, gained through social media, that such rules have recently come into effect. Moreover, he believes that these features are useful only for auditors. To address his concerns, CA S attempts to explain these matters to him.

After resolving their doubts, they decided to constitute an LLP named Blitz Products LLP with the professional assistance of CA S, who helped them in completing the necessary paper formalities. After constituting an LLP, they acquired dealerships of few reputed companies and received a good response from market due to prominent location of their showroom and are confident of achieving their turnover expectation within the first year of business.

They plan to get their accounts audited after closure of the financial year 2023-24 from CA S. The finance and accounts function of business is being headed by Piyush and he plans to contact him somewhere around August 2024 for getting audit of financial statements conducted, filing income tax return and making necessary regulatory compliances on behalf of LLP.

Based on the above facts, answer the following: -

5. Which of the following is correct regarding the difference in types of organisational structures and connected matters?
- (a) LLP gives the benefit of flexibility of limited liability of a partnership and good governance of a company. A Minimum of two individuals are required to form an LLP and at least 2 partners are required to take DIN. The regulatory authority in the case of LLPs is Registrar of firms of the respective state where the LLP is located.
 - (b) LLP gives the benefit of limited liability of a company and flexibility of partnership. A minimum of two individuals are required to form an LLP and at least 2 partners are required to take DPIN. The regulatory authority in the case of LLPs is Registrar of Companies (ROC).
 - (c) LLP gives the benefits of limited liability of a company and flexibility of partnership. A minimum of two individuals are required to form an LLP and at least 2 partners are required to take DIN. The regulatory authority in the case of LLPs is Registrar of Companies (ROC).
 - (d) LLP gives the benefits of limited liability of a company and flexibility of partnership. A minimum of three individuals are required to form an LLP and at least 2 partners are required to take DPIN. The regulatory authority in the case of LLPs is Registrar of Companies (ROC).

6. Which advice would have been provided by CA S to Revanth regarding audit of financial statements of LLP considering description provided in case scenario?
- (a) There is no provision for compulsory audit of LLPs under the LLP Act, 2008 and relevant Rules. However, partners may choose to get accounts audited due to advantages associated with an audit.
 - (b) Every LLP is compulsorily required to get its accounts audited under the LLP Act, 2008 and relevant Rules.
 - (c) There exist provisions under the LLP Act, 2008 and relevant Rules for audit of LLPs based upon twin criteria of turnover and contribution thresholds. However, the proposed business doesn't meet thresholds and would not be required to get its accounts audited.
 - (d) There exist provisions under the LLP Act, 2008 and relevant Rules for audit of LLPs based upon twin criteria of turnover and contribution thresholds. The proposed business meets thresholds and would be required to get its accounts audited.
7. Which of the following statement is correct regarding Manohar's point of view?
- (a) Audit trails are useful only for auditors. However, maintenance of accounts in software having feature of audit trail is not compulsory for LLPs.
 - (b) Audit trails are useful for businesses as well as auditors. However, maintenance of accounts in software having feature of audit trail is not compulsory for LLPs.
 - (c) Audit trails are useful for businesses as well as auditors. Maintenance of accounts in a software having feature of audit trail is compulsory for LLPs.
 - (d) Audit trails are useful for businesses as well as auditors. Maintenance of accounts in a software having feature of audit trail is compulsory for LLPs having certain turnover thresholds.
8. Which of the following statement is correct regarding Piyush's plan?
- (a) Auditor is required to be appointed at least 30 days prior to March 31st, 2024. Therefore, Piyush's plan to approach CA S is not in accordance with the relevant rules and regulations.
 - (b) Auditor is required to be appointed at least 60 days prior to March 31st, 2024. Therefore, Piyush's plan to approach CA S is not in accordance with the relevant rules and regulations.
 - (c) Auditor is required to be appointed at any time before March 31st, 2024. Therefore, Piyush's plan to approach CA S is not in accordance with the relevant rules and regulations.
 - (d) Piyush's plan is proper and there are no specific provisions for appointment of auditor of an LLP in accordance with relevant rules and regulations.

9. Considering Piyush's plan to contact CA S in August 2024 for making necessary regulatory compliances could lead to_____
- (a) Default by LLP in filing its annual return.
 - (b) Default by LLP in filing its Statement of account and solvency.
 - (c) Default by LLP in filing its annual return as well as statement of account and solvency.
 - (d) No default by LLP in making necessary compliances.

Case Scenario 3

Vama & Associates were appointed as auditors for Royal Constructions Ltd. for the financial year 2023-2024. During the audit, the auditors observed a significant amount of work-in-progress inventory. Instead of attending the physical inventory count, they relied on alternative procedures. These included reviewing production reports, reconciling them with recorded inventory levels, and analysing variance trends to assess the accuracy of the work-in-progress balance.

The auditor also noticed that the company has obsolete inventory of ₹1,75,000, which had an estimated realisable value of ₹ 50,000, and the company has valued it at cost in its financial statements.

During the review of Property Plant and Equipment (PPE), the audit team noted that the company included ₹ 1,05,000 for employee benefits related to the acquisition of PPE and ₹ 1,25,000 for testing the functionality of the equipment, offset by ₹ 35,000 received from the sale of samples produced during testing.

Vama & Associates derive a significant portion of their income from Royal Constructions Ltd., amounting to ₹ 10,00,000, which represents 65% of their total annual revenue. Despite finding financial discrepancies of ₹ 3,00,000 in the company's accounts, the partners decided to overlook these issues to maintain their lucrative relationship with the client.

Based on the above facts, answer the following: -

10. Royal Constructions Ltd. should value the obsolete inventory at:
- (a) ₹ 50,000.
 - (b) ₹ 1,25,000 .
 - (c) ₹ 1,75,000.
 - (d) It should be written off completely.
11. What amount should be included in the cost of PPE in the financial statements of Royal Constructions Ltd.?
- (a) ₹ 1,95,000.
 - (b) ₹ 2,30,000.
 - (c) ₹ 2,65,000.
 - (d) ₹ 1,05,000.

12. What potential threat to the independence of Vama & Associates arises from receiving fees of ₹ 10,00,000 from Royal Constructions Ltd.?
- (a) Self-interest threat.
 - (b) Self-review threat.
 - (c) Intimidation threat.
 - (d) Familiarity threat.

MCQs

13. M/s RJ & Associates, Chartered Accountants, has been auditing the books of GP Resorts Private Limited for the past two years. GP Resorts Private Limited has experienced a significant increase in visitors due to a successful marketing campaign. This increase in number of visitors has prompted the Resort to introduce new services, such as event hosting, which contribute to higher revenue. Whether M/s RJ & Associates should issue a revised audit engagement letter to the GP Resorts Private Limited?
- (a) No, since M/s RJ & Associates has been auditing the GP Resorts Private Limited for the past two years, new audit engagement letter is not required.
 - (b) Yes, the auditor is required to issue a new audit engagement letter for each period.
 - (c) Yes, a new engagement letter is required due to significant changes in the nature and size in the business of the GP Resorts Private Limited.
 - (d) No, M/s RJ & Associates is not required to provide a new engagement letter, as GP Resorts Private Limited will send new engagement letter to M/s RJ & Associates.
14. TAD & Associates, a sole proprietor firm of Agamy, is offered appointment as auditor of a company engaged in manufacturing of automobile components for the first time. She is checking the facts about the integrity of promoters of the company and key managerial persons. Matters such as the competence of staff to perform the engagement are also considered by her. The appointment is subsequently accepted by her. What is CA Agamy trying to do by checking such facts?
- (a) CA Agamy is establishing an audit strategy.
 - (b) CA Agamy is conducting preliminary engagement activities.
 - (c) CA Agamy is designing audit plan.
 - (d) CA Agamy is checking her compliance of ethical requirements.
15. A practicing Chartered Accountant has been engaged by a company to perform certain procedures relating to its trade payables. Such agreed upon procedures includes verification of purchases from related parties, sending confirmation letters and reporting factual discrepancies to the management of the company. Which of the following statement is correct in this context?

- (a) The practicing CA shall perform work in accordance with Standards on Related Services and Standards on Auditing.
- (b) The practicing CA shall perform work in accordance with Standards on Related Services and SQC 1.
- (c) The practicing CA shall perform work in accordance with Standards on Auditing only.
- (d) The practicing CA shall perform work in accordance with Standards on Assurance Engagements and SQC 1.

PART II - Descriptive Questions

Question No. 1 is compulsory.

*Attempt any **four** questions from the Rest.*

1. (a) During the audit of a company, CA Jack obtained written representations from management regarding all known instances of non-compliance with laws and regulations that should be considered in the preparation of the financial statements. However, during the audit, he observed that the information provided in this regard was incomplete, and the audit evidence indicating such non-compliance contradicted the written representations, casting doubt on their reliability.

How should CA Jack proceed in this situation? **(5 Marks)**
- (b) CA Shubham, the auditor of Sigma Limited, is performing tests of controls and tests of details using audit sampling. During these procedures, he observed deviations in compliance with management's prescribed procedures for sales transactions of small values of a product at one location during tests of controls. Additionally, misstatements were identified in the sample related to these small-value sales transactions during tests of details. How should he proceed to analyse the nature and cause of the deviations and misstatements observed in the sample results? **(5 Marks)**
- (c) CA Srishti, while auditing KSM Private Limited for the first time, utilised software to analyse financial data, comparing amounts recorded in the financial statements for the current audit year with the preceding two years. Her objective was to evaluate the risk of material misstatement.

Identify the type of audit procedure performed by CA Srishti in the given case, discuss its relevance, and explain whether an auditor's opinion can solely rely on such procedures. **(4 Marks)**

2. (a) CA Paras has accepted audit of financial statements of an entity. According to the Standards on Auditing, the auditor is required to send an audit engagement letter to the entity. What are the key areas that should be included in the audit engagement letter? Under what circumstances is the auditor not required to record the terms of engagement in such a written agreement? **(5 Marks)**
- (b) "When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section." Briefly explain when the auditor should express:
- (i) Qualified Opinion.
- (ii) Adverse Opinion and
- (iii) Disclaimer of Opinion. **(5 Marks)**
- (c) Rajul Ltd. engaged an external practitioner CA Rajul to provide assurance on its prospective financial information for the upcoming year, which includes projections for a new product line. The company projected a 15% increase in revenue, estimating total sales of ₹ 75 crore, driven by the expected launch of this new product. Mention the applicable Engagement and Quality Control Standard and the level of assurance that will be provided in the given situation. Also explain how Prospective Financial Information is different from Historical Financial Information. **(4 Marks)**
3. (a) Mahavir and Associates is appointed as the statutory auditor of KBC Bank for the financial year 2023-2024. During the audit, Ms. Chandana, an article trainee, noticed that Sidharth Industries had an outstanding loan of ₹ 50,00,000 as on March 31, 2024. On March 29, 2024, the company made a payment of ₹ 10,00,000, reducing the outstanding loan balance to ₹ 40,00,000. However, on April 4, 2024, Sidharth Industries initiated a reversal transaction of ₹ 8,00,000, increasing the outstanding loan balance back to ₹ 48,00,000. The payment and subsequent reversal occurred within a short period, with the final outstanding balance remaining ₹ 48,00,000 after the reversal.
- Considering this scenario, what should be the response of Mahavir and Associates to this matter, particularly regarding the classification of the borrower's account and the potential risk of it slipping into the NPA category? **(5 Marks)**
- (b) You are appointed as an auditor of "The Prestigious Township Club". As the auditor of "The Prestigious Township Club" for the financial year 2023-24, what are the key points you would consider while auditing the income and expenditure items of the club? **(5 Marks)**
- (c) During the audit of a limited company as a statutory auditor you discovered that a fraud amounting to ₹ 5 lakh has been committed by the company. What are the reporting requirements regarding fraud under the Companies Auditor's Report Order, 2020? **(4 Marks)**

4. (a) CA Karan wants to test the “completeness” assertion relating to intangible assets reflected in the financial statements of Data Solutions Private Limited. State audit procedures to be performed by CA Karan in this regard. **(5 Marks)**
- (b) SA 330 states that auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to operating effectiveness of relevant controls. Briefly discuss when such tests are to be designed and performed in accordance with SA 330?
- If an auditor intends to place greater reliance on effectiveness of a control, state its likely effect on audit evidence to be obtained as a result of such tests of controls. Why a higher level of assurance may be sought by an auditor about the operating effectiveness of controls? **(5 Marks)**
- (c) Lotus Ltd., a rapidly growing manufacturing company, appointed Ridhi & Co., as statutory auditor. The engagement team of Ridhi & Co. identified key areas requiring scrutiny, such as revenue recognition, inventory valuation, and related party transactions. Based on his professional judgment, CA Ravi, the engagement partner, directed the engagement team to focus on these critical areas, emphasising the need for detailed testing to ensure accuracy and compliance. Give some examples of the factors need to be considered by CA Ravi for establishing the audit strategy. **(4 Marks)**
5. (a) M/s KSJS & Associates are the statutory auditors of Moon Ltd. for the financial year 2023-24. During an audit briefing, CA Sanket, the engagement partner, explained that the auditor must assemble the audit documentation in an audit file and complete the administrative process of finalising the audit file on a timely basis after the date of the auditor’s report. He also highlighted the requirements of SQC 1 regarding establishment of policies and procedures for the retention of engagement documentation in a firm. Explain the requirements related to the timely assembly and retention of audit files in accordance with relevant Engagement and Quality Control Standards. **(5 Marks)**
- (b) The reliability of audit evidence depends on its source, nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance. Although exceptions may exist, few generalisations can be made about reliability of audit evidence. Considering above discuss such generalisations that can be made about the reliability of audit evidence. **(5 Marks)**
- (c) Kyte Private Limited acquired an immovable property of substantial value during the financial year 2023-24, which is recorded in the financial statements as an addition in the Schedule of PPE. The auditor also observed that this immovable property has been mortgaged to a bank for availing credit facilities. How should the auditor verify the rights and obligations assertion for this property to ensure the entity's legal ownership and identify any charges against it? **(4 Marks)**

6. (a) KR & Associates, an auditor of FDP Ltd., observed that the company has implemented various internal controls addressing financial reporting, operational efficiency, and compliances during their preliminary evaluation. CA Karan suggests that all controls should be assessed to mitigate the risk of material misstatement in the financial statements, while CA Rajat is of the view that only those controls deemed relevant to the audit should be assessed based on professional judgment.

Comment, whether the auditor should assess all the internal controls or limit the assessment to only those considered relevant by the auditor during the audit. Also, discuss the factors influencing the auditor's judgment on the relevance of controls. **(5 Marks)**

- (b) Audit programme is a list of examination and verification steps to be applied and set out in such a way that the inter-relationship of one step to another is clearly shown and designed, keeping in view the assertions apparent in the statements of account produced for audit or based on an appraisal of the accounting records of the client. For example, while auditing a company's inventory, the program may include steps to verify physical stock counts, ownership rights, and valuation. What are the advantages of an audit programme? **(5 Marks)**
- (c) As the statutory auditor of Ginni Ltd., you need to verify if the company has valid legal ownership rights over the inventories recorded in the balance sheet as on March 31, 2024. What audit procedures should you perform to verify the company's ownership of the inventories, including items stored at third-party locations? **(4 Marks)**

OR

During the audit of a company, CA Atul noticed that company is facing significant skilled labour shortages resulting in hampering operations of the company. The company's manufacturing is dependent upon skilled labour coming from villages in certain districts of Eastern UP. However, due to job opportunities available near villages now, many are not interested in leaving their native villages.

The company failed to keep its commitments due to such situation, consequently lost orders and faced decrease in its revenues. The fixed costs of the company remain at a high level. As a result, the company is facing a liquidity crunch and is not able to pay its creditors on time. The bankers of the company are also not willing to help the company to tide over liquidity crisis. The auditor has doubts over going concern status of the company. How should management of the company try to address auditor's concerns? What audit procedures may be performed by auditors in such a situation? **(4 Marks)**

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PAPER – 5: AUDITING AND ETHICS

SUGGESTED ANSWERS / HINTS

Part I - Multiple Choice Questions

1. (b)
2. (a)
3. (a)
4. (b)
5. (b)
6. (d)
7. (b)
8. (c)
9. (a)
10. (a)
11. (a)
12. (a)
13. (c)
14. (b)
15. (b)

Part II - Descriptive Answers

1. (a) In the given situation, company's management has not provided complete information regarding instances of non-compliance with laws & regulations. If the auditor has concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, the auditor shall determine the effect that such concerns may have on the reliability of representations and audit evidence in general.

The above situation highlights that auditor has obtained audit evidence relating to non-compliance with laws which is inconsistent with written representations in this respect casting a doubt about reliability of written representations.

As per SA 580, "Written Representation", if written representations are inconsistent with other audit evidence, the auditor shall perform audit procedures to attempt to resolve the matter. If the matter remains unresolved, the auditor shall reconsider the assessment of the competence, integrity, ethical values or diligence of management, or of its commitment to or enforcement of these, and shall determine the effect that this may have on the reliability of representations and audit evidence in general.

If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report" having regard to the requirement of disclaimer of opinion.

- (b)** In the given case, while performing tests of details on a sample in respect of sales, misstatements have been found by CA Shubham in selected sample pertaining to the sales transactions of small values. This indicates observance of deviations and misstatements while performing tests of controls and tests of details respectively in selected samples.

As per SA 530, "Audit Sampling", in analysing the deviations and misstatements identified, the auditor may observe that many have a common feature, for example, type of transaction, location, product line or period of time.

In such circumstances, the auditor may decide to identify all items in the population that possess the common feature, and extend audit procedures to those items. In addition, such deviations or misstatements may be intentional, and may indicate the possibility of fraud.

Therefore, the auditor shall investigate the nature and causes of any deviations or misstatements identified, and evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit.

In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population. The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.

- (c)** In the given case, CA Srishti is performing analytical procedures as risk assessment procedures.

Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information.

Analytical procedures may help identify the existence of unusual transactions or events, and amounts, ratios, and trends that might indicate matters that have audit implications. Unusual or unexpected relationships that are identified may assist the auditor in identifying risks of material misstatement, especially risks of material misstatement due to fraud.

Risk assessment procedures are a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion levels. Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.

Thus, it can be concluded that auditor's opinion cannot be solely based upon such procedures.

2. (a) Key areas that should be included in Audit engagement letter are:
- (i) The objective and scope of the audit of the financial statements;
 - (ii) The responsibilities of the auditor;
 - (iii) The responsibilities of management;
 - (iv) Identification of the applicable financial reporting framework for the preparation of the financial statements and
 - (v) 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.

- (b) "When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section." The auditor should consider the following while expressing the opinion in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

(i) **Qualified Opinion**

- The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, are material, but not pervasive or
- The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

- (ii) **Adverse Opinion:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
- (iii) **Disclaimer of Opinion:** The auditor shall disclaim an opinion when he is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and he concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.
- (c) In the given situation, Standards on Assurance Engagements will be applicable and such type of assurance engagement provides only a “moderate” level of assurance.

In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that management’s assumptions on which the prospective financial information is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions and it is properly presented and all material assumptions are adequately disclosed.

“Historical financial information” and “Prospective financial information.” The former relates to information expressed in financial terms of an entity about economic events, conditions or circumstances occurring in past periods. The latter relates to financial information based on assumptions about occurrence of future events and possible actions by an entity. Therefore, historical financial information is rooted in past events which have already occurred whereas prospective financial information is related to future events.

3. (a) **Accounts regularized near the Balance Sheet Date:** The asset classification of borrower accounts where a solitary or a few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity. Where the account indicates inherent weakness on the basis of the data available, the account should be deemed as NPA.

The auditor should check for sample transactions immediately before the closing of the financial year and immediately after the closing of the financial year to get a knowledge of the objective behind the transactions if they have any relation to each other in the borrower accounts or if any/some transactions are being reversed during the first few days after closing which might show an arrangement to prevent the Borrower account(s) from slipping into the NPA category.

In the given case of Sidharth Industries, a payment of ₹10,00,000 was made on March 29, 2024 reducing the outstanding loan balance to ₹40,00,000. and subsequently reversed by ₹8,00,000 on April 4, 2024. Thus, Mahavir and Associates should carefully assess the classification

of Sidharth Industries' Account, and determine if the payment and reversal transactions indicate an attempt to prevent the account from slipping into the NPA category. If yes, the account should be classified as an NPA in compliance with regulatory guidelines.

(b) The following points need to be considered while auditing income and expenditure items of a club: -

- (1) Entrance Fee: Vouch the receipt on account of entrance fees with members' applications, counterfoils issued to them, as well as on a reference to minutes of the Managing Committee.
- (2) Subscriptions: Vouch members' subscriptions with the counterfoils of receipt issued to them, trace receipts for a selected period to the Register of Members; also reconcile the amount of total subscriptions due with the amount collected and that outstanding.
- (3) Arrears of Subscriptions: Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscriptions received in advance have been correctly adjusted.
- (4) Arithmetical accuracy: - Check totals of various columns of the Register of members and tally them across.
- (5) Irrecoverable Member Dues :- See the Register of Members to ascertain the Member's dues which are in arrear and enquire whether necessary steps have been taken for their recovery; the amount considered irrecoverable should be mentioned in the Audit Report.
- (6) Pricing: Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests, as well as, with the fees chargeable for the special services rendered, such as billiards, tennis, etc.
- (7) Member Accounts: Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.
- (8) Purchases: Vouch purchase of sports items, furniture, crockery, etc. and trace their entries into the respective inventory registers.
- (9) Margins earned: Vouch purchases of foodstuffs, cigars, wines, etc., and test their sale price so as to confirm that the normal rates of gross profit have been earned on their sales. The inventory of unsold provisions and stores, at the end of year, should be verified physically and its valuation checked.
- (10) Management Powers: Examine the financial powers of the secretary and, if these have been exceeded, report specific case for confirmation by the Managing Committee.

- (c) **Reporting requirements of a fraud under the CARO 2020:** The auditor is required to report the fraud under clause (xi) of Paragraph 3 of CARO 2020:
- (a) whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated;
 - (b) whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;
 - (c) whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;
4. (a) The audit procedures to be performed by CA Karan to test completeness assertion relating to intangible assets are as under: -
- Verify the movement in the intangible assets schedule compiled by the management i.e. Opening balances + Additions – Deletions = Closing balances. Tally the closing balances to the entity's books of account.
 - Check the arithmetical accuracy of the movement in intangible assets schedule.
 - For additions during the period under audit, obtain a listing of all additions from the management and undertake the following procedures: -
 - For all material additions, verify whether such expenditure meets the criterion for recognition of an intangible asset as per AS 26.
 - Ensure that no intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred. Check the certificate or report or other similar documentation maintained by the entity to verify the date of use of the intangible which could be linked to date of commencement of commercial production/ economic use to the entity, for all additions to intangible assets during the period under audit.
 - Verify whether the additions (acquisitions) have been approved by appropriate entity's personnel.
 - Verify whether proper internal processes and procedures like inviting competitive quotations/ proper tenders etc. were followed prior to finalizing the vendor for procuring item of intangible assets by testing those documents on a sample basis.
 - In relation to deletions of intangible assets, understand from the management the reason and rationale for deletion and the

manner of disposal. Obtain the management approval and disposal note authoring disposal of the asset from its active use. Verify the process followed for sale of discarded asset, for example inviting competitive quotes, tenders and the basis of calculation of sales proceeds. Verify that the management has accurately recorded the deletion of intangible asset (original cost and accumulated amortization up to the date of disposal) and the resultant gain/ loss on disposal in the entity's books of account.

(b) The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when: -

- (i) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures) or
- (ii) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence, the greater the reliance the auditor places on the effectiveness of a control.

A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular, where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.

(c) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts.

The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant. Preliminary identification of material classes of transactions, account balances and disclosures help auditor in establishing overall audit strategy. More attention need to be devoted to significant matters to obtain desired outcomes.

Examples of the factors that need to be considered by CA Ravi for establishing audit strategy are: -

- Volume of transactions which may determine whether it is more efficient for the auditor to rely on internal control.
- Significant industry developments such as changes in industry regulations and new reporting requirements.
- Significant changes in the financial reporting framework, such as changes in accounting standards.

- Other significant relevant developments, such as changes in the legal environment affecting the entity.
5. (a) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.
- ❖ SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files.
 - ❖ An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.
 - ❖ Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature. **Examples of such changes include:**
 - Deleting or discarding superseded documentation.
 - Sorting, collating and cross-referencing working papers.
 - Signing off on completion checklists relating to the file assembly process.
 - Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.
 - ❖ After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.
 - ❖ SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.
- (b) While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:
- The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
 - The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.
 - Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.

- Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally
 - Audit evidence obtained as original documents is more reliable than audit evidence obtained as photocopies or facsimiles, or documents that have been filmed, digitised or otherwise transformed into electronic form because in these cases the reliability of which may depend on the controls over their preparation and maintenance.
- (c)** To verify the rights and obligations assertion regarding Property, Plant, and Equipment (PPE), the auditor must ensure the entity has valid legal ownership and identify any charges against it. The audit procedures should include the following:
- In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity.
 - For all additions to land and building in particular, the auditor should check the conveyance deed/ sale deed to verify whether the entity is the legal and valid owner or not.
 - The auditor should insist and verify title deeds for immoveable property acquired.
 - In case, the entity has given such immoveable property as security for any borrowings and the original title deeds are not likely to be available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security.
 - The auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.
- 6. (a)** There is a direct relationship between an entity's objectives and the control it implements to provide reasonable assurance about their achievement. FDP Ltd. has implemented internal controls addressing financial reporting, operational efficiency, and compliance. However, not all of these objectives and controls are relevant to the auditor's risk assessment.
- Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:
- Materiality.
 - The significance of the related risk.
 - The size of the entity.

- The nature of the entity's business, including its organisation and ownership characteristics.
- The diversity and complexity of the entity's operations.
- Applicable legal and regulatory requirements.
- The circumstances and the applicable component of internal control.
- The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
- Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

In the given case, CA Karan suggests that all controls should be assessed to mitigate the risk of material misstatement in the financial statements, while CA Rajat is of the view that only those controls deemed relevant to the audit should be assessed based on professional judgment.

Based on the factors mentioned above, it can be concluded that the auditors should assess only those controls deemed relevant to mitigate the risk of material misstatement in FDP Ltd.'s financial statements.

(b) The advantages of an audit programme are:

- It provides the assistant carrying out the audit with total and clear set of instructions of the work generally to be done.
- It is essential, particularly for major audits, to provide a total perspective of the work to be performed.
- Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.
- Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a risk of ignoring or overlooking certain books and records. Under a properly framed programme, such risk is significantly less and the audit can proceed systematically.
- The assistants, by putting their signature on programme, accept the responsibility for the work carried out by them individually and, if necessary, the work done may be traced back to the assistant.
- The principal can control the progress of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
- It serves as a guide for audits to be carried out in the succeeding year.

- A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of professional auditor.
- (c) The statutory auditor of Ginni Ltd. should perform the following audit procedures to verify if the company has valid legal ownership rights over the inventories recorded in the balance sheet as on March 31st, 2024.
- Vouch recorded purchases to underlying documentation (purchase requisition, purchase order, receiving report, vendor invoice and cancelled cheque or payment file).
 - Evaluate the consigned goods.
 - Examine client correspondence, sales and receivables records, purchase documents.
 - Determine existence of collateral agreements.
 - Review consignment agreements.
 - Review material purchase commitment agreements.
 - Examine invoices for evidence of ownership i.e. the invoices shall be in the name of the client.
 - Obtain confirmation for significant items of inventory.
 - For instances of inventory held by third party, the auditor should insist on obtaining declaration from the third party on its business letterhead and signed by an authorized personnel of that third party confirming that the items of inventory belong to the entity and are being held by such third party on behalf of and for the benefit of the entity under audit.

OR

Significant shortage of skilled labour, inability to pay creditors on time and overall liquidity crisis faced by the company are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.

In such a situation, management should try to address auditor's concerns by preparing its future plan of action including preparation of cash flow forecast showing inflow and outflow of cash. Such a cash flow forecast should address auditor's concerns regarding liquidity crisis being faced by the company.

The auditor should perform audit procedures to evaluate the reliability of the underlying data to prepare the forecast and determining whether there is adequate support for the assumptions underlying the forecast.

The auditor should also consider whether any additional facts or information have become available since the date on which management made its assessment.