



PAPER – 5: AUDITING AND ETHICS



QUESTIONS

PART – I: Multiple Choice Questions based on Case Scenarios

Case Scenario

Joy Ltd., a company engaged in the business of trekking essentials, appointed CA Raj as the Statutory Auditor for the year. Due to the large volume of transactions of the company, the audit engagement team of CA Raj realized that it would not be feasible to audit each transaction separately during the financial year under audit. Therefore, Engagement Partner decided to apply following audit sampling techniques:

- Random number tables were used for selection of sample for power, telephone, and fuel charges.
- No structured method of sampling was used for office stationery.
- Transactions exceeding ₹ 8,000 were selected for travel expenses.
- The first 200 sales invoices from the sales book for the month of July were selected for sales.

Mr. Suresh, one of the team members, compared the salary expenses incurred by the company during the current year with those of the previous five years. He noticed a significant percentage increase in the expenses. This unusual increase raised doubts in his mind. He decided to compare such an increase in salary expenses with the increase in the number of employees.

The company is having warehouse at 2 locations. CA Raj is planning to attend the physical inventory count process. The inventory includes finished products

such as trekking jackets, bags, shoes etc., and raw materials like leather, cloth, chemicals, etc. Some of the inventory is also held by a third party.

During a discussion among the team members regarding the sufficiency and appropriateness of audit evidence, they agreed that sufficiency is the measure of quantity of the audit evidence and appropriateness is the measure of quality of audit evidence.

Joy Ltd. operates 100 stores on rented premises across the country and is in the process of expanding. Although the rent expenses have been accounted for, the auditor requested the management to provide all active rent agreements for the year under audit for detailed examination.

Based on above, answer the following questions: -

1. Which of the sampling techniques were used for the following transactions:
 - (i) Power, telephone and fuel charges;
 - (ii) Office Stationery;
 - (iii) Travel expenses; and
 - (iv) Sales.

(Answer in the given order)

 - (a) Random sampling, Systematic sampling, Monetary unit sampling, Block sampling.
 - (b) Systematic sampling, Random sampling, Block sampling, Haphazard sampling.
 - (c) Random sampling, Haphazard sampling, Monetary unit sampling and Block sampling.
 - (d) Random sampling, Haphazard sampling, Monetary unit sampling and Systematic sampling.
2. Which audit procedure was Mr. Suresh intended to perform by comparing salary expenses?
 - (a) Test of details.
 - (b) Test of balances.

- (c) Test of control.
 - (d) Substantive analytical procedure.
3. Which of the following is not part of CA Raj's responsibility with respect to the inventories held by the third parties?
- (a) CA Raj should request confirmation from the third party regarding the quantity and condition of the inventory held by them.
 - (b) CA Raj should perform an independent valuation of the inventory based solely on the company's internal records.
 - (c) CA Raj should request the third party to allow him to physically inspect the inventories held by them.
 - (d) CA Raj should review the terms of the agreement between the company and the third party to understand the responsibilities related to inventory management.
4. Which audit procedure was used by CA Raj while collecting all rent agreements?
- (a) Inspection.
 - (b) Analytical procedure.
 - (c) Reperformance.
 - (d) Observation.
5. In the given case, the audit team of CA Raj discusses the sufficiency and appropriateness of audit evidence. In the context of Joy Ltd.'s audit, the team was considering various factors affecting the sufficiency of the evidence they gathered for large-volume transactions. Which of the following is not a factor that would influence the auditor's judgment on the sufficiency of audit evidence?
- (a) Materiality of the transactions.
 - (b) Risk of material misstatement in the financial statements.
 - (c) Size and characteristics of the population being audited.
 - (d) The type of products Joy Ltd. manufactures (trekking essentials).

General MCQs

6. CA Sumit, during the process of assembling the audit file after the completion of the audit, briefed his team on the changes to be made in the audit documentation. Which of the following changes can be made during the audit file assembly stage?
 - A. Sorting, collating and cross referencing of working papers.
 - B. Deleting or discarding superseded documents.
 - C. Recalculation of depreciation.
 - D. Recalculation of Interest on loans.
 - E. Signing off of completion checklist relating to file assembly.
 - (a) A, B and E
 - (b) C and D
 - (c) A, C and D
 - (d) A, C, D and E
7. CA Rao is conducting an audit for ABC Ltd., a large client. He is informed by the client's CFO that if they report certain deficiencies, the auditor's firm may not be considered for future engagements. Which type of threat does this scenario represent?
 - (a) Familiarity Threat
 - (b) Intimidation Threat
 - (c) Self-interest Threat
 - (d) Advocacy Threat
8. CA Kaushal, the statutory auditor of Femo Ltd., obtained trade receivables ageing report, analysed it and identified doubtful debts during the audit of accounts receivable balances. Which Balance Sheet assertion is CA Kaushal intended to check?
 - (a) Valuation
 - (b) Rights and obligations
 - (c) Existence

- (d) Completeness

PART II – Descriptive Questions

Chapter 1 - Nature, Objective and Scope of Audit

9. RST Ltd., a retail company, has set up internal controls requiring all invoices to be stamped and signed by an authorised person in “Goods Receiving Section” of the company stating the date and time of receiving goods in premises to ensure that only those purchase bills are produced for payment for which goods have been actually received.

During the audit, the auditor finds that two employees – a purchasing manager and an accounts clerk – have worked together to bypass this control, submitting fake invoices that resulted in payments for goods that were never received. You are required to state the objectives of an audit, as per SA 200, when it comes to ensuring the reliability of financial statements? Also explain, why auditor can provide only reasonable, rather than absolute, assurance that the financial statements are free from material misstatement due to fraud or error in the context of the given situation?

Chapter 2 - Audit Strategy, Audit Planning and Audit Programme

10. During the audit of ABC Ltd., a medium-sized manufacturing company, the engagement partner is responsible for directing and supervising the work of the engagement team. The team includes both experienced members and several new trainees. Additionally, certain areas of the audit have been identified as high-risk, such as revenue recognition and inventory valuation, due to recent changes in ABC Ltd.'s accounting policies. What factors should the engagement team members consider when determining the nature, timing, and extent of direction, supervision, and review of the engagement team's work?

Chapter 3 – Risk Assessment and Internal Control

11. The auditor of EFG Ltd., a company engaged in the Tours & Travel business, needs to obtain an understanding of the company's control environment. To do this, the auditor evaluates whether:
- (i) Management has created and maintained a culture of honesty and ethical behaviour; and

- (ii) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

What is included in control environment? Also explain the elements of control environment.

Chapter 4 – Audit Evidence

12. CA Mukul is the external auditor of Beige Ltd., a large company, engaged in the manufacturing of fast-moving consumer (FMCG) goods. After assessing the internal audit function of the company, CA Mukul decided to use the internal auditor of the company to provide direct assistance. In this context, what is meant by direct assistance under relevant Standard on Auditing? Also comment whether prior to using internal auditor for direct assistance for the purpose of audit, CA Mukul is required to obtain any written agreements or not. Give examples of procedures in which CA Mukul shall not use an internal auditor to provide direct assistance.

Chapter 5 - Audit of Items of Financial Statements

13. During the audit of Rapid Industries Private Limited, CA Akshat notices that inventories of raw materials & consumables and work-in- progress amounting ₹ 2.50 crores and ₹ 0.25 crores appear in the financial statements of the company as on March 31st, 2024. He wants to verify that the above-mentioned inventories have been valued appropriately and as per generally accepted accounting policies and practices. How should he proceed to verify the above?

Chapter 6 – Audit Documentation

14. CA Ripun completed the audit of a listed company, and the audit report was issued on July 17th, 2024. However, he had not properly organized the audit working papers, including records of discussions with management, audit procedures performed, and conclusions reached. More than six months after issuing the report, he received a letter from the regulator in connection with audit of the company requesting him to share copy of audit file. In a hurry, CA Ripun quickly assembled the audit file, adding some papers he thought were necessary, but he used the

current date on these newly added documents. He then sent the audit file to the regulator. Discuss the issues involved related to "audit documentation" and assembling of the final audit file in this case.

Chapter 7- Completion and Review

15. During the audit of a company, CA Kartik has noticed that company's turnover has fallen drastically as compared to last three years due to loss of its major markets and key customers. The company is in need of funds for new product development, but bankers are not willing to lend financial support. Which additional audit procedures need to be performed by CA Kartik in accordance with SA 570 when such events or conditions are identified?

Chapter 8 – Audit Report

16. The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements.

Explain clearly the differences between the approaches stating the essential audit reporting. Also define comparative information and audit procedures regarding comparative information.

17. Kiran, a CA student, was reviewing an audit report of the company when she noticed an 18-digit alphanumeric code below the auditor's signature and membership number. She wants to understand the purpose and importance of this randomly generated number as unique code. Is this code required for audit reports only?

Chapter 9 – Special Features of Audit of Different Type of Entities

18. An NGO based in Kolkata collected significant donations for flood victims in Bihar. The funds were distributed to various NGOs operating in Bihar to support relief efforts. You have been appointed as the auditor for this NGO's accounts for the year in which it collected and disbursed these donations. Draft an audit program to audit the receipts of donations and the remittance of the collected funds to different NGOs.

Chapter 10 – Audit of Banks

19. Agrim, a CA student, is part of an engagement team conducting audit of Madurai branch of ARB Bank. CA Bhuvan, engagement partner, has asked him to verify provision made by branch as on March 31st, 2024 in respect of the following non-performing assets: -

Name of Account	NPA classification	Outstanding amount as on March 31st, 2024 (In ₹ lakhs)	Amount of provision made (In ₹ lakhs)
AK Industries	Doubtful (D1)	10.00	5.00
Jupiter Traders	Substandard asset	50.00	7.50
VT & Co.	Doubtful (D2)	30.00	30.00
ASD & Sons	Loss	1.00	1.00

The engagement partner has already verified NPA classification. Outstanding amounts as on March 31st, 2024, relating to each NPA account listed above (except ASD & Sons) are fully secured. However, only personal guarantee of proprietor (Net worth of proprietor ₹50 lakhs) is available in account of ASD & Sons. Comment on the correctness of the above provisions.

Agrim is in dilemma regarding classification of above accounts as NPA although these are fully secured or guaranteed. Guide him.

Chapter 11 – Ethics and Terms of Audit Engagements

20. CA Sudhakar has been appointed as the auditor of AMRO Ltd. Before accepting the appointment, he learns that his cousin, who held shares in the company and recently passed away without children, named him as the nominee for these shares, which have substantial value. Although holding such shares through a distant relative does not violate legal provisions or affect his independence, this unexpected inheritance places him in a dilemma. Advise CA Sudhakar on how he should deal with this situation and safeguard his independence.



SUGGESTED ANSWERS/HINTS

Answer Key- Case Scenario – 1

PART – I: Answers to Multiple Choice Questions

MCQ No.	Answer
1.	(c)
2.	(d)
3.	(b)
4.	(a)
5.	(d)
6.	(a)
7.	(b)
8.	(a)

PART – II: Answers to Descriptive Questions

9. In conducting audit of financial statements, objectives of auditor in accordance with SA 200, "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing" are: -
- To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
 - To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error. These fundamental limitations arise due to the factors such as nature of financial reporting,

nature of audit procedures, not in the nature of investigation, timeliness of financial reporting and decrease in relevance of information over time and future events.

Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, the auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors. One of the premises for conducting an audit is that management acknowledges its responsibility of preparation of financial statements in accordance with applicable financial reporting framework and for devising suitable internal controls. However, such controls may not have operated to produce reliable financial information due to their own limitations.

In the context of RST Ltd., the management designed a control requiring that all invoices be stamped and signed by an authorized person in the Goods Receiving Section to confirm receipt of goods. However, collusion between two employees—the purchasing manager and the accounts clerk—allowed them to bypass this control by submitting fake invoices for payment. Collusion is a significant limitation of internal controls, as it overrides controls designed to prevent such fraud.

Given these factors, the auditor cannot provide absolute assurance that the financial statements are entirely free from material misstatements due to fraud or error.

- 10.** The auditor shall plan the nature, timing and extent of direction and supervision of engagement team members and the review of their work. The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including: -
1. The size and complexity of the entity.
 2. The area of the audit.
 3. The assessed risks of material misstatement
 4. The capabilities and competence of the individual team members performing the audit work.

11. The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:
- (i) Management has created and maintained a culture of honesty and ethical behaviour and
 - (ii) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

The control environment includes:

- (i) the governance and management functions and
- (ii) the attitudes, awareness, and actions of those charged with governance and management.
- (iii) the control environment sets the tone of an organization, influencing the control consciousness of its people.

Elements of the Control Environment

Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:

(a) Communication and enforcement of integrity and ethical values

The effectiveness of controls cannot rise above the integrity and ethical values of the people who create, administer, and monitor them. Integrity and ethical behaviour are the product of the entity's ethical and behavioural standards, how they are communicated, and how they are reinforced in practice. The enforcement of integrity and ethical values includes, for example, management actions to eliminate or mitigate incentives or temptations that might prompt personnel to engage in dishonest, illegal, or unethical acts. The communication of entity policies on integrity and ethical values may include the communication of behavioural standards to personnel through policy statements and codes of conduct and by example.

- (b) **Commitment to competence:** Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.
- (c) **Participation by those charged with governance:** It includes attributes of those charged with governance such as their independence from management, their experience and stature, the extent of their involvement and the information they receive and the scrutiny of activities.
- (d) **Management's philosophy and operating style:** Management's philosophy and operating style encompass a broad range of characteristics. For example, management's attitudes and actions towards financial reporting- what approach is taken by management in selecting accounting policies, approach in developing accounting estimates etc. Matters such as approach of management to taking and managing business risks, management's attitude towards information processing and accounting function and personnel reflects upon management's philosophy and operating style.
- (e) **Organisational structure:** The framework within which an entity's activities for achieving its objectives are planned, executed, controlled, and reviewed. Establishing a relevant organisational structure includes considering key areas of authority and responsibility and appropriate lines of reporting. The appropriateness of an entity's organisational structure depends, in part, on its size and the nature of its activities.
- (f) **Assignment of authority and responsibility:** Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established.
- (g) **Human resource policies and practices**
Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions. Human resource policies and

practices often demonstrate important matters in relation to the control consciousness of an entity.

- 12.** As per SA 610, "Using the work of Internal Auditor", direct assistance refers to the use of internal auditors to perform audit procedures under the direction, supervision and review of the external auditor.

Prior to using internal auditors to provide direct assistance for purposes of the audit, CA Mukul, the external auditor shall: -

- (a) Obtain written agreement from an authorized representative of the entity that the internal auditors will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the internal auditor performs for the external auditor and
- (b) Obtain written agreement from the internal auditors that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

Examples of procedures in which CA Mukul shall not use internal auditor to provide direct assistance to him are: -

- (a) Procedures which involve making significant judgments in the audit;
- (b) Procedures relating to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited.
- (c) Procedures relating to work with which the internal auditors have been involved and which has already been, or will be, reported to management or those charged with governance by the internal audit function; or
- (d) Procedures relating to decisions the external auditor makes in accordance with this SA regarding the internal audit function and the use of its work or direct assistance.

13. To verify that inventories of raw material & consumables and work-in-progress have been valued appropriately and as per generally accepted accounting policies and practices, the following procedures should be performed by CA Akshat:

For Raw materials and consumables:

- Ascertain what elements of cost are included e.g. carriage inward, non-refundable duties etc.
- If standard costs are used, enquire into basis of standards; how these are compared with actual costs and how variances are analysed and accounted for/ treated in accounting records.
- Test check cost prices used with purchase invoices received in the month(s) prior to counting.
- Follow up valuation of all damaged or obsolete inventories noted during observance of physical counting with a view to establishing a realistic net realizable value.

For Work in Progress:

- Ascertain how the various stages of production/ value additions are measured and in case estimates are made, understand the basis for such estimates.
 - Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity.
 - Ensure that material costs exclude any abnormal wastage factors.
14. 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.

Further, preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

In the given case, even after passage of more than six months, CA Ripun has not assembled an audit file. Besides, he has put in some papers with the current date which is not permissible at all. It shows that part of the audit documentation has been prepared afterwards putting a question mark on the quality of audit.

- 15.** Loss of major markets, key customers and inability to obtain financing for new product development are examples of events or conditions that may cast a significant doubt on the entity's ability to continue as going concern.

If events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:

- (a) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.
 - (b) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
 - (c) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions: -
 - (i) Evaluating the reliability of the underlying data generated to prepare the forecast; and
 - (ii) Determining whether there is adequate support for the assumptions underlying the forecast.
 - (d) Considering whether any additional facts or information have become available since the date on which management made its assessment.
 - (e) Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.
- 16.** The nature of the comparative information that is presented in an entity's financial statements depends on the requirements of the applicable financial reporting framework. There are two different broad approaches to the auditor's reporting responsibilities in respect of such comparative information: corresponding figures and comparative financial statements. The approach to be adopted is often specified by law or regulation but may also be specified in terms of engagement.

The essential audit reporting differences between the approaches are:

- (a) For corresponding figures, the auditor's opinion on the financial statements refers to the current period only; whereas

- (b) For comparative financial statements, the auditor's opinion refers to each period for which financial statements are presented.

Definition of Comparative Information – The amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework.

Audit Procedures regarding comparative information

The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. For this purpose, the auditor shall evaluate whether:

- (a) The comparative information agrees with the amounts and other disclosures presented in the prior period; and
 - (b) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.
- 17.** The 18-digit alpha numeric number noticed by her at the end of the audit report is Unique Document Identification number (UDIN). It is a system generated unique number. It was noticed that financial documents/ certificates attested by third persons misrepresenting themselves as CA Members were misleading the Authorities and Stakeholders. ICAI also received number of complaints of signatures of CAs being forged by non CAs. To curb the malpractices, ICAI implemented the concept of UDIN i.e. Unique Document Identification Number. Chartered Accountants having full-time Certificate of Practice can register on UDIN Portal and generate UDIN by registering the certificates attested/certified by them. An auditor is required to mention the UDIN with respect to each audit report being signed by him, along with his membership number while signing an audit report and Certificates.

It is required to be stated in case of audit reports and certificates.

18. Receipt of Donations:

- (i) Internal Control System: Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.
- (ii) Custody of Receipt Books: Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.
- (iii) Receipt of Cheques: Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.
- (iv) Bank Reconciliation: Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.
- (v) Cash Receipts: Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.
- (vi) Foreign Contributions, if any, to receive special attention to compliance with applicable laws and regulations.

Remittance of Donations to Different NGOs:

- (i) Mode of Sending Remittance: All remittances are through account payee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.
- (ii) Confirming Receipt of Remittance: All remittances are supported by receipts and acknowledgements.
- (iii) Identity: Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.
- (iv) Direct Confirmation Procedure: Send confirmation letters to entities to whom donations have been paid.

- (v) Donation Utilisation: Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.
- (vi) System of NGOs' Selection: System for selecting NGO to whom donations have been sent.

19. The auditor is required to ensure that provision for NPA is made as per its classification in different categories which are given as under:

Categories of Non-Performing Assets:	Provision required
☐ Substandard Assets: Would be one, which has remained NPA for a period less than or equal to 12 months.	15%
☐ Doubtful Assets: Would be one which has remained in the substandard category for a period of 12 months. <u>Sub-categories:</u> Doubtful up to 1 Year (D1) Doubtful 1 to 3 Years (D2) Doubtful more than 3 Years (D3)	(Secured + Unsecured) 25% + 100% 40% + 100% 100% + 100%
☐ Loss Assets	100%

From the above provision, it can be concluded that in case of:

AK Industries- It has been classified as Doubtful (D1) category. Therefore, it requires provision of 25% of secured amount. That is provision of Rs 2.50 lakh (i.e 25% of ₹10 lakh) should be made instead of ₹ 5 lakh.

Jupiter Traders- It has been classified as Substandard asset. It requires provision of 15% of outstanding amount (i.e 15% of ₹ 50 lakhs) which comes to ₹ 7.50 lakh. Therefore, provision made by the branch is correct.

VT & Co.- It has been classified as Doubtful (D2) category. It requires provision of 40% of secured amount. That is provision of ₹ 12.00 lakh (40% of ₹ 30 lakhs) should be made instead of ₹ 30 lakh.

ASD & Sons- It has been classified as a loss asset which requires provision of 100% of outstanding amount. Therefore, the provision made by the branch is correct.

Classification as NPA should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise. Hence, these accounts have been classified as NPA on the record of recovery although these are fully secured or guaranteed.

- 20.** In the given situation, holding shares by CA Sudhakar involves financial interest in the company and is in nature of self-interest threat. Though he has come to hold shares due to nomination made by his distant relative before accepting the appointment.

Chartered Accountants have a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to address the threats.

Safeguards are actions, individually or in combination, that the professional accountant takes that effectively reduce threats to comply with the fundamental principles to an acceptable level.

To address the issue, the following guiding principles are to be applied: -

- For the public to have confidence in the quality of audit, it is essential that auditors should always be and appear to be independent of the entities that they are auditing.
- Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.
- When such threats exist, the auditor should either desist from the task or eliminate the threat or at the very least, put in place safeguards which reduce the threats to an acceptable level. All such safeguard measures need to be recorded in a form that can serve as evidence of compliance with due process.
- If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

Considering above, holding of shares of the same company for which he is offered appointment as auditor constitutes threat to his independence. Therefore, CA Sudhakar should take steps to eliminate the threat by selling shares immediately before accepting the appointment and in the absence of same, he should not accept the appointment as an auditor.