

MOCK TEST PAPER- 1
INTERMEDIATE GROUP – II
PAPER – 6: AUDITING AND ASSURANCE

Time Allowed – 3 Hours

Maximum Marks – 100

Division A- Multiple Choice Questions

Case Scenario 1 carries 10 Marks

Case Scenario 2 carries 10 Marks

Total: 30 Marks

General MCQs carry 1 Mark each

Case Scenario 1

Honest Limited is a listed Company engaged in the construction business. The Company constructs residential buildings after purchasing vacant land and then sells ready flats to customers. The Company has not been earning good profits and so no dividend was declared in the last financial year for which the statutory audit is to be conducted.

XYZ & Company has been appointed as the statutory auditor of Honest Limited. The audit firm has seven partners and is a reputed firm with the partners having expert knowledge in various areas.

While conducting the audit, the engagement partner, CA Z suspects some fraudulent activities undertaken by the officers and employees of the Company. CA Z is aware that for the purpose of SAs, the auditor is concerned with fraud that causes a material misstatement in the financial statements. He understands that misstatements in the financial statements can arise from either fraud or error.

On detailed verification by the audit team, it was observed that accounts were manipulated with a view to presenting a false state of affairs. The fraud was committed to avoid incidence of income-tax and withhold declaration of dividend. There was also an incidence of cash receipts being suppressed which came to the notice of the audit team.

CA Z had enough reasons to believe that the offence of fraud, involved individually an amount of Rs.1 crore, and had been committed against the company by its officers or employees. The audit team discussed the reporting requirements of the fraud committed.

One of the audit team members puts forward his recommendations on reporting which includes disclosure in the Board's Report. He states that sub-section (12) of section 143 of the Companies Act, 2013 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.

CA Z discusses the reporting under Companies (Auditor's Report) Order, 2020 [CARO, 2020] wherein the auditor is required to report under clause (xi) of paragraph 3 of Companies (Auditor's Report) Order, 2020, about fraud by the company or any fraud on the Company.

Based on the above information, answer the following questions:

1. Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is:
 - (a) Fraud causes a material misstatement in the financial statements.
 - (b) Fraud is an intentional act.
 - (c) Fraud is easier to detect than error.

- (d) Fraud can be committed by only the management, those charged with governance, and the employees.
2. Which of the following is not a technique of suppressing cash receipts?
- (a) Writing down asset values in entirety, selling them subsequently and misappropriating the proceeds.
- (b) Adjusting unauthorized or fictitious rebates, allowances, discounts, etc. to customer' accounts and misappropriating amount paid by them.
- (c) Manipulating totals of wage rolls either by including therein names of dummy workers or by inflating them in any other manner.
- (d) Writing off as debts in respect of such balances against which cash has already been received but has been misappropriated.
3. To whom should XYZ & Company report the fraud committed in Honest Limited?
- (a) Report the matter only to the Audit Committee constituted under section 177 since the amount of fraud has not exceeded 1 crore.
- (b) Report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days and on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations.
- (c) Report the matter only to the Board since the amount of fraud is not less than 1 crore.
- (d) Report the matter either to the audit committee constituted under section 177 or the Central Government since the amount of fraud is neither less nor more than 1 crore.
4. Sub-rule (4) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that the auditor is required to disclose in the Board's Report details of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year. Which of the following details is not required to be disclosed in the Board's Report?
- (a) Nature of Fraud with description.
- (b) Parties involved, if remedial action taken.
- (c) Approximate Amount involved
- (d) Remedial actions taken.
5. For reporting under clause (xi) of paragraph 3 of Companies (Auditor's Report) Order, 2020, which of the following points the auditor may consider?
- (a) Fraud by the company or on the company by its officers, employees or third parties to be reported.
- (b) Only suspected frauds shall be included here and not the noticed frauds.
- (c) Principles of materiality outlined in Standards on Auditing.
- (d) The auditor's withdrawal from the engagement and the reasons for the withdrawal.

(5 x 2 = 10 Marks)

Case Scenario 2

SAM & Company, a Chartered Accountant firm, is in the process of finalising the audit of Health is Wealth Limited which is a Company listed on the Bombay Stock Exchange. Since the past decade, Health is Wealth Limited has made its presence felt in over 10 countries, including India, making it a leader in the global fitness industry. It runs a chain of fitness centres that offers energetic group workouts and multiple workout formats

to choose from. It also offers the best equipment, knowledgeable staff and personal advice in a welcoming environment.

SAM & Company being a very reputed firm, was appointed for the statutory audit of Health is Wealth Limited. The Engagement Partner CA A and her team of 8 members have conducted the audit in an efficient and effective manner. The senior manager in the team, CA K is of the opinion that they have obtained sufficient appropriate audit evidence, which concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements. One of the article clerks, Mr N, is a fresher and this audit is his first experience as an auditor in a limited company. He is a sharp boy and has grasped all the concepts and techniques very well. However, the term “pervasive” confused him so CA K patiently explained to Mr N the pervasive effects on the financial statements as per the auditor’s judgement. Mr. N understood the term well and thanked CA K for clearing all his doubts.

CA A disagreed with CA K that they have obtained sufficient appropriate audit evidence, which concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements. So, the entire team held various meetings and discussions, and finally reached to a conclusion. They concluded that they have obtained reasonable assurance that the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion took into account:

- (a) Whether sufficient appropriate audit evidence had been obtained;
- (b) Whether uncorrected misstatements were material, individually or in aggregate;
- (c) The evaluations.

The Auditor’s Report was prepared in writing and it was decided that an unmodified opinion would be expressed. The first section of the auditor’s report included the auditor’s opinion, and had the heading “Opinion”. Following the Opinion section, was a section with the heading “Basis for Opinion”. When expressing an unmodified opinion on financial statements, the auditor’s opinion used the following phrase,

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

During the audit, the audit team had observed that there was uncertainty in Health is Wealth Limited relating to the future outcome of a regulatory action. So, a paragraph was included in the auditor’s report that referred to this matter which was appropriately disclosed in the financial statements and that, in the auditor’s judgment, was of such importance that it was fundamental to users’ understanding of the financial statements.

CA A also determined whether the financial statements included the comparative information required by the applicable financial reporting framework and whether such information was appropriately classified. One team member, Mr R was curious to know whether the auditor’s opinion referred to the corresponding figures or not, whenever the corresponding figures are presented. CA A explained the circumstances to Mr R in which, when the corresponding figures are presented, auditor’s opinion referred to the corresponding figures.

Based on the above information, answer the following questions:

1. CA K explained to Mr. N the pervasive effects on the financial statements in the auditor’s judgement. Pervasive effects on the financial statements are those that, in the auditor’s judgement:
 - (i) Are not confined to specific elements, accounts or items of the financial statements;
 - (ii) If so confined, represent or could represent a substantial proportion of the financial statements; or
 - (iii) In relation to disclosures, are fundamental to users’ understanding of the financial statements.

Which of the following is correct?

- (a) (i), (iii)
- (b) (ii),(iii)
- (c) (i), (ii)

- (d) (i), (ii) and (iii)
2. When expressing an unmodified opinion on financial statements, SAM & Company used the following phrase:
“In our opinion, the accompanying financial statements **give a true and fair view of** [...] in accordance with [the applicable financial reporting framework].”
Which is the other phrase which is regarded as being equivalent to the above phrase and could also be used by SAM & Company?
- (a) In our opinion, the accompanying financial statements **give a true and correct view of** [...] in accordance with [the applicable financial reporting framework];
- (b) In our opinion, the accompanying financial statements **present correctly, in all material respects,** [...] in accordance with [the applicable financial reporting framework];
- (c) In our opinion, the accompanying financial statements **present fairly, in all material respects,** [...] in accordance with [the applicable financial reporting framework];
- (d) In our opinion, the accompanying financial statements **give a correct and fair view of** [...] in accordance with [the applicable financial reporting framework].
3. Which of the following statements is not included in the section with the heading “Basis for Opinion” in the Auditor’s Report?
- (a) Audit was conducted in accordance with the Accounting Standards.
- (b) Auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor’s other ethical responsibilities in accordance with these requirements.
- (c) Description of the auditor’s responsibilities under the SAs.
- (d) States whether the auditor believes that the audit evidence the auditor has obtained, is sufficient and appropriate to provide a basis for the auditor’s opinion.
4. A paragraph was included in the Auditor’s Report of Health is Wealth Limited that referred to a matter which was appropriately disclosed in the financial statements that, in the auditor’s judgment, was of such importance that it was fundamental to users’ understanding of the financial statements. What is this section of the Auditor’s Report called?
- (a) Other Matters.
- (b) Emphasis of Matters.
- (c) Key Audit Matters.
- (d) Auditor’s Responsibilities for the Audit of the Financial Statements.
5. CA A explained the circumstances to Mr. R in which, when the corresponding figures are presented, auditor’s opinion referred to the corresponding figures. Which of these circumstances did he mention to Mr. R?
- (a) If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which a modified opinion has been previously issued.
- (b) If the auditor’s report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is resolved.
- (c) Prior Period Financial Statements are audited by another auditor.
- (d) Prior Period Financial Statements not audited.

(5 x 2=10 Marks)

General MCQs

1. In designing and performing test of controls, the auditor shall perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:
- (i) How the controls were applied at relevant times during the period under audit.
 - (ii) The consistency with which they were applied.
 - (iii) By whom or by what means they were applied.

Which of the following is correct?

- (a) (i) and (ii)
 - (b) (ii) and (iii)
 - (c) (i),(ii) and (iii)
 - (d) (i) and (iii)
2. Which of the following is not an example of an event or condition that may cast significant doubt on entity's ability to continue as a going concern:
- (a) Loss of key management without replacement
 - (b) Adverse key financial ratios
 - (c) Inability to pay creditors on due date
 - (d) Current year profit turns to loss after providing depreciation
3. _____ implies analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years.
- (a) Trend analysis
 - (b) Ratio analysis
 - (c) Structural modelling
 - (d) Account fluctuations analysis
4. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include:
- (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.

Which of the following is correct?

- (a) (i),(ii),(iii)
- (b) (i),(ii),(iii), (iv), (v)
- (c) (i),(ii), (iv), (v)
- (d) (i),(ii),(iii), (iv)

5. Obtaining trade receivables ageing report and analysis and identification of doubtful debts is performed during audit of accounts receivable balances to address the following balance sheet assertion:
- Valuation
 - Rights and obligations
 - Existence
 - Completeness
6. The auditors should classify Credit card accounts as NPA, if _____ amount due, as mentioned in the credit card statement is not paid fully within _____ days from next statement date.
- Total, 90
 - Minimum, 90
 - Minimum, 30
 - Minimum, 60
7. The auditor finds that there is something unusual about the balances outstanding in the receivables. Date wise verification of the bank reconciliation performed by the auditor has resulted in mismatch in dates in most of the receivable ledger. The auditor has identified a pattern in the mismatches. He suspects that there might be a misappropriation of cash and the detection of this misappropriation is being prevented by crediting the amount received subsequently to the account of customer who paid earlier.
- What is the kind of fraud that the auditor has faced in the above case?
- Teeming and Lading
 - Cash skimming
 - Defalcation of cash by inflating cash payment
 - Misappropriation of receivables
8. A Ltd. has been assigned a Cash Credit limit of INR 20 lacs as against its Book Debts furnished as security. What kind of Security creation is it?
- Pledge
 - Mortgage
 - Assignment
 - Set-off
9. Owing to the _____ limitations of an audit, there is _____ risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.
- Inherent, unavoidable
 - Inherent, complete
 - Management, unavoidable
 - Regulatory, control
10. Consider the following statements pertaining to nature and meaning of “assertions”:-
- Statement I—Assertions are representations by the management which are present in financial statements.
- Statement II —The assertions have to be necessarily explicit.

Which of the following is correct?

- (a) Only Statement I is true.
- (b) Only Statement II is true.
- (c) Both statements I and II are true.
- (d) Both statements I and II are false.

(10 x 1=10 Marks)

Division B- Descriptive Questions

Question No. 1 is compulsory.

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

Total 70 Marks

1. Examine with reasons (in short) whether the following statements are correct or incorrect : (Attempt any **7** out of **8**)
 - (i) The preparation of financial statements involves judgment by management.
 - (ii) Evolving one audit programme applicable to all business under all circumstances is not practicable
 - (iii) Inquiry alone ordinarily does not provide sufficient audit evidence.
 - (iv) The SAs do not ordinarily refer to inherent risk and control risk separately.
 - (v) Intentional errors are most difficult to detect and auditors generally devote greater attention to this type
 - (vi) All automated environments are not complex.
 - (vii) A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is known as meaningful data.
 - (viii) An auditor has to report on the matters specified in section 143(1) of the Companies Act, 2013.

(7 x 2 = 14 Marks)
2. Discuss the following:
 - (a) As an auditor of XYZ Ltd, how would you consider the acceptance of a change in audit engagement? **(4 Marks)**
 - (b) CA Vikas Jain discussed with his audit team about advantages and disadvantages of audit programme. He explained to his team that –“work may become mechanical” as disadvantage of the audit programme. Discuss explaining the disadvantages of an audit programme **(4 Marks)**
 - (c) The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source, its nature and the circumstances under which it is obtained. Explain and elucidate the guiding principles which are useful in assessing the reliability of audit evidence. **(3 Marks)**
 - (d) 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 materiality, size of the entity etc. Explain the other relevant considerations in the above context. **(3 Marks)**
3.
 - (a) Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. Explain giving examples. **(4 Marks)**
 - (b) Explain some of the points that an auditor should consider to obtain an understanding of the company’s automated environment. **(4 Marks)**

- (c) ABC Ltd is a Large Company with huge purchase and sales transactions. Which sampling approach is recommended in such a company? Explain giving features of such sampling approach along with example **(3 Marks)**
- (d) While conducting audit of Air Space Ltd, the auditor observes that it has issued shares at discount to its creditors when its debt is converted into shares in pursuance of debt restructuring scheme in accordance with any guidelines specified by the Reserve Bank of India. Discuss explaining clearly the provisions relating to discount on issue of shares and its verification by the auditor. **(3 Marks)**
4. (a) Discuss the provisions regarding appointment of First auditors of a Government company and a Non-Government company. **(4 Marks)**
- (b) While applying the Substantive Analytical Procedures what techniques can be used by the statutory auditor of a company to obtain sufficient and appropriate audit evidence? **(4 Marks)**
- (c) XYZ Ltd made huge additions to Intangible assets during the period 01-04-2021 to 31-03-2022 i.e period under audit. You have been appointed as an auditor and you want to verify the additions made to intangible assets during the period. Suggest the audit procedure to verify the additions to intangible assets. **(6 Marks)**
5. (a) State the matters to be included in auditor's report as per CARO, 2020 regarding "Default in repayment of loan or borrowing to a financial institution, bank etc." **(3 Marks)**
- (b) Under provisions of Section 143(2), the auditor shall make a report to the members of the company on the accounts examined by him. Explain along with relevant rule of The Companies (Audit and Auditors) Rules, 2014 **(4 Marks)**
- (c) While conducting audit of VED Ltd., you as an auditor are not only prevented in completing certain audit procedures but also are not able to obtain audit evidence even by performing alternative procedures. How you will deal with this situation? **(4 Marks)**
- (d) What are the circumstances in which auditors are required to qualify their reports of companies for matters related to AS-I 'Disclosure of Accounting Policies'? **(3 Marks)**
6. (a) The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. Explain this statement. **(4 Marks)**
- (b) Audit of government expenditure is one of the major components of government audit conducted by the office of C & AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. Explain those standards. **(4 Marks)**

OR

- (c) Explain the categories of Agricultural Advances in case of Banks and related NPA norms. **(4 Marks)**
- (d) You have been appointed auditor of M/s. BLK Hospital. Discuss important points that would attract your attention while audit. **(6 Marks)**

MOCK TEST PAPER 1
INTERMEDIATE : GROUP – II
PAPER – 6: AUDITING AND ASSURANCE
SUGGESTED ANSWERS / HINTS
Division A-Multiple Choice Questions

Case Scenario 1

1. (b)
2. (c)
3. (b)
4. (b)
5. (c)

Case Scenario 2

1. (d)
2. (c)
3. (a)
4. (b)
5. (d)

General MCQs

1. (c)
2. (d)
3. (a)
4. (b)
5. (a)
6. (b)
7. (a)
8. (c)
9. (a)
10. (a)

Division B -Descriptive Answers

1. (i) **Correct:** The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.

- (ii) **Correct:** Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable
- (iii) **Correct:** Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.
- (iv) **Correct:** The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.
- (v) **Correct:** Intentional errors are most difficult to detect and auditors generally devote greater attention to this type because out of long and sometimes unfortunate experience, auditors have developed a point of view that, if they direct their procedures of discovering the more difficult intentional errors, they are reasonably certain to locate the more simple and far more common unintentional errors on the way.
- (vi) **Correct:** The complexity of an automated environment depends on various factors including the nature of business, level of automation, volume of transactions, use of ERP and so on. There could be environment where dependence on IT and automation is relatively less or minimal and hence, considered less complex or even non-complex.
- (vii) **Incorrect** A combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is known as Data Analytics.
- (viii) **Incorrect:** The auditor is not required to report on the matters specified in section 143(1) of the Companies Act, 2013 unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. However, the auditor should make a report to the members in case he finds answer to any of these matters in adverse.

2. (a) Acceptance of a Change in Engagement:

1. An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.
2. A request from the client for the auditor to change the engagement may result from a change in circumstances affecting the need for the service, a misunderstanding as to the nature of an audit or related service originally requested or a restriction on the scope of the engagement, whether imposed by management or caused by circumstances. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement, especially any legal or contractual implications.

3. If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to:
 - (1) the original engagement; or
 - (2) any procedures that may have been performed in the original engagement, except where the engagement is changed to an engagement to undertake agreed-upon procedures and thus reference to the procedures performed is a normal part of the report.
4. The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.
5. If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.
6. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:
 - (a) Withdraw from the audit engagement where possible under applicable law or regulation; and
 - (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

(b) Some disadvantages are there in the use of audit programme. The disadvantages are:

- (i) The work may become mechanical and particular parts of the programme may be carried out without any understanding of the object of such parts in the whole audit scheme.
- (ii) The programme often tends to become rigid and inflexible following set grooves; the business may change in its operation of conduct, but the old programme may still be carried on. Changes in staff or internal control may render precaution necessary at points different from those originally decided upon.
- (iii) Inefficient assistants may take shelter behind the programme i.e. defend deficiencies in their work on the ground that no instruction in the matter is contained therein.
- (iv) A hard and fast audit programme may kill the initiative of efficient and enterprising assistants.

(c) Reliability of Audit Evidence: As per SA 500 on "Audit Evidence", the reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions.

While recognising that exceptions may exist, the following guiding principles about the reliability of audit evidence may be useful:

- (i) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- (ii) 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.

- (iii) Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
 - (iv) Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
 - (v) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.
- (d) 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.
- 3. (a)** Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:
- (i) Inadequate segregation of duties or independent checks.
 - (ii) Inadequate oversight of senior management expenditures, such as travel and other reimbursements
 - (iii) Inadequate record keeping with respect to assets.
 - (iv) Inadequate system of authorization and approval of transactions (for example, in purchasing).
 - (v) Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
 - (vi) Lack of complete and timely reconciliations of assets.
 - (vii) Lack of timely and appropriate documentation of transactions, for example, credits for merchandise returns.
 - (viii) Lack of mandatory vacations for employees performing key control functions.
 - (ix) Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
 - (x) Inadequate access controls over automated records, including controls over and review of computer systems event logs.

(b) Given below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment:

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

The understanding of a company's IT environment that is obtained should be documented

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

Features/Characteristics of Statistical Sampling:

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

For Example: An auditor while verifying the Purchases during the year realised that the purchase transactions in that year are more than 45000 in number, then in such case, statistical sampling will be highly recommended in the audit program. Random Sampling (discussed ahead in this topic) is the method you decide to choose sample in such a situation.

(d) **Shares issued at a discount**

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.

- (3) Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

The auditor needs to check

- (i) the movement in share capital during the year and wherever there is any issue,
- (ii) he should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price.
- (iii) Further, auditor should also verify that in case a 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.

In the given case of Air Space Ltd, it is clear that it can issue shares to its creditors when its debt is converted into shares in accordance with approved restructuring scheme.

4. (a) **Appointment of First Auditor of a Government Company:** Section 139(7) of the Companies Act, 2013 provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.

Appointment of First Auditor of a Non-Government Company: As per Section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

- (b) While applying the Substantive Analytical Procedures the statutory auditor of a company may use the following techniques to obtain sufficient and appropriate audit evidence

Trend analysis – Trend analysis is a commonly used technique. It is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. We evaluate whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.

Ratio analysis – Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry.

Reasonableness tests – Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts. In other words these tests are made by reviewing the relationship of certain account balances to other balances for reasonableness of amounts.

Structural modelling – A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression).

The statutory auditor may use any of the above mentioned techniques while applying substantive analytical procedures depending upon the availability of data and requirements of the case.

- (c) 1. Verify the movement in the intangible assets schedule (asset class wise like software, designs/ drawings, goodwill etc.) compiled by the management i.e. Opening balances + Additions – Deletions = Closing balances. Tally the closing balances to the entity's books of account.
2. 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:

- (i) For all material additions, verify whether such expenditure meets the criterion for recognition of an intangible asset as per AS 26.
 - (ii) Ensure that no cost related to research (or from the research phase of an internal project) gets recognized as intangible asset.
 - (iii) 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.
 - (iv) Verify whether the additions (acquisitions) have been approved by appropriate entity's personnel.
 - (v) 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.
 - (vi) 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, 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.
5. (a) **The auditor is required to report as per clause (ix) of paragraph 3 of CARO 2020**
- (a) 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;
- (b) Under provisions of Section 143(2), the auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made thereunder or under any order made under sub-section (11).

Further, auditor has to report whether to best of his information and knowledge, the said accounts, financial statements give a true and fair view of ***the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and following matters as prescribed under relevant rules (Rule 11):-***

- (i) whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement;
- (ii) whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts;
- (iii) whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company.
- (iv) (1) Whether the management has represented that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been advanced or loaned or invested (either from borrowed funds or share premium or any other sources or kind of funds) by the company to or in any other person(s) or entity(ies), including foreign entities ("Intermediaries"), with the understanding, whether recorded in writing or otherwise, that the Intermediary shall, whether, directly

or indirectly lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the company ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries;

- (2) Whether the management has represented, that, to the best of its knowledge and belief, other than as disclosed in the notes to the accounts, no funds have been received by the company from any person(s) or entity(ies), including foreign entities ("Funding Parties"), with the understanding, whether recorded in writing or otherwise, that the company shall, whether, directly or indirectly, lend or invest in other persons or entities identified in any manner whatsoever by or on behalf of the Funding Party ("Ultimate Beneficiaries") or provide any guarantee, security or the like on behalf of the Ultimate Beneficiaries; and
 - (3) Based on such audit procedures that the auditor has considered reasonable and appropriate in the circumstances, nothing has come to their notice that has caused them to believe that the representations under sub-clause (i) and (ii) contain any material mis-statement.
- (v) Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013
- (c) As per SA 705, "Modifications to the Opinion in the Independent Auditor's Report", if, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

If management refuses to remove the limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (1) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (2) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
 - (i) Withdraw from the audit, where practicable and possible under applicable law or regulation; or
 - (ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

If the auditor withdraws, before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

- (d) While discharging their attest function, the members of the Institute may keep the following in mind with regard to mandatory Accounting Standards. As per **AS 1 - Disclosure of Accounting Policies**, in the case of a company, members should qualify their audit reports in case:
- (i) accounting policies required to be disclosed under Schedule III or any other provisions of the Companies Act, 2013, have not been disclosed, or

- (ii) accounts have not been prepared on accrual basis, or
 - (iii) the fundamental accounting assumption of going concern has not been followed and this fact has not been disclosed in the financial statements, or
 - (iv) proper disclosures regarding changes in the accounting policies have not been made.
6. (a) The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. In general, the internal controls over advances should include, *inter alia*, the following:
- The bank should make an advance only after satisfying itself as to the credit worthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank.
 - All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
 - The compliance with the terms of sanction and end use of funds should be ensured.
 - Sufficient margin as specified in the sanction letter should be kept against securities taken so as to cover for any decline in the value thereof. The availability of sufficient margin needs to be ensured at regular intervals.
 - If the securities taken are in the nature of shares, debentures, etc., the ownership of the same should be transferred in the name of the bank and the effective control of such securities be retained as a part of documentation.
 - All securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to give title to the bank.
 - In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipt. The godowns should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.
 - Drawing Power Register should be updated every month to record the value of securities hypothecated. These entries should be checked by an officer.
 - The accounts should be kept within both the drawing power and the sanctioned limit.
 - All the accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly.
 - The operation of each advance account should be reviewed at least once a year and at more frequent intervals in the case of large advances.
- (b) **Expenditure Audit:** The audit of government expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are to ensure that there is provision funds authorised by competent authority fixing the limits within which expenditure can be incurred. These standards are—
- (i) that the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the Financial Rules and Regulations framed by the competent authority. Such an audit is called as the audit against 'rules and orders'.
 - (ii) that there is sanction, either special or general, accorded by competent authority authorising the expenditure. Such an audit is called as the audit of sanctions.

- (iii) that there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority. Such an audit is called as audit against provision of funds.
- (iv) that the expenditure is incurred with due regard to broad and general principles of financial propriety. Such an audit is also called as propriety audit.
- (v) that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Such an audit is termed as the performance audit.

(c) As per the guidelines, Agricultural Advances are of two types:

- (1) Agricultural Advances for “long duration” crops; and
- (2) Agricultural Advances for “short duration” crops.

The “long duration” crops would be crops with crop season longer than one year and crops, which are not “long duration” crops would be treated as “short duration” crops.

The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers’ Committee in each State.

The following NPA norms would apply to agricultural advances (including Crop Term Loans):

- A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons; and
- A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

(d) AUDIT OF HOSPITAL

The important points involved in such an audit are stated below-

- (i) **Register of patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients’ attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
- (ii) **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence. For eg. copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills etc.
- (iii) **Income from Investments, Rent etc.:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends and interest on securities have been collected.
- (iv) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- (v) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- (vi) **Authorisation and sanctions:** Vouch all purchases and expenses and verify that the capital expenditure incurred only with the prior sanction of the trustees of the Managing Committee and that appointments and increments to staff have been duly authorised.

- (vii) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
- (viii) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
- (ix) **Internal Check:** Examine the internal check as regards the receipt and issue of stores, medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
- (x) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
- (xi) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
- (xii) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check the percentage of the items physically, also compare their total values with respective ledger balances.
- (xiii) **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.