

PAPER – 6: AUDITING AND ASSURANCE

PART – I : ACADEMIC UPDATE

Chapter 9 (Printed Copy)

At Page 10 - Topic “Shares issued at a discount” is revised and being given hereunder. Students are advised to study this topic from here and not from printed copy of the study material.

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

This topic has also been revised at page no. 10 of chapter 9 and students can refer at the link given below:

<https://resource.cdn.icai.org/66605bos53774-cp9.pdf>

Chapter 10 – Company Audit

On Page number 10.36, point (j) to be read as under:

- (j) such other matters as may be prescribed Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in auditor's report. The auditor's report shall also include their views and comments on the following matters, namely:-
- (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 it's 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 it's 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 (1) and (2) contain any material misstatement.
 - (v) Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.
 - (vi) Whether the company has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same

has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention.

Chapter 10 (Printed Copy) At Page 10.61 - Topic “Punishment for non-compliance” is revised and being given hereunder. Students are advised to study this topic from here and not from printed copy of the study material.

PUNISHMENT FOR NON-COMPLIANCE

Section 147 of the Companies Act, 2013 prescribes following punishments for contravention:

- (1) If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees, but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees, but which may extend to one lakh rupees.
- (2) If an auditor of a company contravenes any of the provisions of section 139, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees, but which may extend to five lakh rupees or four times the remuneration of the auditor, whichever is less.

It may be noted that if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, whichever is less.

- (3) Where an auditor has been convicted under sub-section (2), he shall be liable to:
 - (i) refund the remuneration received by him to the company.
 - (ii) and pay for damages to the company statutory bodies or authorities or to members or the creditors of the Company for loss arising out of incorrect or misleading statements of particulars made in his audit report.
- (4) The Central Government shall, by notification, specify any statutory body or authority of an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.
- (5) Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in an fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil criminal as provided in this Act or in any other law for the time being in force, for such act shall be the partner or partners concerned of the audit firm and

of the firm jointly and severally. However, in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.

This topic has also been revised at page no. 10.61 of chapter 10 and students can refer at the link given below:

<https://resource.cdn.icai.org/66606bos53774-cp10.pdf>

Case study given at page no. 10.15 in Chapter 10 of Module 2 has been revised and is given hereunder:

CASE STUDY

Facts of the Case: CA. Donald was appointed as the auditor of PS Ltd. at the remuneration of ₹ 30,000. However, after 4 months of continuing his services, he could not continue to hold his office of the auditor as his wife got a government job at a distant place and he needs to shift along with her to the new place. Thus, he resigned from the company and did not perform his responsibilities relating to filing of statement to the company and the registrar indicating the reasons and other facts as may be relevant with regard to his resignation.

How much fine may he be punishable with under section 140(3) for non-compliance of section 140(2) of the Companies Act, 2013?

Explanation: For non-compliance of sub-section (2) of section 140 of the Companies Act, 2013, the auditor shall be punishable with fine, which shall not be less than fifty thousand rupees or the remuneration of the auditor, whichever is less but which may extend to two lakh rupees, under section 140(3) of the said Act.

Conclusion: Thus, the fine under section 140(3) of the Companies Act, 2013 shall not be less than ₹ 30,000 but which may extend to ₹ 2,00,000.

The revision has also been made at Page no. 10.15 in Chapter 10 of the Study Material at the link given below:

<https://resource.cdn.icai.org/66606bos53774-cp10.pdf>

Note: Students are also advised to refer RTP of Paper-2: Corporate and Other Laws for academic updates relating to Company Law and Other Laws.

PART – II: QUESTIONS AND ANSWERS

PART – II A: Multiple Choice Questions based on Case Scenarios

Case Scenario - 1

Kartik, a CA student undergoing his articled training, is part of an engagement team conducting statutory audit of MSE Auto Private Limited, a company engaged in manufacturing of automobile spare parts. The company has its manufacturing facilities located in Pimpri- Chinchwad industrial belt near Pune. It is a profit making company and one of the most sought after by banks in the area due to its good track record. The following is extract of financial information taken from its pre-audit financial statements for year 2022-23. Figures have been rounded off in ₹ 000's.

Particulars	Year 2022-23	Year 2021-22
Share capital	2500.00	2500.00
Long term borrowings	0.00	15000.00
Short term borrowings	55000.00	15000.00
Inventories	35000.00	27000.00
Trade receivables	60000.00	25000.00
Revenue from Operations	300000.00	100000.00
Profit before tax	60000.00	18000.00

While going through schedule of long term borrowings and books of accounts, he finds that reduction of long term borrowings of the company is on account of full payment of a term loan in month of April 2022 taken from a bank in past. However, he finds that charge in respect of above term loan in favour of bank is still subsisting on MCA portal beyond statutory period due to non-registration of charge satisfaction.

He had read about assertions pertaining to balance sheet and income statement. However, he was not sure about nomenclatures assigned to assertions pertaining to balance sheet and income statement.

The team had also attended physical inventory count of the company as at year end in accordance with SA 501.

Besides, company's trade receivables have increased from ₹ 25000 in year 2021-22 to ₹ 60000 in year 2022-23 (both figs in '000s). His understanding is that increase in company's trade receivables as compared to last year signifies longer time taken by company's customers to make their payments.

Considering substantial rise in revenue from operations of the company in the year under audit, team wants to ensure that revenues of company are not overstated.

Based on above, answer the following questions: -

- 1.1 Keeping in view description regarding full payment of term loan in April 22 taken from a bank in past and non-registration of satisfaction of charge, which of following statements is correct?
- (a) The above fact may be disclosed by the company's management in its financial statements at its discretion along with reasons as such disclosure would bring transparency.
 - (b) The above fact along with reasons is required to be disclosed by the company in its financial statements in accordance with requirements of Standards on Auditing.
 - (c) The above fact along with reasons is required to be disclosed by the company in its financial statements in accordance with requirements of Schedule III of Companies Act, 2013.
 - (d) The above fact is not required to be disclosed as term loan has already been repaid in full and there are no outstanding long term borrowings.
- 1.2 The company's short-term borrowings have increased during the year 2022-23 as compared to last year. One of following assertions is not relevant to verification of short-term borrowings. Which odd one you would suggest to Kartik in this regard?
- (a) Existence
 - (b) Occurrence
 - (c) Completeness
 - (d) Valuation
- 1.3 As regards team's attendance at physical inventory count process of company's inventories in accordance with SA 501 is concerned, which of following is not a relevant audit procedure?
- (a) Inspection of inventories
 - (b) Checking appropriateness of method employed for valuation of inventories
 - (c) Evaluating management's instructions for recording results of physical inventory count
 - (d) Performing test counts
- 1.4 The company's trade receivables have increased during year 2022-23 as compared to last year. Which of following statements is most appropriate regarding understanding of Kartik on this issue?
- (a) The view of Kartik is correct and it has led to increased audit risk pertaining to valuation of trade receivables. Therefore, team needs to go through trade receivables ageing schedule to confirm it.

- (b) The view of Kartik is incorrect.
 - (c) The view of Kartik is correct and it has led to increased audit risk pertaining to valuation of trade receivables. Therefore, team needs to perform direct confirmation procedures to confirm it.
 - (d) The view of Kartik is correct and it has led to increased audit risk pertaining to valuation of trade receivables. Therefore, team needs to perform cut-off procedures to confirm it.
- 1.5 The team wants to ensure that revenues of company are not overstated. Which of following is not likely to be a relevant audit procedure in this regard?
- (a) Obtaining confirmations from customers
 - (b) Reviewing GST returns and their reconciliation with revenue stated in statement of profit & loss
 - (c) Reviewing credit notes issued by company post year end
 - (d) Reviewing debit notes issued by company post year end

Case Scenario - 2

CA X has accepted offer of conducting statutory audit of financial statements of DOS Solutions Private Limited. Keeping in mind requirements of Standards on Auditing including those relating to SA 300, he plans audit so that it is conducted in an effective manner. He knows that because of inherent limitations of an audit, there is audit risk in audit of financial statements even though audit is properly planned and performed in accordance with Standards on Auditing.

Considering nature of operations of the company, he has decided to use audit sampling in performing audit procedures. The various areas of his testing include testing controls over revenues, expenditures, assets and liabilities of the company. Besides, he has decided to perform tests of details in respect of all these areas of financial statements.

While verifying tests of controls over purchase orders placed by the company based

on selected audit samples, he has erroneously concluded that Standard operating procedures (SOP) for placing purchase orders are not being followed strictly and controls are less effective than they actually are.

Further, while testing controls over wage payments, he has tested 20 sample wage sheets of different sections of company and finds that one wage sheet has not been signed by authorized officer of the company. The rate of deviation was earlier set by him at 3%.

During the course of designing procedures for selecting samples for verification of trade receivables, he has decided to divide trade receivable balances into groups viz. balances in excess of ₹ 10 lakh, balances in range of ₹ 7,50,001 to ₹ 10,00,000, balances in range of ₹ 5,00,001 to ₹ 7,50,000, balances in range of ₹ 2,50,001 to ₹ 5,00,000 and balances of ₹ 2,50,000 and below. He has planned to pick up different percentage of items from each of above groups. Random sample is chosen from each group using random number tables.

Some of the trade payables of the company were outstanding since long. He has decided to merely verify arithmetical accuracy of ageing schedule and its reconciliation with books of accounts.

Therefore, nature of audit procedures, nature of financial reporting itself and need for audit to be conducted within a reasonable period of time and at a reasonable period of cost all lead to inherent limitations of audit.

- 2.1 The auditor has erroneously concluded that Standard operating procedures (SOP) for placing purchase order are not being followed strictly and controls are less effective than they actually are. Which of the following statements is likely to be true in this regard?
- (a) It is a sampling risk and might lead to auditor expressing inappropriate audit opinion.
 - (b) It is a sampling risk and affects audit effectiveness.
 - (c) It is a sampling risk and affects audit efficiency.
 - (d) It is a control risk and affects audit effectiveness.
- 2.2 The auditor has tested 20 sample wage sheets in different sections of the company and finds that one wage sheet has not been signed by authorized officer of the company. It represents _____?
- (a) Tolerable misstatement
 - (b) Misstatement
 - (c) Tolerable rate of deviation
 - (d) Actual rate of deviation
- 2.3 Which method of selecting samples for verification of trade receivables has been planned by auditor?
- (a) Simple random sampling
 - (b) Systematic sampling
 - (c) Block sampling
 - (d) Stratified sampling
- 2.4 The auditor has decided to merely verify arithmetical accuracy and reconciliation of ageing schedule relating to trade payables. The use of above audit procedure can lead to _____?
- (a) Sampling risk
 - (b) Non-sampling risk
 - (c) Inherent risk
 - (d) Control risk

- 2.5 Keeping in view inherent limitations of audit of financial statements, which of following statements is likely to be most appropriate?
- (a) Due to inherent limitations of audit, auditor obtains conclusive audit evidence.
 - (b) Due to inherent limitations of audit, auditor can be satisfied with less than persuasive evidence.
 - (c) Due to inherent limitations of audit, subsequent discovery of material misstatement in financial statements after audit, which was conducted in accordance with SAs, does not indicate a failure of audit.
 - (d) Due to inherent limitations of audit, auditor can skip a difficult, time-consuming and costly procedure.

General MCQs

1. Mr. A, auditor and Mr. B, Finance Manager of XYZ Pvt Ltd are friends. Mr. A prepares the audit report according to the wishes and directions of Mr. B. In this situation which essential quality of the auditor has been compromised:
 - (a) Professional Competence
 - (b) Independence
 - (c) Professional Skepticism
 - (d) Due care
2. _____ occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests.
 - (a) Familiarity threats
 - (b) Advocacy threats
 - (c) Self Review threats
 - (d) Intimidation threats
3. The persons with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity are:
 - (a) management
 - (b) those charged with governance
 - (c) audit committee
 - (d) board of directors
4. Which of the following is a risk that arises from the use of IT systems?
 - (a) Direct data changes (backend changes).
 - (b) Limited/Monitored access.

- (c) Adequate segregation of duties.
 - (d) Authorized access to data.
5. ABC Limited is engaged in manufacturing of electric two-wheelers. During the year, a customer has gone to court due to incident of fire in battery-operated vehicle. The damages claimed are to tune of ₹5 lakhs. The company insists that this incident was due to improper charging of battery and has nothing to do with manufacturing design of vehicle. The company's lawyers advise that it is probable that company is not likely to be held liable. It is likely to be reflected in financial statements of company under_____?
- (a) Provisions
 - (b) Reserves
 - (c) Contingent liabilities
 - (d) Other current Liabilities

PART II B – DESCRIPTIVE QUESTIONS

1. State with reason (in short) whether the following statements are true or false:
- (i) There is direct relationship between detection risks and the combined level of inherent and control risks.
 - (ii) For auditor's opinion, reasonable assurance is an absolute level of assurance.
 - (iii) Internally generated Goodwill can be recognized as an asset.
 - (iv) Sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.
 - (v) The inclusion of an Emphasis of Matter paragraph in the Auditor's Report affects the auditor's opinion.
 - (vi) A perceived opportunity to commit fraud may exist when an individual believes internal control can be overridden.
 - (vii) Control environment can prevent, detect and correct a material misstatement.
 - (viii) An unexplained decrease in GP Ratio may result due to fictitious sales.

Chapter 1 - Nature, Objective and Scope of Audit

2. (a) "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." Discuss.
- (b) Mr. Z, auditor of the Company, Different and Capable Limited for the financial year 2022-23, explained to audit team members about the objectives of the Independent Auditor in accordance with the relevant Standard on Auditing. Explain those objectives.

3. (a) There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain with examples.
- (b) In case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Discuss those subject matters.

Chapter 2 - Audit Strategy, Audit Planning and Audit Programme

4. (a) You have been appointed as an auditor of MKP Ltd. for the first time. Discuss briefly, the factors to be considered by you while establishing overall audit strategy
 - (b) The audit plan includes the nature, timing and extent of audit procedures to be performed by engagement team members. Explain.
5. In establishing the overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement. Explain with examples.

Chapter 3 - Audit Documentation and Audit Evidence

6. (a) Written representations are to be provided by the management to the auditor when requested. Explain
 - (b) Audit Documentation refers to the record of three items. Explain stating clearly the objective and nature of audit documentation.
7. (a) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis. Explain in detail.
 - (b) T Ltd has used the services of an expert for the purpose of physical verification of its inventory which is appearing in the financial statements of the company at ₹ 75 Crores. Discuss the broad parameters auditor would take into consideration while deciding about using the work performed by the Management's Expert in physical verification of company's inventory.
8. SA 500 – "Audit Evidence", explains what constitutes audit evidence in an audit of financial statements. A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements. Explain and discuss the meaning of Audit Evidence in detail.

Chapter 4 - Risk Assessment and Internal Control

9. (a) Obtaining an understanding of the entity and its environment establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit. Explain by giving examples.
 - (b) Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware. Explain
10. Risk of material misstatement refers to the risk that the financial statements are materially misstated prior to audit. Discuss the levels at which this risk exists.

Chapter 5 - Fraud and Responsibilities of the Auditor in this Regard.

11. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Illustrate any three techniques by which fraud can be committed by management overriding controls.
12. Write the circumstances that indicate the possibility of fraud due to problematic or unusual relationship between the auditor and management.

Chapter 6 - Audit in an Automated Environment

13. When a business operates in a more automated environment, we are likely to see several business functions and activities happening within the systems. List down the business functions and activities happening within the systems.
14. List the points that an auditor should consider to obtain an understanding of the Company's automated environment.

Chapter 7- Audit Sampling

15. Chintamani Ltd appoints Chintan & Mani as statutory auditors for the financial year 2022-2023. Chintan & Mani seem to have different opinion on audit approach to be adopted for audit of Chintamani Ltd. Mani is of the opinion that 100% checking is not required and they can rely on Audit Sampling techniques in order to provide them a reasonable basis on which they can draw conclusions about the entire population.

Chintan is concerned whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530.

16. The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement. Explain in detail.

Chapter 8 - Analytical Procedures

17. Flower Limited presented its financial statements for the F.Y. 2022-2023 to its auditor for expressing an opinion thereon. The auditor while carrying out the audit started comparing various items of profit and loss account of the year under audit with previous financial years. What is auditor trying to achieve by carrying out those comparisons?
18. When designing and performing substantive analytical procedures, either alone or in combination with tests of details as substantive procedures in accordance with SA 330, the auditor shall determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and tests of details, if any, for these assertions. Discuss.

Chapter 9 - Audit of Items of Financial Statements

19. M/s MP & Co, Chartered Accountants, have been appointed as auditors of LMP Private Limited. The partner of the firm asked the Audit assistant to carry out the 'examination-in-depth' of the payment made to a creditor. Advise him about the documents to be verified.
20. (a) As an auditor, how will you verify the hire purchase transaction in the case of an entity engaged in the business of hire purchase?
(b) A junior accountant of a limited company has not separated transactions of one period from those in the ensuing period. As an Auditor, state the correct procedure to be followed and the areas in which it can be applied.

Chapter 10 - The Company Audit

21. Provisions regarding appointment of Auditors -
 - (i) First auditor of a Government company and a Non-Government company.
 - (ii) Subsequent auditor of a Government company and a Non- Government company.
22. As per Sec 143(3)(j) of the Companies Act, 2013, the auditor's report shall also include such other matters as may be prescribed by Rule 11 of the Companies (Audit and Auditors) Rule, 2014. Discuss those matters on which views and comments of the auditor are required.
23. State the matters to be included in the auditor's report as per CARO, 2020 regarding:
 - (i) Nidhi Company.
 - (ii) Transactions with related parties.

Chapter 11 - Audit Report

24. Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not considered as a substitute or alternative for a number of important items. What are those items?
25. What an auditor should state in the "Basis for opinion" section of auditor's report ? When the auditor modifies the opinion on the financial statements, explain the amendments he should make in this section?

Chapter 12 - Bank Audit

26. Your firm has been appointed as branch auditor of SP Bank Ltd. Discuss about the primary evidence you will look into while carrying out verification of advances.
27. TEP Industries Private Limited, a company engaged in obtaining rice from paddy, is enjoying a cash credit facility against hypothecation of paid stocks and book debts (eligible up to 90 days only) from LMV Bank for ₹ 4.00 crore. The letter sanctioning the above credit

facility stipulates margin @ 25% on stocks and @ 40% on eligible book debts up to 90 days.

While preparing stock statement as on 30.6.23, accountant of the company calculates value of stocks for ₹ 5 crore (including ₹ 1 crore of rice which was lying in a low lying godown and was completely damaged during recent floods caused by river Yamuna). Debtors outstanding as on 30.6.23 are ₹ 3 crore (including ₹ 50 lacs outstanding for last 6 months). Trade creditors outstanding as on date are ₹ 2 crore. He calculates DP as on 30.6.23 for ₹ 3.30 crore. Is he correct? Justify with your workings.

What does drawing power calculated by you signify to the borrower company?

Chapter 13 - Audit of Different Types of Entities

28. (a) "Public moneys should not be utilised for the benefit of a particular person or section of the community". List out the exceptions to this rule while conducting audit against propriety.
- (b) State six important advantages of audit of accounts of a Partnership firm.

SUGGESTED ANSWERS

Case Scenario – 1

Answer Key- Case Scenario - 1

Question No.	Answer
1.1	(c) The above fact along with reasons is required to be disclosed by company in its financial statements in accordance with requirements of Schedule III of Companies Act, 2013.
1.2	(b) Occurrence
1.3	(b) Checking appropriateness of method employed for valuation of inventories
1.4	(b) The view of Kartik is incorrect.
1.5	(d) Reviewing debit notes issued by company post year end

Answer Key- Case Scenario - 2

Question No.	Answer
2.1	(c) It is a sampling risk and affects audit efficiency.
2.2	(d) Actual rate of deviation
2.3	(d) Stratified sampling

2.4	(b) Non-sampling risk
2.5	(c) Due to inherent limitations of audit, subsequent discovery of material misstatement in financial statements after audit which was conducted in accordance with SAs does not indicate a failure of audit.

General MCQ's

1. (b) Independence
2. (a) Familiarity threats
3. (b) those charged with governance
4. (a) Direct data changes (backend changes).
5. (c) Contingent liabilities

Descriptive Answers

1. (i) **Incorrect:** There is an inverse relationship between detection risks and the combined level of inherent and control risks. For example, when inherent and control risks are high, acceptable detection risks need to be low to reduce audit risk to an acceptably low level. On the other hand, when inherent and control risks are low, an auditor can accept a higher detection risk and still reduce audit risk to an acceptably low level.
- (ii) **Incorrect:** Reasonable assurance is a high level but not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.
- (iii) **Incorrect:** As per AS-26, internally generated goodwill is not recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost.
- (iv) **Correct:** The decision whether to use a statistical or non-statistical sampling approach is a matter for the auditor's judgment; however, sample size is not a valid criterion to distinguish between statistical and non-statistical approaches.

Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.
- (v) **Incorrect:** When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall indicate that the auditor's opinion is not modified in respect of the matter emphasized. Such a paragraph shall refer only to information presented or disclosed in the financial statements. The inclusion of an Emphasis of Matter paragraph in the auditor's report does not affect the auditor's opinion.

- (vi) **Correct:** A perceived opportunity to commit fraud may exist when an individual believes internal control can be overridden, for example, because the individual is in a position of trust or has knowledge of specific deficiencies in internal control.
 - (vii) **Incorrect:** The control environment in itself does not prevent, or detect and correct, a material misstatement. It may, however, influence the auditor's evaluation of the effectiveness of other controls (for example, the monitoring of controls and the operation of specific control activities) and thereby, the auditor's assessment of the risks of material misstatement.
 - (viii) **Incorrect:** A fictitious sale will increase the GP Ratio, instead of decreasing it. GP ratio normally comes down if there are unrecorded sales or reversal of fictitious sale entries recorded in the previous year or fictitious purchase or decrease in closing stock.
2. (a) **Acceptance of a Change in Engagement:** 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.

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.

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-

- (i) the original engagement; or
- (ii) 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.

The auditor should not agree to a change of engagement where there is no reasonable justification for doing so.

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.

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-

- (i) Withdraw from the audit engagement where possible under applicable law or regulation; and
 - (ii) 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) As per SA-200 “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, in conducting an audit of financial statements, the overall objectives of the auditor are:
- (a) 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
 - (b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor’s findings.
3. (a) **The Nature of Audit Procedures:** There are practical and legal limitations on the auditor’s ability to obtain audit evidence. For example:
1. There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.
 2. Fraud may involve sophisticated and carefully organised schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
 3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.
- (b) In case of certain subject matters, limitations on the auditor’s ability to detect material misstatements are particularly significant. Such assertions or subject matters include:
- Fraud, particularly fraud involving senior management or collusion.
 - The existence and completeness of related party relationships and transactions.

- The occurrence of non-compliance with laws and regulations.
 - Future events or conditions that may cause an entity to cease to continue as a going concern.
4. (a) As per SA-300, "Planning an Audit of Financial Statements", the auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. **In establishing the overall audit strategy, the auditor shall:**
- (i) Identify the characteristics of the engagement that define its scope;
 - (ii) Ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required;
 - (iii) Consider the factors that, in the auditor's professional judgment, are significant in directing the engagement team's efforts;
 - (iv) Consider the results of preliminary engagement activities and, where applicable, whether knowledge gained on other engagements performed by the engagement partner for the entity is relevant; and
 - (v) Ascertain the nature, timing and extent of resources necessary to perform the engagement.
- (b) The auditor shall develop an audit plan that shall include a description of
- (a) The nature, timing and extent of planned risk assessment procedures, as determined under SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment".
 - (b) The nature, timing and extent of planned further audit procedures at the assertion level, as determined under SA 330 "The Auditor's Responses to Assessed Risks".
 - (c) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.
- The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.
5. In establishing the overall audit strategy, the auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required.

For Example:

- The entity's timetable for reporting, such as at interim and final stages.

- The organization of meetings with management and those charged with governance to discuss the nature, timing and extent of the audit work.
 - The discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, both written and oral, including the auditor's report, management letters and communications to those charged with governance.
 - The discussion with management regarding the expected communications on the status of audit work throughout the engagement.
6. (a) **Management from Whom Written Representations Requested:** SA-580, "Written Representations", the auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge of the matters concerned.

Written representations are requested from those responsible for the preparation and presentation of the financial statements. Those individuals may vary depending on the governance structure of the entity, and relevant law or regulation; however, management (rather than those charged with governance) is often the responsible party. Written representations may therefore be requested from the entity's chief executive officer and chief financial officer, or other equivalent persons in entities that do not use such titles. In some circumstances, however, other parties, such as those charged with governance, are also responsible for the preparation and presentation of the financial statements.

If management does not provide one or more of the requested written representations, the auditor shall-

- (i) discuss the matter with management;
- (ii) re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- (iii) take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

The auditor shall disclaim an opinion on the financial statements if management does not provide the written representations.

- (b) Audit Documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

The objective of the auditor is to prepare documentation that provides:

- (i) A sufficient and appropriate record of the basis for the auditor's report; and
- (ii) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Nature of Audit Documentation**Audit documentation provides:**

- (a) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and
 - (b) evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.
7. (a) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

- ◆ SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files.
- ◆ An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.
- ◆ Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature.

Examples of such changes include:

- Deleting or discarding superseded documentation.
- Sorting, collating and cross-referencing working papers.
- Signing off on completion checklists relating to the file assembly process.
- Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.
- ◆ After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.
- ◆ SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

- (b) **When information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes:**
- (a) Evaluate the competence, capabilities and objectivity of that expert;
 - (b) Obtain an understanding of the work of that expert; and
 - (c) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion.
8. SA 500 – "Audit Evidence", explains what constitutes audit evidence in an audit of financial statements, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

Audit evidence may be defined as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Explaining this further, audit evidence includes:

- (1) **Information contained in the accounting records: Accounting records include**
- the records of initial accounting entries and supporting records, such as checks and records of electronic fund transfers;
 - invoices;
 - contracts;
 - the general and subsidiary ledgers, journal entries and other adjustments to the financial statements that are not reflected in journal entries; and
 - records such as work sheets and spreadsheets supporting cost allocations, computations, reconciliations and disclosures.
- (2) **Other information that authenticates the accounting records and also supports the auditor's rationale behind the true and fair presentation of the financial statements:** Other information which the auditor may use as audit evidence includes, for example
- minutes of the meetings,
 - written confirmations from trade receivables and trade payables,
 - manuals containing details of internal control etc.

A combination of tests of accounting records and other information is generally used by the auditor to support his opinion on the financial statements.

9. (a) Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. This understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit, for example, when:
- ◆ Assessing risks of material misstatement of the financial statements;
 - ◆ Determining materiality in accordance with SA 320;
 - ◆ Considering the appropriateness of the selection and application of accounting policies;
 - ◆ Identifying areas where special audit consideration may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions;
 - ◆ Developing expectations for use when performing analytical procedures;
 - ◆ Evaluating the sufficiency and appropriateness of audit evidence obtained, such as the appropriateness of assumptions and of management's oral and written representations.
- (b) Analytical procedures performed as risk assessment procedures may identify aspects of the entity of which the auditor was unaware and may assist in assessing the risks of material misstatement in order to provide a basis for designing and implementing responses to the assessed risks. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information, for example, the relationship between sales and square footage of selling space or volume of goods sold.

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

However, when such analytical procedures use data aggregated at a high level (which may be the situation with analytical procedures performed as risk assessment procedures), the results of those analytical procedures only provide a broad initial indication about whether a material misstatement may exist. Accordingly, in such cases, consideration of other information that has been gathered when identifying the risks of material misstatement together with the results of such analytical procedures may assist the auditor in understanding and evaluating the results of the analytical procedures.

10. The risks of material misstatement may exist at two levels:
- (i) **The overall financial statement level** - Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
 - (ii) **The assertion level for classes of transactions, account balances, and disclosures** - Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.
11. **Techniques of fraud committed by Management:** Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:
- (1) Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives
 - (2) Inappropriately adjusting assumptions and changing judgments used to estimate account balances
 - (3) Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period
 - (4) Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements
 - (5) Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity
 - (6) Altering records and terms related to significant and unusual transactions.
12. **Problematic or unusual relationships between the auditor and management, including:**
- 1. Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.
 - 2. Undue time pressures imposed by management to resolve complex or contentious issues.
 - 3. Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.
 - 4. Unusual delays by the entity in providing requested information.

5. Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques.
 6. Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel.
 7. An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable.
 8. An unwillingness to address identified deficiencies in internal control on a timely basis.
 9. Unwillingness by management to permit the auditor to meet privately with those charged with governance
 10. Accounting Policy that appears to be variance with industry norms
 11. Frequent changes in accounting estimates that do not appear to result from changed circumstances
 12. Tolerance of variations in the entity's code of conduct
- 13. Relevance of Information Technology in an Audit:** When a business operates in a more automated environment it is likely that we will see several business functions and activities happening within the systems. Following are such types of functions and activities:
- (i) Computation and Calculations are automatically carried out (for example, bank interest computation and inventory valuation).
 - (ii) Accounting entries are posted automatically (for example, sub-ledger to GL postings is automatic).
 - (iii) Business policies and procedures, including internal controls, are applied automatically (for example, delegation of authority for journal approvals, customer credit limit checks are performed automatically).
 - (iv) Reports used in business are produced from systems. Management and other stakeholders rely on these reports and information produced (for example, debtors ageing report).
 - (v) User access and security are controlled by assigning system roles to users (**for example**, segregation of duties can be enforced effectively).
- 14. Understanding of the Company's Automated Environment:** 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)

15. As per SA 530, “Audit Sampling”, the auditor shall evaluate:

- (a) The results of the sample; and
- (b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:

- (I) Request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or
- (II) Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

16. The auditor is required to project misstatements for the population to obtain a broad view of the scale of misstatement but this projection may not be sufficient to determine an amount to be recorded.

- ◆ When a misstatement has been established as **an anomaly**, it may **be excluded** when projecting misstatements to the population. However, the effect of any such misstatement, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous misstatements.
- ◆ For tests of details, the auditor shall project misstatements found in the sample to the population whereas for tests of controls, **no explicit projection of deviations** is necessary since the sample deviation rate is also the projected deviation rate for the population as a whole.

17. Purpose of Applying Analytical Procedure: Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable.

The auditor of Flower Ltd. would achieve the following by carrying out the comparison stated in the question:

- (i) If balances included in the Statement of Profit and Loss of an entity are compared with those contained in the Statement of Profit and Loss with that of the previous

period, it would be possible to find out the reasons for increase or decrease in the amount of profits of those years.

- (ii) By setting up certain expenses' ratios on the basis of balances included in the Statement of Profit and Loss, for the year under audit, comparing them with the same ratios for the previous year, it is possible to ascertain the extent of increase or decrease in various items of expenditure in relation to sales and that of trading profit in relation to sales.
 - (iii) If differences are found to be material, the auditor would ascertain the reasons thereof and assess whether the accounts have been manipulated to inflate or suppress profits.
 - (iv) It would be possible to identify the existence of unusual transactions, amounts, ratios and trends that might indicate matters that have audit implications.
18. Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.
- ◆ The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary.
 - ◆ However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.
 - ◆ In some cases, even an unsophisticated predictive model may be effective as an analytical procedure.

Different types of analytical procedures provide different levels of assurance. Analytical procedures involving, for example, the prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details, provided the elements are appropriately verified. In contrast, calculation and comparison of gross margin percentages as a means of confirming a revenue figure may provide less persuasive evidence, but may provide useful corroboration if used in combination with other audit procedures.

The determination of the suitability of particular substantive analytical procedure is influenced by the nature of the assertion and the auditor's assessment of the risk of material misstatement. For example, if controls over sales order processing are weak, the auditor may place more reliance on tests of details rather than on substantive analytical procedures for assertions related to receivables.

Particular substantive analytical procedures may also be considered suitable when tests of details are performed on the same assertion. For example, when obtaining audit

evidence regarding the valuation assertion for accounts receivable balances, the auditor may apply analytical procedures to an aging of customers' accounts in addition to performing tests of details on subsequent cash receipts to determine the collectability of the receivables.

- 19. Examination – in depth of the payment made to creditor:** The Audit Assistant of M/s MP & Co., should verify the following documents of LMP Private Limited in case of payment to a creditor is to be verified “in depth”:
- (i) The invoice and statement of account received from the supplier.
 - (ii) The entry in the inventory record showing that the goods were received.
 - (iii) The Goods Received Note and Inspection Certificate showing that the goods on receipt were verified and inspected.
 - (iv) The copy of the original order and authority showing that the goods in fact were ordered by an authority which was competent to do so.
- 20. (a) Verification of Hire-purchase transactions:** While checking the hire-purchase transaction, the auditor may examine the following:
1. Hire purchase agreement is in writing and is signed by all parties.
 2. Hire purchase agreement specifies clearly -
 - (i) The hire-purchase price of the goods to which the agreement relates;
 - (ii) The cash price of the goods, that is to say, the price at which the goods may be purchased by the hirer for cash;
 - (iii) The date on which the agreement shall be deemed to have commenced;
 - (iv) The number of instalments by which the hire-purchase price is to be paid, the amount of each of those instalments, and the date, or the mode of determining the date, upon which it is payable, and the person to whom and the place where it is payable; and
 - (v) The goods to which the agreement relates, in a manner sufficient to identify them.
 3. Ensure that payments are being received regularly as per the agreement.
- (b) Cut-off Arrangement:**
1. Accounting is a continuous process because the business never comes to halt. It is, therefore, necessary that transactions of one period would be separated from those in the ensuing period so that the results of the working of each period can be correctly ascertained. The arrangement that is made for this purpose is technically known as “cut-off arrangement”.
 2. It essentially forms part of the internal control system of the organisation.

3. Accounts, other than sales, purchase and inventory are not usually affected by the continuity of the business and therefore, this arrangement is generally applied only to sales, purchase and inventory.
4. The auditor satisfies by examination and test-checks that the cut-off procedures are adequately followed and ensure that:
 - (i) Goods purchased, property in which has already been passed on to the client, have in fact been included in the inventories and that the liability has been provided for in case credit purchase.
 - (ii) Goods sold have been excluded from the inventories and credit has been taken for the sales. If the value of sales is to be received, the concerned party has been debited.
5. The auditor may examine a sample of documents, evidencing the movement of inventory into and out of stores, including documents pertaining to period shortly before and after the cut-off date and check whether inventories represented by those documents were included or excluded as appropriate during inventory taking for perfect and correct presentation in the financial statements.

21. (i) **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.

- (ii) **Appointment of Subsequent Auditor of a Government Company:** As per Section 139(5) of the Companies Act, 2013, 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 Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.

Appointment of Subsequent Auditor of a Non-Government Company: As per section 139(1) of the Companies Act, 2013, every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

22. Rule 11 of the Companies (Audit and Auditors) Rules, 2014 prescribes the other matters to be included in auditor's report. The auditor's report shall also include their views and comments on the following matters, namely:
- (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 (1) and (2) contain any material misstatement.
- (v) Whether the dividend declared or paid during the year by the company is in compliance with section 123 of the Companies Act, 2013.
- (vi) Whether the company has used such accounting software for maintaining its books of account which has a feature of recording audit trail (edit log) facility and the same has been operated throughout the year for all transactions recorded in the software and the audit trail feature has not been tampered with and the audit trail has been preserved by the company as per the statutory requirements for record retention

23. As per clause (xii) of CARO, 2020, the following matters are required to be included in the auditor's report relating to Nidhi Company

- (a) whether the Nidhi Company has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability;
- (b) whether the Nidhi Company is maintaining ten per cent. unencumbered term deposits as specified in the Nidhi Rules, 2014 to meet out the liability;
- (c) whether there has been any default in payment of interest on deposits or repayment thereof for any period and if so, the details thereof;

As per clause (xiii) of CARO, 2020, the following matter is required to be included in the auditor's report relating to transactions with the related parties:

whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act where applicable and the details have been disclosed in the financial statements, etc., as required by the applicable accounting standards;

24. As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not:

- (i) A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- (ii) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report";

- (iii) A substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- (iv) A separate opinion on individual matters.

25. An auditor should state in “Basis for Opinion” section of Auditor’s Report as under:

Basis for Opinion:

The auditor’s report shall include a section, directly following the Opinion section, with the heading “**Basis for Opinion**”, that:

- (i) States that the audit was conducted in accordance with Standards on Auditing;
- (ii) Refers to the section of the auditor’s report that describes the auditor’s responsibilities under the SAs;
- (iii) Includes a statement that the 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.
- (iv) 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.

Amendments an Auditor should make:

When the auditor modifies the opinion on the financial statements, the auditor shall, in addition to the specific elements required by SA 700 (Revised):

- (i) Amend the heading “Basis for Opinion” required by para of SA 700 (Revised) to “Basis for Qualified Opinion,” “Basis for Adverse Opinion,” or “Basis for Disclaimer of Opinion,” as appropriate; and
- (ii) Within this section, include a description of the matter giving rise to the modification.

26. Verification of Advances: Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:

- (i) Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
- (ii) Advances represent amount due to the bank.
- (iii) Amounts due to the bank are appropriately supported by Loan documents and other documents as applicable to the nature of advances.
- (iv) The stated basis of valuation of advances is appropriate and properly applied, and that the recoverability of advances is recognised in their valuation.

- (v) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
- (vi) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.
- (vii) There are no unrecorded advances.

27. The calculation of DP is as under:

Value of stocks as on 30.6.23	₹ 5.00 crore
Less: value of damaged stocks	₹ 1.00 crore
Value of stocks considered as on 30.6.23	₹ 4.00 crore
Less: Trade creditors	₹ 2.00 crore
Paid stocks	₹ 2.00 crore
Less: Margin @ 25%	₹ 0.50 crore
Drawing power for stocks [A]	₹ 1.50 crore
Value of Trade debtors	₹ 3.00 crore
Less: Debtors outstanding for more than 90 days	₹ 0.50 crore
	₹ 2.50 crore
Less: Margin @ 40%	₹ 1.00 crore
Drawing power for Book debts [B]	₹ 1.50 crore
Total drawing power [A+ B]	₹ 3.00 crore

Accountant's DP calculation is not correct. The drawing power of ₹ 3.00 crore signifies that company can utilize funds to the tune of ₹3.00 crore only against sanctioned cash credit limit of ₹ 4.00 crore.

28. (a) **Exceptions to the rule – Audit Against Propriety:** Public moneys should not be utilised for the benefit of a particular person or section of the community unless:
- the amount of expenditure involved is insignificant; or
 - a claim for the amount could be enforced in a Court of law; or
 - the expenditure is in pursuance of a recognised policy or custom; and
 - the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.
- (b) **Advantages of Audit of Accounts of a Partnership:** On broad considerations, the advantages of audit of accounts of a partnership could be stated as follows:
- Audited accounts provide a convenient and reliable means of settling accounts between the partners and, thereby, the possibility of occurrence of a dispute

among them is mitigated. On this consideration, it is usually provided in and accepted by the partners, shall be binding upon them, unless some manifest error is brought to light within a specified period subsequent to the accounts having been signed.

- (2) On the retirement or death of a partner, audited accounts, which have been accepted by the partners, constitute a reliable evidence for computing the amounts due to the retiring partner or to the representative of the deceased partner in respect of his share of capital, profits and goodwill.
- (3) The accounts of a partnership, which have been audited, are generally accepted by the Income Tax Department as the basis for computing the assessable income of the partners.
- (4) Audited statement of accounts are relied upon by the banks when advancing loans, as well as by prospective purchasers of the business, as evidence of the profitability of the concern and its financial position.
- (5) Audited statements of account can be helpful in the negotiations to admit a person as a partner, especially when they are available for a number of past years.
- (6) An audit is an effective safeguard against any undue advantage being taken by a working partner or partners especially in the case of those partners who are not actively associated with the working of the firm.