



## PAPER – 5: AUDITING AND ETHICS

---



### QUESTIONS

#### **PART – I: Multiple Choice Questions based on Case Scenarios**

##### **Case Scenario**

Pluto Limited is engaged in the manufacturing and distribution of furniture. After Covid, as the number of people working from home has gone up, this customisable range home office furniture has gained lot of importance. They were able to perform very well over the years and the same has been reflected in their financial statements.

During the year 2023-24, M/s Saha and Associates was reappointed as the auditor. The new engagement team has CA Saha (partner) and five article assistants. Given the large volume of transactions, the partner instructed the article assistants to review the financial statements and auditor's report from the previous year, 2022-23, to gain a thorough understanding.

While reviewing the summary page, one of the article Kabir noticed that few points were under discussion with the partner before finalising the audit:

The team verified the following points with respect to employee benefit expenses:

- The employee benefit expenses recorded in the books were actually incurred during the relevant period.
- The expenses in respect of all personnel have been accounted for.
- The expenses recognised during the period are pertaining to the current accounting period.

It was also noted that dividend to equity shareholders for the year 2022-23, was declared on 15.04.2023 and was recognised as liability in the year 2022-23.

Another article Krish noticed that debtors constitute a major component of the company's financial statements. As part of audit procedure, the auditor requested the client to obtain external confirmations from the parties. For this, a list of all the debtors were obtained and a random sampling was performed by the auditor. The client directly obtained the selected debtor confirmations from the customers on time.

Krish also observed addition in the assets amounting ₹ 50 lakhs during the year supported by sufficient audit evidence. However, upon scrutiny, it was found that some of the invoices were not in the name of the company. Further, Cash and cash equivalents were classified as balances with banks, cheques and drafts on hand, cash on hand and earmarked balances with banks (e.g. unpaid dividend)

Based on above, answer the following questions: -

1. Which among the following assertions are discussed with respect to the employee benefit expenses?
  - (i) Measurement
  - (ii) Occurrence
  - (iii) Cutoff
  - (iv) Completeness

Choose the correct combination from below:

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

2. Whether disclosure of dividend under the liability head during the year 2022-23 is appropriate?
- (a) Yes. It should be recognised in the same year irrespective of the year of declaration as the amount of dividend belongs to year 2022-23.
  - (b) No. The amount should be recognised equally between two financial years.
  - (c) No. The amount should not be recognised as a liability. It should be disclosed in the notes to accounts.
  - (d) No. The amount should neither be recognised as liability nor disclosure is required in the financial statements.
3. Krish pointed out that that the method followed to obtain debtor confirmation in the previous year was not in accordance with SA 505. Therefore, M/s Saha & Associated should reperform the same in the correct manner.
- (a) As per SA 505, confirmation should be directly obtained by the auditor. Further, for all significant account balances as on the Balance sheet date confirmations should necessarily be collected and for the smaller outstanding balances, random sampling could be performed.
  - (b) It is ok to obtain confirmation through clients as they are in constant contact with their customers. Also, many customers may not respond to auditor's external confirmation request mail. Random selection can be done for all debtors irrespective of the amount in accordance with SA 505.
  - (c) As per SA 505, confirmation should be directly obtained by the auditor. Whereas random selection can be done for all debtors irrespective of the amount.
  - (d) Either auditor or client can obtain confirmation based on time availability. However, it is necessary to obtain confirmation for all significant account balances as on the Balance sheet date and for the remaining random sampling could be performed in accordance with SA 505.

4. Which assertion has been affected in the case of fixed assets?
- (a) Existence
  - (b) Rights and obligation
  - (c) Completeness
  - (d) Measurement
5. Cash and cash equivalents were not properly classified by the client. Which of the following is incorrect disclosure of the same?
- (a) Balances with banks
  - (b) Cheques and drafts on hand
  - (c) Cash on hand
  - (d) Earmarked balances with banks (e.g.: unpaid dividend)

**General MCQs**

6. CA Chatur provides accounting and book keeping services to Shiv Ganga Limited. He is also offered an audit of the accounts to the Shiv Ganga Limited. Which threat to independence may be involved in accepting such an engagement.
- (a) Self-interest threats
  - (b) Self-review threats
  - (c) Familiarity threats
  - (d) Advocacy threats
7. CA Sargun is conducting statutory audit of branch of KBC Bank. During the course of audit, it is noticed that one borrower has availed a housing loan and a car loan from the branch. Housing loan EMIs are overdue for 120 days as on date of Balance sheet. Car loan EMIs are overdue for 60 days as on date of Balance sheet. Which of the following statements is appropriate?
- (a) Housing Loan should be classified as "Non-Performing Asset" in accordance with RBI norms on asset classification. However, Car loan should be classified as Standard asset.

- (b) Car Loan should be classified as "Non-Performing Asset" in accordance with RBI norms on asset classification. However, Housing Loan should be classified as Standard asset.
  - (c) Both Housing loan as well as car loan should be classified as "Non-Performing Assets" in accordance with RBI norms on asset classification.
  - (d) Both Housing as well as car loans should be classified as Standard assets.
8. Sagar Finance Corporation Limited is a government company. The audit of the company is conducted by statutory auditors appointed by Comptroller and Auditor General of India (C&AG). Who is empowered to conduct "supplementary audit" of Sagar Finance Corporation Ltd.?
- (a) Central Government
  - (b) C&AG
  - (c) Another independent auditor appointed by C&AG
  - (d) Another independent auditor appointed by Ministry of Corporate Affairs

## PART II – Descriptive Questions

### Chapter 1 - Nature, Objective and Scope of Audit

9. Kriti, a CA student, has joined articles in a reputed audit firm. She considers audit engagement to be an "assurance engagement". Her understanding is that audit engagement is the only kind of assurance engagement in which practitioner gives a written assurance report in appropriate form. However, her friend Somaya, does not agree with her. She is of the view that assurance engagements are not restricted to audit alone. Besides, Somaya also thinks that assurance engagements can also relate to matters other than historical financial information. Whose view appears to be correct? State with reasons.

### Chapter 2 - Audit Strategy, Audit Planning and Audit Programme

10. CA N, engagement partner of LPS & Associates, is planning for audit of a large company. As part of preliminary engagement activities being performed in this regard, he wants to ensure that compliance with

independence requirements is adhered. How shall he form a conclusion that audit firm complies with independence requirements?

### Chapter 3 – Risk Assessment and Internal Control

11. Companies are increasingly using data analytics for managing their operations. Auditors can also obtain good results by using data analytics. What are the tools and techniques used by auditors in applying the principles of Data Analytics and in which areas data analytics can be used by auditors?

### Chapter 4 – Audit Evidence

12. Quality Products Limited is engaged in manufacturing of bicycles. As part of manufacturing activities, it sends raw material to some business entities and procures finished components from them. As on 31<sup>st</sup> March 2024 inventories lying with such business entities are material. Being statutory auditor of Quality Products Limited, how you will obtain sufficient appropriate audit evidence regarding existence and condition of inventories lying with such business entities?

### Chapter 5 - Audit of Items of Financial Statements

13. The financial statements of XYZ Limited show long-term borrowings from the banks, financial institutions, leasing, and hire purchase companies. Additionally, the company has issued debentures to its 1000 members to raise funds in accordance with the provisions of the Companies Act, 2013. The money raised by issuing debentures is also reflected in long-term borrowings. As the statutory auditor of XYZ Limited, CA X wants to verify that all borrowings on the balance sheet represent valid claims by banks or other third parties. Suggest a few audit procedures in this regard.

### Chapter 6 – Audit Documentation

14. An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgment exercised in performing the work and evaluating the results. Explain stating clearly the examples of significant matters.

**Chapter 7 – Completion and Review**

15. CA Manoj is the statutory auditor of a company. He has completed the audit and issued the audit report dated June 30, 2024. Before signing the audit report, written representations dated June 29, 2024, were obtained from the management of the company. Discuss the significance of the date of written representations. Also state whether the written representations obtained on June 29, 2024 is appropriate or not.
16. While conducting audit of BYN Limited, CA Y notices that company has lost one of its key markets along with important customers. Additionally, several highly successful competitors have emerged, impacting business of the company. Despite the existence of material uncertainty, CA Y finds the use of going concern basis of accounting appropriate for preparation of financial statements. The company has also disclosed material uncertainty in notes to accounts adequately. How should he deal with the matter in auditor's report?

**Chapter 8 – Audit Report**

17. Discuss the reporting requirements as per CARO, 2020, regarding:
  - (i) Statutory Dues and
  - (ii) Transactions with Related Parties

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

18. Section 77 of Multi-State Cooperative Societies Act, 2002 states that the Central Government may at any time by order direct that a special audit of the Multi-State Co-Operative Society's accounts for such period or periods as may be specified in the order, shall be conducted. Further, it may by the same or a different order appoint either a Chartered Accountant or the Multi-State Co-Operative Society's auditor himself to conduct special audit. Under which circumstances such power can be exercised by the Central Government?

**Chapter 10 – Audit of Banks**

19. Compute the Drawing Power for Cash Credit A/c of Kirpa Limited for the month of March 2024 with following information:

	(Amount in ₹)
Stock	60,000
Debtors	55,000
(Including Debtor of ₹ 15,000 for an invoice dated 20.10.2023)	
Sundry creditors	10,000
Sanctioned Limit	48,000

Margin on stock is 30% and on debtors is 40%.

*Note: Debtors older than 3 months are ineligible for calculation of DP.*

### Chapter 11 – Ethics and Terms of Audit Engagements

20. ABC & Associates, an audit firm, has been approached by a prospective company client that has been in business for about 10 years to conduct an audit of its financial statements. Before accepting the audit engagement, the firm wants to access the integrity of prospective client. With regard to the assessment of integrity, which matters should be considered by the audit firm?



### SUGGESTED ANSWERS/HINTS

#### PART – I: Answers to Multiple Choice Questions

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



**PART – II: Answers to Descriptive Questions**

9. Audit engagement is an assurance engagement. However, assurance engagements are not restricted to auditing alone. There are other assurance engagements too like review engagements, engagements providing assurance involving prospective financial information, engagements providing assurance on internal controls in an entity. Assurance engagements provide assurance to users. The difference is of degree. Whereas an audit provides reasonable assurance which is a high level of assurance, review provides lower level of assurance as compared to audit.

There are also assurance engagements which relate to matters other than historical financial information like providing assurance on matters involving prospective financial information and providing assurance on internal controls in an entity. In assurance reports involving prospective financial information, the practitioner obtains sufficient appropriate evidence to the effect that management's assumptions on which the prospective financial information is based are not unreasonable, the prospective financial information is properly prepared on the basis of the assumptions, and it is properly presented, and all material assumptions are adequately disclosed.

In the given case, Kriti is of the view that audit engagement is the only kind of assurance engagement in which practitioner gives a written assurance report in appropriate form whereas is of the view that assurance engagements are not restricted to audit alone. Thus, view of Somaya is correct.

10. The engagement partner, CA N shall form a conclusion on compliance with independence requirements that apply to the audit engagement. In doing so, CA N shall: -
- (i) Obtain relevant information from the firm to identify and evaluate circumstances and relationships that create threats to independence
  - (ii) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement and

- (iii) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.
- 11.** The tools and techniques that auditors use in applying principles of data analytics are known as Computer Assisted Auditing Techniques (CAATs). Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the following: -
- Check completeness of data and population that is used in either test of controls or substantive audit tests.
  - Selection of audit samples – random sampling, systematic sampling.
  - Re-computation of balances – reconstruction of trial balance from transaction data.
  - Reperformance of mathematical calculations – depreciation, bank interest calculation.
  - Analysis of journal entries Fraud investigation.
  - Evaluating impact of control deficiencies.
- 12.** In accordance with requirements of SA 501, "Audit Evidence- Specific Considerations for Selected Items", when inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:
- (a) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.
  - (b) Perform inspection or other audit procedures appropriate in the circumstances.

Other audit procedure may include –

- Inspecting documentation regarding inventory held by third parties
- Requesting confirmation from other parties when inventory has been pledged as collateral.
- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
- Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.

**13.** The audit procedures required to be undertaken by CA X while auditing borrowings is as follows:

- Review board minutes for approval of new lending agreements. During review, ensure that new loan agreements or bond issuances were authorized. Ensure that significant debt commitments are approved by the board of directors.
- Check the details of loans recorded (interest rate, nature and repayment terms) to the loan agreement. Verify that borrowing limits, if any, imposed by the agreements are not exceeded.
- Roll out and obtain independent balance confirmations (SA 505) in respect of all the borrowings from the lender (banks/ financial institutions etc.).
- Verify the details of leases and hire purchase creditors recorded to underlying contracts/agreements.
- In case of Debentures, examine trust deed for terms and dates of redemption, borrowing restrictions and compliance with covenants.
- When debt is retired, ensure that a discharge is received on assets securing the debt.
- Obtain Written Representation that all the liabilities which have been recorded represent a valid claim by the lenders.

- 14.** As per SA 230, "Audit documentation" judging the significance of a matter requires an objective analysis of the facts and circumstances.

Examples of significant matters include:

- Matters that give rise to significant risks.
- Results of audit procedures indicating (a) that the financial statements could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
- Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
- Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter Paragraph in the auditor's report.

An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgement exercised in performing the work and evaluating the results.

Documentation of the professional judgements made, where significant, explains the auditor's conclusions and reinforces the quality of the judgement.

Such matters are of particular interest to those responsible for reviewing audit documentation, including those carrying out subsequent audits, when reviewing matters of continuing significance (for example, when performing a retrospective review of accounting estimates).

- 15.** As per SA 580, "Written Representations" the date of the written representations shall be as near as practicable to, but not after, the date of the auditor's report on the financial statements.

Since written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated before the date of the written representations. Furthermore, because the auditor must consider events occurring up to the date of the auditor's report that might require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable

to, but not after, the date of the auditor's report on the financial statements.

In the given situation, CA Manoj obtained written representations dated June 29, 2024, from the management of the company before signing the audit report on June 30, 2024.

From the above it can be concluded that written representations have been obtained appropriately.

- 16.** As per SA 570, "Going concern", If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to: -
- (a) Draw attention to the note in the financial statements that discloses such matters.
  - (b) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.
- 17. (i) Reporting under CARO, 2020 regarding statutory Dues [Para 3(vii)]**
- (a) whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;
  - (b) where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending

shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute);

**(ii) Reporting under CARO,2020 regarding transactions with related parties [Para 3(xiii)]**

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.

**18. The Central government has power to order special audit of Multi-State Cooperative Society's Accounts where it is of the opinion: -**

- (a) that the affairs of any multi-state co-operative society are not being managed in accordance with self-help and mutual deed and co-operative principles or prudent commercial practices or with sound business principles or
- (b) that any multi-state co-operative society is being managed in a manner likely to cause serious injury or damage to the interests of the trade industry or business to which it pertains or
- (c) that the financial position of any multi-state co-operative society is such as to endanger its solvency.

**19. Computation of Drawing Power (DP) for CC A/c of Kirpa Ltd.**

Particulars of current assets		Amount (₹)	DP Amt (₹)
(A) Stocks:			
Stocks at realizable value		60,000	
Less: Unpaid stocks:			
- Sundry creditors	10,000	<u>10,000</u>	
Paid for stocks		50,000	
Margin @ 30%		<u>15,000</u>	35,000
(B) Debtors:			
Total Debtors		55,000	
Less: Ineligible debtors		<u>15,000</u>	

Eligible debtors		40000	
Margin @ 40%		<u>16,000</u>	<u>16,000</u>
Total Drawing Power			51,000

The sanctioned limit given in the question is ₹ 48,000 whereas drawing power as per the above working is ₹ 51,000. So, drawing power would be restricted to sanctioned limit i.e., ₹ 48,000/-.

**20.** With regard to the integrity of a client, matters that ABC & Associates should consider include, for example:

- The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.