



Ch-1 Nature, Objective and Scope of Audit + SA 210 + SQC-1/SA 220

1. M Motors Ltd is a leading Indian automobile manufacturer with many offerings across commercial, passenger and electric vehicles. The Company is pioneering India's electric vehicle transition and enjoys considerable advantage in one of the fastest growing automotive markets.

GR & Associates have been appointed as its statutory auditors for financial year 2022-23. J and K are newly appointed audit assistants in the firm and are part of engagement team constituted for purpose of audit of M Motors Ltd. However, they are confused about what such an audit tends to achieve. They perceive audit as a guarantee against possible errors or frauds in financial statements.

Do you agree with perception of both the assistants? In this context, outline objectives of an independent audit conducted in accordance with Standards on Auditing.

In conducting audit of FS, objectives of auditor as per SA-200 OOIACASA are: -

- a) To obtain **reasonable assurance** whether FS are free from material misstatement, whether due to fraud/error, enabling auditor to **express opinion** on whether FS are prepared, in all material respects, as per applicable FRF &
- b) To **report** on FS, & communicate as required by SAs, as per auditor's findings.

Analysis of above brings out following points clearly: -

(1) Auditor's objective is to **obtain a reasonable assurance** whether FS as a whole are free from material misstatement whether due to fraud or error. Reasonable assurance is to be **distinguished from absolute assurance**. Absolute assurance is a **complete assurance or guarantee** that FS are free from material misstatements. Reasonable assurance is not a complete guarantee. Although it's a **high-level of assurance** but it is not complete assurance.

Audit of FS is carried out by the auditor with professional competence and skills as per SA. Audit procedures are applied as per SAs, audit evidence is obtained and evaluated. On the basis of that, conclusions are drawn and opinion is formed. It leads to high level of assurance which is called as reasonable assurance but it is not absolute assurance.

(2) **Misstatements** in FS can occur due to fraud or error or both. Auditor seeks to obtain reasonable assurance whether FS as a whole are free from material misstatements caused by fraud/error. He has to **see effect** of misstatements on FS as a whole, in totality.

(3) Obtaining reasonable assurance that FS are free from material misstatements enables auditor to express **opinion** on whether FS are prepared, in all material respects, as per applicable FRF.

(4) Opinion is **reported & communicated** as per audit findings through a **written report** as required by SA.

Therefore, **perception of both assistants is not proper**. Auditor of FS **doesn't seek to provide guarantee** that FS are free from material misstatements caused by frauds or errors. He **obtains reasonable assurance**.

2. Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information." Explain in detail giving examples.

Standards on Auditing (SAs) apply in "**audit** of historical financial information" whereas Standards on Review Engagements (SREs) apply in "**review** of historical financial information".



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- ✓ Standards on auditing apply in “audit” of historical financial info. which is a reasonable assurance engg. whereas Standards on Review Engagements apply in “review” of historical financial info. which is a limited assurance engg..
- ✓ “Historical financial info. means” info. expressed in financial terms in relation to a particular entity, derived from entity’s accounting system, about economic events occurring in past time periods or economic conditions or circumstances at points in time in the past.
- ✓ Here, we have to broadly understand that “audit” and “review” are two different terms.
- ✓ Audit is a reasonable assurance engg, & objective is reduction in assurance engg risk to an acceptably low level.
- ✓ However, “review” is a limited assurance engg, & its objective is a reduction in assurance engg risk to a level that is acceptable in circumstances of engg.
- ✓ SA have been issued on wide spectrum of issues in the field of auditing including (but not limited to) overall objectives of independent auditor, audit documentation, planning an audit of financial statements, identifying and assessing risk of material misstatement, audit evidence, audit sampling, going concern and forming an opinion and reporting on financial statements.

Some examples of Standards on Auditing are :

- i) SA 200 OOIACASA
- ii) SA 230 Audit Documentation
- iii) SA 315 Identifying & Assessing RoMM through Understanding Entity & its Environment
- iv) SA 500 Audit Evidence
- v) Revised SA 700 Forming an Opinion and Reporting on Financial Statements

Examples of Standards on Review engagements are

- (i) SRE 2400 (Revised) Engagements to Review Historical Financial Statements
- (ii) SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity

3. CA X has been offered audit of financial statements of TDK Industries, a partnership firm. Prior to accepting proposed offer, he insists upon obtaining an agreement of management regarding acknowledgment of its responsibility of having a proper process in place to ensure that financial statements prepared are free from material misstatements. However, management is of the view that it is auditor’s duty to detect material misstatements in financial statements and such an insistence by auditor is totally uncalled for. Whose view is proper? Also discuss reasons for arriving at your conclusion. What should be likely proper course of action for CA X in above situation?

SA 210 deals with auditor’s responsibilities in agreeing terms of audit engg. with mgt & TCWG. This includes establishing certain preconditions for audit, responsibility for which rests with mgt & TCWG are present.

Objective of auditor is to accept or continue an audit engg only when basis upon which it is to be performed has been agreed, through:

- (A) Establishing whether preconditions for audit are present and
- (B) Confirming that there is a common understanding between auditor and mgt & TCWG of terms of audit engg.

One of preconditions to obtain agreement of mgt that it acknowledges & understands responsibility for preparation of FS & internal control necessary to enable preparation of FS free from material misstatements.

In given situation, CA X is insisting only upon obtaining agreement of management regarding acknowledgment of its responsibility for internal control to enable preparation of FS free from material misstatements as per SA 210.



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Design, implementation and maintenance of internal control to ensure preparation of reliable FS free from material misstatements is mgt's responsibility. He is insisting on obtaining agreement of management regarding acknowledgment of its responsibility.

Therefore, CA X's view is proper. In case mgt doesn't provide such agreement acknowledging its responsibility, auditor shall not accept proposed audit engg unless required by law or regulation.

4. "SA 220 is premised on the basis that the firm is subject to SQC 1". What do you understand by given statement in context of audit quality?

Audit quality is essential to maintain confidence in independent assurance provided by auditors. It is responsibility of auditor to maintain high audit quality.

SQC 1 & SA 220 both deal with quality control.

SQC 1 applies to entire firm. However, SA 220 applies to a particular audit engg.

Based upon quality control system of firm established as per SQC 1, quality control policies pertaining to audit engg are decided by engg teams.

Engg. partner is responsible for quality control procedures of a particular audit engg as per SA 220.

Therefore, SA 220 is premised on basis that firm is subject to SQC 1. Within context of firm's system of quality control, engagement teams have a responsibility to implement quality control procedures applicable to audit engg.

Ch-2 Audit Strategy, Audit Planning and Audit Programme

1. Preliminary engagement activities include certain activities to be performed by an auditor while planning an audit. Discuss such activities briefly. How performing such activities assists an auditor?

Preliminary engagement activities include following activities: -

- Performing procedures regarding the continuance of the client relationship
- Evaluating compliance with ethical requirements, including independence
- Establishing an understanding of terms of engagement

Performing preliminary engg. activities assists auditor in identifying & evaluating events or circumstances that may affect auditor's ability to plan & perform audit engg.

2. The assistant of CA K is assigned responsibility of drafting "audit programme" relating to purchases appearing in financial statements of "Broad Industries", a partnership firm. The said firm is a GST registered tax payer and is engaged in manufacturing of packing boxes from a special type of paper taxable under GST. Help him by drafting a sample audit programme for purchases.

Name of Concern : Broad Industries

Financial Year : 20XX-XX

Prepared by : Name of person with date

Reviewed by : Name of person with date

Approved by : Name of person with date

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S No.	Nature of procedure	Extent of check	Basis of sample	Done by
a)	Vouch few purchase invoices of paper from purchase records of concern.			
b)	Trace these invoices into account books of concern.			
c)	Verify few purchase invoices of paper on GST portal.			
d)	Trace few purchase invoices of paper in stock records to ensure that these have been added to stocks of raw material.			

Ch-3 Audit Documentation

1. Rajni, a CA student, has understood that SA 230 requires auditor to prepare audit documentation on a timely basis. While reading about SQC 1, she notices that time limit for completion of final audit file is ordinarily not more than 60 days after the date of auditor's report. She finds it to be puzzling. Unable to comprehend, she seeks your guidance. Guide her.

SA 230 requires auditor shall prepare audit documentation on a timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance quality of audit & facilitates effective review & evaluation of audit evidence obtained & conclusions reached before auditor's report is finalized.

SQC 1, however, requires auditor to complete assembly of final audit file in ordinarily not more than 60 days after date of auditor's report.

Completion of the assembly of final audit file after date of the auditor's report is only administrative process that does not involve performance of new audit procedures or drawing of new conclusions.

Therefore, auditor shall prepare documentation on timely basis. However, completion of assembly of final audit file which is an administrative process, time period of 60 days after date of auditor's report has been required in SQC 1.

2. Discussing meaning of completion memorandum, elaborate upon its importance.

Completion memorandum is a summary that describes significant matters identified during audit & how they were addressed.

- Such a summary may facilitate effective & efficient review & inspection of audit documentation, particularly for large and complex audits.
- Further, preparation of such a summary may assist auditor's consideration of significant matters.
- It may also help auditor to consider whether there is any individual relevant SA objective that auditor cannot achieve that would prevent auditor from achieving overall objectives of auditor.

Ch-4 RAIC

Satrange Foods Private Limited is engaged in manufacturing of pickles. The auditors of the company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that misstatements in revenue recognition are not identified by planned audit procedures. Identify and explain that particular risk in detail.



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There is a possibility that planned audit procedures may not achieve desired result and fail to detect misstatements in revenue recognition. Such a risk is referred to as “**detection risk**”.

SA 200 defines detection risk as risk that **procedures performed** by auditor to reduce audit risk to an acceptably low level will **not detect a misstatement** that exists & that could be material, either individually or when aggregated with other misstatements.

For eg, auditor of a Co. uses certain audit procedures for the purpose of obtaining audit evidence & reducing audit risk, but still there will remain a risk that audit procedures used by the auditor may not be able to detect a misstatement which by nature is material, then that risk is known as detection Risk.

Detection risk comprises sampling and non-sampling risk.

(a) Sampling risk is risk that **auditor's conclusion** based on a **sample may be different from conclusion** if entire **population** were subjected to same audit procedure. It simply means that the **sample was not representative of population** from which it was chosen.

(b) Non-sampling risk is the risk that the auditor reaches an **erroneous conclusion** for any **reason not related to sampling risk**. Like an auditor may reach an erroneous conclusion due to application to some **inappropriate audit procedure**.

Ch-9 SA 550/560/570/580

1. CA K is statutory auditor of DEMA Private Limited for the year 2022-23. The company has three plants in India. He is nearing completion of audit procedures relating to financial statements for the year under audit and has yet to sign audit report. Meanwhile, a huge fire had broken out in one of plants of the company located near Nashik on 25th June, 2023 damaging substantial part of machinery and work-in-process resulting in loss of about ₹ 5 crores. Unaware of the incident, he is in process of finalizing his report in first fortnight of July 2023. State few audit procedures to be performed by him to obtain sufficient appropriate evidence for identifying such events. Also explain auditor's responsibilities in this situation.

In given situation, a huge fire had broken out in one of plants of company on 25.6.23 destroying substantial part of machinery & work-in-process resulting in loss of ₹ 5 crores.

Before signing audit report, he should perform following audit procedures to obtain SAAE that all such events have been identified and are appropriately reflected in FS: -

- **Inquiry** of mgt whether any subsequent events have occurred
- **Reading minutes of meetings** of owners, mgt held after date of FS & inquiring about matters discussed at such meetings for which minutes not available
- Reading entity's latest **subsequent interim FS**
- Obtaining **Written representations** from mgt as per SA 580

Situation is **eg of subsequent event** occurring between date of FS & date of audit report **requiring disclosure** in FS. Auditor has to obtain SAAE whether such event requiring disclosure in FS is appropriately reflected in FS.

2. Kundan, a CA student, is part of an engagement team conducting audit of an entity. The audit procedures are nearing completion. He notices that engagement partner has asked for a cash flow forecast from management for next twelve months from date of financial statements. Keeping in view above, answer the following: -

- i) Discuss likely purpose of engagement partner in the above situation. Elaborate upon significance of such testing being performed by engagement partner.



ii) State any two audit procedures in relation to cash flow forecast likely to be performed by engagement partner.

i) In given situation, Engg. partner has asked for a cash flow forecast from mgt for next 12 months from date of FS. Audit procedures are also nearing completion.

Therefore, purpose of engg partner in requiring a cash flow forecast is to obtain SAAE and conclude on appropriateness of mgt's use of going concern basis of accounting in preparation of its FS.

Further, his purpose is also to conclude on basis of audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast a significant doubt on ability to entity to continue as a going concern, and report as per SA 570.

Significance of testing going concern assumption is due to its effect on preparation of FS. When use of going concern is considered as appropriate, assets & liabilities are recorded on basis that entity will be able to realize its assets & discharge liabilities in normal course of business.

Otherwise, FS are prepared on liquidation basis.

Hence, testing such assumption provides evidence to auditor whether use of such assumption is appropriate or not.

ii) 2 audit procedures in relation to cash flow forecast likely to be performed

- Evaluate reliability of underlying data generated to prepare the forecast
- Determine whether there is adequate support for assumptions underlying the forecast

Ch-12 Audit Report

1. CA. S, while conducting audit of an entity is facing the following issues: -

- i. He has not been provided with necessary support for attending inventory count process of entity as at year end.
- ii. Accounts Manager is not providing him present addresses of customers as well as suppliers for sending external confirmations. Even mail ids have not been provided on the pretext of business confidentiality.
- iii. He was not able to verify revenues of entity due to lack of complete details.
- iv. He has been asking for bills on a sample basis for the purpose of verifying expenses, but staff has been making lame excuses.

The matter was brought to knowledge of higher management, but of no avail. The auditor, CA S has come to the conclusion that the possible effects on the financial statements of undetected misstatements would be material and affecting many aspects of financial statements and in such a case, a qualification of the opinion would be inadequate to communicate the gravity of the situation.

How should the auditor proceed in such a situation?

In given case, auditor has not been able to obtain SAAE relating to inventories, debtors, creditors, revenues & expenses. Matter was brought to knowledge of mgt but no result has been achieved.

Auditor should proceed as under: -

If the auditor concludes that possible effects on FS of undetected misstatements, if any, could be both material & pervasive so that a qualification of the opinion would be inadequate to communicate gravity of situation, auditor shall:

- i) Withdraw from audit, where practicable & possible under applicable law or regulation; or

ii) If withdrawal not practicable or possible, disclaim an opinion on FS.

If auditor withdraws from such engg, before withdrawing, communicate to TCWG any matters regarding misstatements identified during audit that would have given rise to modification of opinion.

Ch-14 Bank Audit

1. While conducting statutory audit of branch of a nationalized bank, it is noticed by CA Z that credit facilities granted to a borrower consisting solely of term loan have been classified as “Sub-standard Asset” during the year 2022-23 due to failure of borrower to pay EMIs on time. Such EMIs were outstanding for more than 90 days and account was, therefore, classified as “Sub-Standard Asset”. CA Z has also agreed to above asset classification made by branch management. What are CA Z’s responsibilities regarding verification of compliance with income recognition norms by branch in respect of above credit facilities?

RBI norms stipulate that if any advance account becomes NPA at close of any year, entire interest accrued or credited to income account in past periods should be reversed or provided for, if not realized.

Further, in respect of NPAs, fees, commission and other similar income that have accrued should cease to accrue in the current period & should be reversed or provided for with respect to past periods, if uncollected.

In given case, account has turned Sub-standard asset which is a type of NPA. Therefore, auditor should make compliance of above norms relating to income recognition.

Ch-17 Audit of Different types of Entities

From a lessee’s perspective, highlight main differences between an operating lease and finance lease only in relation to accounting treatment and tax benefits.

Accounting treatment

Operating lease is generally treated like a renting arrangement. Lease payments are treated as operating expenses & asset does not appear as asset in lessee’s balance sheet.

Finance lease is treated like a loan arrangement. Hence, asset ownership is considered of that of lessee & thus appears on balance sheet of lessee.

Tax benefits

Operating lease payment is considered like an expense just as in case of renting. However, no depreciation can be claimed by lessee. In case of finance lease, lessee can claim both interest and depreciation as it is treated like a loan.

Ch-18 Audit of Items of F.S.

1. Proceedings have been initiated against False Limited for holding benami property under law relating to prohibition of benami transactions and the rules made thereunder but such property is not recorded in books of accounts. As a consultant to the company, what will you advise the company as far as disclosure requirements are concerned in financial statements in relation to said proceedings?

[Benami Property Disclosures \[Covered in Disclosures video included in Revisions playlist\]](#)

2. Droma Shoes Private Limited was established in year 2022-23 for manufacturing of footwear. As funds were needed to carry on its business activities - including for purchase of different raw materials, incurring of regular expenses like power and fuel and payment of wages etc., it had got sanctioned a credit facility amounting to ₹ 2 crores repayable on

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demand from a bank against primary security of its current assets and collateral security of residential house of one of its directors. Duly signed guarantee documents by directors in favour of bank also form part of bank's loan documentation. Account statement of above facility downloaded from bank's website shows debit balance of ₹ 1.85 crores as on 31st March, 2023. The operations in above credit facility are satisfactory.

In this regard: -

- Identify nomenclature of such credit facility given by banks. How would above amount of ₹ 1.85 crores be reflected and classified in financial statements of company as on 31.3.23?
- Also state specific disclosure requirements of Schedule III of Companies Act, 2013 in relation to above.

i) Type of credit facilities referred in above situation given by banks to meet working capital requirements of business which are repayable on demand are known as "cash credit facilities/overdraft" facilities.

Amount of ₹1.85 crores outstanding as on 31.3.23 reflects borrowings of Co. and classified as "short-term borrowings" as loans repayable on demand from banks under current liabilities in balance sheet of Co. Borrowings shall further be subclassified as secured.

ii) Specific disclosure requirements of short-term borrowings under Schedule III to Companies Act, 2013 in given situation are as under: -

- Nature of security i.e. primary security of current assets & collateral security of residential house belonging to a director shall be specified.
- As loans have been guaranteed by directors, aggregate amount of such loans shall be disclosed.

To be disclosed as Additional Regulatory Information

Since Co. has borrowings from bank on basis of security of current assets, it shall also disclose following:-

- whether quarterly returns or statements of current assets filed by Co. with banks or financial institutions in agreement with books of a/c.
- if not, summary of reconciliation & reasons of material discrepancies, if any to be adequately disclosed.

3. Following is extract of notes to accounts of financial statements of STU Private Limited listing some ratios. Discuss, whether disclosure, given in following manner meets requirements of Schedule III of the Companies Act, 2013. Ignore other ratios which are not listed in extract given below:

Name of Ratio	31.03.23	31.03.22
Current Ratio	2.50	2.30
Inventory Turnover Ratio	3.00	6.00
Trade receivable turnover ratio	1.75	5.00
Net profit ratio	13%	10%

Disclosure given in question doesn't meet requirements of Schedule III to Companies Act, 2013.

Schedule III requires that the company shall explain items included in numerator & denominator for computing ratios.

Further explanation for any change in ratio by more than 25% compared to preceding year.

In given table, Co. has not explained the items included in numerator and denominator for computing ratios.



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Further, variations in ratios as compared to preceding year are as under: -

Name of Ratio	31.03.23	31.03.22	Variation
Current Ratio	2.50	2.30	
Inventory Turnover Ratio	3.00	6.00	
Trade receivable turnover ratio	1.75	5.00	
Net profit ratio	13%	10%	

As calculated above, there is change in

by more than 25% as compared to preceding year. Therefore, explanations for such changes have also to be provided where there are changes by more than 25% as compared to preceding year.