Section A Multiple Choice Questions

MCQs 1-6 carry 1 mark each and MCQs 7-8 carry 2 marks each. (Total 10 marks)

1. In the case of _____, the auditor, as per SA-260, shall communicate with TCWG that he has complied with relevant ethical requirements regarding independence including related safeguards applied to eliminate threats to independence.
(a) All the entities
(b) Listed entities
(c) Listed entities and prescribed classes of companies
(d) Banking companies

2. Which of the following is not an example of subsequent event?
(a) Event occurring between date of financial statements and date of auditor's report.
(b) Event occurring on date of financial statements.
(c) Event occurring after filing audit report with tax authorities. Had such an event been known earlier, auditor would have amended report.
(d) Event occurring during course of performing audit procedures after date of financial statements.

3. As regards auditor's responsibility regarding matters communicated orally with those charged with governance, which of following is most appropriate
(a) Matters communicated orally have to be documented by the auditor stating when and to whom these were communicated.
(b) Matters communicated orally need not be put into writing. It is sufficient for auditor to have communicated orally.
(c) Matters communicated orally need not be put into writing. It is not practically feasible.
(d) Matters communicated orally have to be documented by the auditor stating to whom these were communicated.

4. If the management has prepared financial statements based on going concern assumption but auditor concludes that use of going concern basis is inappropriate, then auditor shall –
(a) Express a qualified opinion
(b) Express an adverse opinion
(c) Disclaim his opinion
(d) Either option (a) or option (b)

CASE SCENARIO:

M/s UVW & Associates have been appointed as auditors of Mars Ltd. for the Financial Year 2023-24.
• During the course of audit, the auditors notice that there are certain legal expenses been charged to revenue during the financial year by Mars Ltd.
• These legal expenses are related to litigations going against the company regarding its Corporate Social Responsibility expenses incurred near its factory area.
• Also, the auditors have noticed certain related party transactions reflected in the financial statements of Mars Ltd during the financial year under audit. The transaction is between Mars Ltd and a Company owned by wife of one of the directors of Mars Ltd.
• The auditors have become aware of certain subsequent events occurring in case of Mars Ltd. These are related to the outcomes of the litigations going against Mars Ltd.
• The auditors are also concerned whether the litigations going against Mars Ltd. and their outcomes have any impact on the going concern of the company.

Based on the above facts, answer the following:-

5. Statement 1: Although Written Representations provide necessary audit evidence, they do not provide sufficient and appropriate audit evidence on their own about the matters with which they deal.
Statement 2: Written Representations do not include financial statements, the assertions within, or supporting books and records.
(a) Only Statement 1 is correct
(b) Only Statement 2 is correct
(c) Both Statement 1 & 2 are correct
(d) None of Statement 1 & 2 is correct

6. The auditor can perform the following procedures to identify litigation and claims of Mars Ltd:-
(a) Inquiry of management including in house legal counsel.
(b) Reviewing legal expenses account.
(c) Reviewing of minutes of meetings of those charged to governance and correspondence between entity and external legal counsel.
(d) All of the above.

7. The auditor's report shall include a separate section under the heading "material uncertainty relating to going concern" in case –
(a) Adequate disclosure of a material uncertainty has been made in the financial statements
(b) Adequate disclosure of material uncertainty is not made in the financial statements
(c) Management may be unwilling to make or extend his assessment
(d) All of these

8. Regarding subsequent events, auditor shall comply with the requirements given in SA-560. State which of the following is not correct in this regard?
(a) The auditor shall inquire the management and those charged with governance regarding the subsequent events
(b) Auditor should read the entity's subsequent interim financial statements, if any
(c) The auditor may inquire entity's lawyer regarding the pending cases and outcomes therefrom
(d) Auditor need not consider whether subsequent event may have an impact on going concern assumption

Section B : Descriptive Questions

Question 1: State the documentation requirements for an auditor regarding misstatements identified during audit under SA 450 (3 marks)

Answer 1:

The audit documentation as per "SA 450 - EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT" shall include:

(a) The amount below which misstatements would be regarded as clearly trivial.

(b) All misstatements accumulated during the audit and whether they have been corrected; and

(c) The auditor's conclusion as to whether uncorrected misstatements are material, individually or in aggregate, and the basis for that conclusion.

Question 2: In the course of audit of ABC Ltd. its management refuses to provide written representations. As an auditor what is your duty? (4 marks)

Answer 2:

As per SA 580 "Written Representations", if the 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 the 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 should disclaim an opinion on the financial statements if management does not provide written representations in accordance with SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”.

Question 3: Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. During the course of audit of ABC Ltd., you observed that significant deficiency exists in the internal control system and you want to ascertain the same. Elucidate the various indicators of significant deficiencies which will help you in assessing the efficiency of internal control system of the organization. (6 marks)

Answer 3: It is given that During the course of audit of ABC Ltd., it has been observed that significant deficiency exists in the internal control system. As per SA 265 "COMMUNICATING DEFICIENCIES IN INTERNAL CONTROL TO THOSE CHARGED WITH GOVERNANCE AND MANAGEMENT" it is Auditor's responsibility to Communicate such significant deficiency to the TCWG and Management in writing Indicators of significant deficiencies in internal control include, for example:

- Evidence of ineffective aspects of the control environment, such as:
  1. Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.
  2. Identification of management fraud, whether or not material, that was not prevented by the entity’s internal control.
  3. Management’s failure to implement appropriate remedial action on significant deficiencies previously communicated.
- Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
- Evidence of an ineffective entity risk assessment process, such as management’s failure to identify a risk of material misstatement that the auditor would expect the entity’s risk assessment process to have identified.
- Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
- Misstatements detected by the auditor’s procedures that were not prevented, or detected and corrected, by the entity’s internal control.
- Evidence of management’s inability to oversee the preparation of the financial statements.

Question 4: The significance of a deficiency or a combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude of the misstatement. Significant deficiencies may therefore exist even though the auditor has not identified misstatements during the audit. State some examples that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency. (6 marks)

Answer 4:

Example of matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a significant deficiency include:

- The likelihood of the deficiencies leading to material misstatements in the financial statements in the future.
- The susceptibility to loss or fraud of the related asset or liability.
- The subjectivity and complexity of determining estimated amounts, such as fair value accounting estimates.
- The financial statement amounts exposed to the deficiencies.
- The volume of activity that has occurred or could occur in the account balance or class of transactions exposed to the deficiency or deficiencies.
- The importance of the controls to the financial reporting process.

Question 5: "Factors governing mode of communication of auditor with those charged with governance." Comment. (5 marks)

Answer 5:

As per SA-260, which deals communicate the audit matters of governance interest with TCWG, he should consider the form and content of such communication. He shall determine if communication should be orally or in writing how much detailed communication is required etc. based upon following factors:

1. Sensitivity of matter involved
2. The size and operating structure of the entity.
3. Whether management is already having knowledge of subject matter to be communicated and they do not need detailed information.
4. Legal requirements. Sometimes laws also make communication mandatory within time frame set by statute for example, reporting of fraud u/s 143(12) to (15) to board of directors/ audit committee.
5. Arrangements regarding periodical meetings with TCWG.
6. The extent of dialogue between auditor and TCWG.
7. Any change in the governance structure.

Question 6: During course of audit of a company, CA. Varun Aggarwal notices that company is facing significant skilled labour shortages resulting in hampering of operations of company. The company's manufacturing is dependent upon skilled labour coming from villages in certain districts of Eastern UP. However, due to job opportunities available near villages now, many are not interested in going out from their native villages. Such a situation has led to company not being able to keep its commitments, losing out on orders and fall in its revenues. Fixed costs of the company remain at a high level. As a result, company is facing a liquidity crunch and is not able to pay its creditors on time. The bankers of company are also not willing to help the company to tide over liquidity crisis. The auditor is having doubts over going concern status of the company. How should management of the company try to address auditor's concerns? What audit procedures may be performed by auditor in such a situation? Further, if management is unwilling to make or extend its assessment when requested to do so by the auditor, how he should deal with it? (6 marks)

Answer 6:

- As per SA-570 "Going concern", auditor should consider whether going concern assumption followed by the management holds good. It lists certain financial, operating and other indicators, whose presence create a doubt on going concern assumption.
- Significant shortage of skilled labour, inability to pay creditors on time and overall liquidity crisis faced by the company are examples of events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern.
- In such a situation, management should try to address auditor's concerns by preparing its future plan of action including preparation of cash flow forecast showing inflow and outflow of cash. Such a cash flow forecast should address auditor's concerns regarding liquidity crisis being faced by the company.
- The auditor should perform audit procedures to evaluate the reliability of the underlying data to prepare the forecast and determining whether there is adequate support for the assumptions underlying the forecast.
- The auditor should also consider whether any additional facts or information have become available since the date on which management made its assessment.

Management Unwilling to Make or Extend Its Assessment

- If management is unwilling to make or extend its assessment when requested to do so by the auditor, the auditor shall consider the implications for the auditor's report.
- In such a situation, a qualified opinion or a disclaimer of opinion in the auditor's report may be appropriate, because it may not be possible for the auditor to obtain sufficient appropriate audit evidence regarding management's use of the going concern basis of accounting in the preparation of the financial statements.