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# *Scanner* Appendix

**CA Inter Group - II  
(Solution of May - 2023)**

**Paper - 6 : Auditing and Assurance**

**Chapter - 2 : Audit Strategy, Audit Planning and Audit Programme**

**3**

***Development of Audit Plan***

**2023 - May [4] (a)**

**As per SA 315**, 'Identifying and Assessing the Risk and Material Misstatement through Understanding the Entity and its Environment', without adequate knowledge of Client's business, a proper audit is not possible. The auditor shall obtain an understanding of the following:

- (1) Relevant industry, regulatory & external factors including the applicable FRF.
- (2) **The nature of entity includes:**
  - Its operations
  - Its ownership & governance
  - The types of investments that the entity is making and plans to make, including investments in special-purpose.
  - The way that the entity is structured & how it is financed; to enable auditor to understand the classes of transaction, account balances & disclosures:
- (3) The entity's selection & application of accounting policies, including the reasons for changes thereto.
- (4) The entity's objectives & strategies and those related business risks may result in risks of material misstatement.
- (5) The measurement and review of the entity's financial performance.

**5****Documentation of Audit Plan****2023 - May [1] {C} (a)**

**Incorrect:** As per SA 300, documentation of the overall audit strategy is not a record of the audit evidence considered necessary to properly plan the audit and assign various audit functions to the engagement team. It outlines the scope, objectives and approach of the audit engagement.

**7****Audit Planning and Materiality****2023 - May [2] (c)**

Determining materiality involves the exercise of professional judgement. The auditor has to apply his professional judgement in determining materiality, choosing appropriate benchmark and determining level of benchmark.

A percentage is often applied to a chosen benchmark as a starting point in determining the materiality of the F.S. or whole Factory affect the identification of an appropriate benchmark include the following:

(1) The elements of Financial Statements.

**Example:** Assets, liabilities, equity, revenue etc.

(2) Whether there are items on which the attention of the users of the particular entity's F.S. tends to be focused.

The nature of entity, where the entity is at in its life cycle, & the industry & economic environment in which the entity operates. The entity's ownership structure & the way it is Financed.

**Chapter - 3 : Audit Documentation and Audit Evidence**

**2****Audit Evidence****2023 - May [1] {C} (e)**

**Incorrect:** As per SA 500 - Audit evidence, appropriateness is not a measure of the quantity of audit evidence Appropriateness refers to quality on relevance of the audit evidence gathered by the auditor.

**Chapter - 4 : Risk Assessment and Internal Control****1*****Audit Risk*****2023 - May [2] (b)**

**Audit risk** means the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. Thus, it is the risk that the auditor may fail to express an appropriate opinion in an audit assignment.

**Example:** - Strength Ltd. purchased P&M ₹ 2 cr. in F.Y. 20-21.

The accountant debited ₹ 2 cr. in the Repair & Maintenance account in the statement of P&L instead of taking it to the balance sheet as PPE and claim depreciation on it.

While auditing the accounts of this co. the auditor did not notice this & consequently did not report anything regarding the P&M.

Therefore, opinion given by auditor would be inappropriate.

**Following are not included in Audit Risk:**

- (1) Audit risk does not include the risk that auditor might express an opinion on F.S. are materially misstated when they are not.
- (2) Further, audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risk such as loss from litigation, adverse publicity, or other events with the audit of F.S.

**2*****Identifying and Assessing the Risks of Material Misstatement*****2023 - May [5] (d)**

Much of the information obtained by the auditor's inquiries is obtained from the Mgt & Those responsible for financial reporting. However, the auditor may also obtain info. In identifying risks of material misstatement through inquiries of other within the entity.

**Examples:**

- (1) Inquiries directed towards TCWG may help the understand the environment in which financial statements are prepared.

- (2) Inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help to evaluate the accounting policies.
- (3) Inquiries directed to the risk management function may provide information about operational and regulatory risks.
- (4) Inquiries directed to information system personnel may provide info, about system changes, system or control failures or other system related risks.

**3*****Internal Control*****2023 - May [4] (d)****In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:**

- Whether the risk is a risk of fraud;
- Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;
- Whether the risk involves significant transactions with related parties;
- The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
- Whether the risk involves significant transactions that are outside the normal course of business of the entity or that otherwise appear to be unusual.

**Chapter - 6 : Audit in an Automated Environment****1*****What is An Automated Environment?*****2023 - May [2] (a)**

The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

The level of sampling risk that the auditor is willing to effects the sample size required.

The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

**Sampling Risk:** The risk that the auditor's conclusions based on a sample may be different from conclusions if the entire population were subjected to the same audit procedure.

If the acceptable sampling risk is low, larger sample size is needed.

**Non-Sampling Risk:** The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

**3*****Risk and Controls in an Automated Environment***

**2023 - May [1] {C} (h)**

**Incorrect:** Utilizing integrated ERP software can stream line the audit process by providing centralized data, standardized process, a robust audit trail, data analysis capabilities and built-in - controls. However, the overall complexity of the audit is influenced by additional factors beyond the software used like size, complexity of business operation & effectiveness of internal controls implemented within ERP system.

**4*****Testing Methods***

**2023 - May [2] (d)**

Data analytics can be used in the testing of electronic records and data residing in IT system using spread sheets and specialised audit tools to perform the following:

- (1) Check completeness of data and population is used in test of controls.
- (2) Selection of audit samples
- (3) Re-computation of balances-reconstruction of trial balance from transaction data.

- (4) Reper formance of mathematical cal<sup>n</sup> - dep<sup>n</sup>, bank int cal<sup>n</sup>
- (5) Analysis of journal entries as required by SA 240
- (6) Fraud investigation
- (7) Evaluating the impact of control deficiencies.

### Chapter - 8 : Analytical Procedures

**2*****Purpose and Timing of Analytical Procedure*****2023 - May [1] {C} (f)**

**Correct:** As per SA 520 Analytical Procedure - analytical procedures can be used during execution and conclusion stage of audit & as per SA 315, it should be used in planning the audit, especially in risk assessment procedure.

**3*****Substantive Analytical Procedures*****2023 - May [4] (c)**

The reliability of data is influenced by its source & nature and is dependent on the circumstances under which it is obtained. **The following are relevant substantive analytical procedures:**

- (1) Source of the information available.
- (2) Comparability of the information available.
- (3) Nature & relevance of information available.
- (4) Controls over the Preparation of information that is designed to ensure its completeness, accuracy & validity.

### Chapter - 9A : Audit of Balance Sheet Items

**4*****Share Capital*****2023 - May [3] (b)**

**As per Section 53 of the Companies Act, 2013:**

- (1) A Company **shall not issue shares at a discount** except as provided in Section 54.
- (2) Any share issued by a company at a discount shall be **void**
- (3) However, a co. may issue shares at a discount to its creditors when its **debt is converted into share in pursuance of any statutory redaction plan on debt restructuring scheme** in accordance with RBI Act.
- (4) Any Company **fails to comply with provision of Section 53**, such co. and every officer who is in default shall be liable to:
- (a) A penalty equal to the **amount raised through the issue of shares at a discount or ₹ 5 Lakhs** whichever is less, and
- (b) Liable to **refund all monies received with interest at the rate of 12% p.a.**

In the given case, it is clear that is can issue shares to its creditors are not as per law. The auditor needs to check:

- He should verify that the shares issued at a discount by recording the minutes of meeting of its directors & shareholders authorizing the issue of share capital & issue price.
- He should discuss the issue with management and inform the TCWG and also consider the impact of non-compliance on its Auditor report.

**12*****Provision and Contingent Liabilities*****2023 - May [3] (d)**

<b>Assertion</b>	<b>Audit Procedure</b>
<b>Existence</b>	<ul style="list-style-type: none"> <li>• Inspect underlying agreements like agreement with customers to assess warranty commitments, any legal &amp; other claims on entity.</li> </ul>

<b>Completeness</b>	<ul style="list-style-type: none"> <li>Obtain list of all provisions &amp; compare them with balances in ledger.</li> <li>Obtain written representation from mgt that it has made all provisions which were required to be made as per recognized accounting principles.</li> </ul>
<b>Valuation</b>	<ul style="list-style-type: none"> <li>Obtain underlying working &amp; basis for each of provisions made &amp; verify same is complete &amp; accurate.</li> <li>Obtain expert's report cal<sup>n</sup> &amp; underlying working for provision amount. Request for assessment made by legal expert in relation to likelihood of liability devolving on entity.</li> </ul>

### Chapter - 9B : Audit of Statement of P&L Accounts Items

**1**

### ***Sale of Product and Services***

**2023 - May [3] (c)**

**Audit Procedures for sale of Scrap as follows:**

- Review the internal control as regards generation, storage and disposal of Scrap.
- Check whether the organization is maintaining a reasonable record for the generation of Scrap.
- Analyze the raw material used, production & generation pattern of Scrap and compare the same with figures of the earlier year.
- Check the rates at which Scrap has been sold & compare the rate with previous year.
- Vouch sales, with invoices raised, the advertisement for tender, rate contract with Scrap dealers.
- Ensure that there exists a proper control procedure to identify Scrap.
- Make an overall assessment of the value of realization from Scrap as to its reasonableness.



**5*****Depreciation & Amortisation*****2023 - May [1] {C} (c)**

**Incorrect:** Amortisation is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

**Chapter - 10 : Company Audit****6*****Provisions Related to Audit Committee*****2023 - May [6] (a)**

**In addition to listed public companies, the following classes of companies shall constitute an Audit Committee:**

- (1) all public companies with a paid-up capital of ten crore rupees or more;
- (2) all public companies having turnover of one hundred crore rupees or more;
- (3) all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more

The paid-up share capital or turnover or outstanding loans, or borrowings or debentures or deposits, as the case may be, as existing on the date of the last audited Financial Statements shall be taken into account for the purposes of this rule.

Therefore, provisions of the constitution of the audit committee are applicable only to listed companies and public companies satisfying the criteria as stated above.

**Present Case:**

ATM Ltd., a public company having paid up capital of ₹ 12 crores and turnover of ₹ 105 crores will be required to constitute an Audit Committee under section 177 even if its outstanding loan is below ₹ 50 crores because the requirement for constitution of Audit Committee arises if the company falls into any of the prescribed categories.

7

**Auditor's Remuneration****2023 - May [1] {C} (d)**

**Correct:** As per Sec. 142, the remuneration shall in addition to the fee payable to an auditor, include the expenses, if any incurred by the auditor in connection with the audit of the company.

10

**Powers/Rights of Auditors****2023 - May [5] (b)**

Since the fraud involves 1 cr. Sec. 143(12) of the company's Act, 2013 shall apply in the following manner-

**Reporting to the Audit Committee or Board:** Sub-section (12) of section 143 of the Companies Act, 2013 further prescribes that in case of a fraud involving lesser than the specified amount [i.e. less than ₹ 1 crore], the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed.

In this regard, sub-rule (3) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that in case of a fraud involving lesser than the amount specified in sub-rule (1) [i.e. less than ₹ 1 crore], the auditor shall report the matter to Audit Committee constituted under section 177 or to the Board immediately but not later than 2 days of his knowledge of the fraud and he shall report the matter specifying the following:

- (1) Nature of Fraud with description;
- (2) Approximate amount involved; and
- (3) Parties involved

**Disclosure in the Board's Report:**

Sub-section (12) of Section 143 of the Companies Act, 2013 furthermore prescribes that the companies, whose auditors have reported frauds under this sub-section (12) to the audit committee or the Board, but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed.

In this regard, sub-rule (4) of Rule 13 of the Companies (Audit and Auditors) Rules, 2014 states that in the Board's Report the following details

of each of the fraud reported to the Audit Committee or the Board under sub-rule (3) during the year:

- (1) Nature of Fraud with description;
- (2) Approximate Amount involved;
- (3) Parties involved, if remedial action not taken; and
- (4) Remedial actions taken.

11

***Duties of Auditor***

**2023 - May [4] (b)**

**As per Clause (ix) of CARO, 2020**, reporting requirements in case of default by the company in repayments of borrowings would be:

- (a) Whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period and the amount of default to be reported as per the format below:-

Nature of borrowing including debt securities	Name of lender	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any
	Lender-wise details to be provided in case of				
	defaults to banks, financial institutions and Government.				

- (b) Whether the company is a declared wilful defaulter by any bank or financial institution or other lender.
- (c) Whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported.
- (d) Whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated.

**Chapter - 11 : Audit Report**

4

### ***Modifications to the opinions in the Independent Auditor's Report***

**2023 - May [5] (c)**

**In following cases auditor shall modify the opinion in auditor's report:-**

- The auditor concludes that, based on the audit evidence obtained, the F.S. as a whole are not free from material Misstatement or.
- The auditor is unable to obtain SAAE to conclude that the F.S. as a whole are free from material misstatement.

**There are 3 types of modified opinions:-**

(1) Qualified (2) An adverse (3) A disclaimer

<b>Nature of Matter Giving Rise to the Modifications</b>	<b>Auditor's judgement about the Pervasiveness of the effects on possible effects on the F.S.</b>	
	<b>Material but not pervasive</b>	<b>Material and Pervasive</b>
Financial Statement are materials misstated	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence (SAAE)	Qualified opinion	Disclaimer of opinion

**The decision regarding types of opinion depends upon:**

- (a) The nature of matter giving rise to the modification, that is whether the F.S. are material misstated or in case of an inability to obtain SAAE may be material misstated &
- (b) The auditor's judgement about pervasiveness of effects or possible effects of the matter on the F.S.

6

### ***Communicating Key Audit Matters in the Independent Auditor's Report***

**2023 - May [1] {C} (b)**

**Incorrect:** Communicating key audit matter is a requirement of SA 701 to provide additional information about significant matters in the audit process.

It does not represent separate opinions on individual matters.

## Chapter - 12 : Audit of Banks

**7****Computation of Drawing Power**

2023 - May [6] (c)

**Drawing power:** It is the actual amount that borrower can currently withdraw or utilize from sanctioned credit limits.

**Sanctioned limit:** It is the total credit limit approved by the lender for the borrower, representing maximum amount of funds that can be made available.

It is important for the borrower to manage their utilization and keep track of their drawing power to ensure compliance with terms and conditions of credit facility.

- (1) **Bank's Duties:** Ensure the drawing in working capital account are covered by adequacy of current assets. Stock statement relied upon by banks for drawing power should not be older than 3 months.
- (2) **Auditor's Concern:** Statement quarterly returns & other statements submitted by borrower to bank should be scrutinized in details.
- (3) **Computation of DP:** DP is calculated as per extant guidelines formulated by BOD of respective bank.
- (4) **Stock Audit :** Stock Audit should be carried out by bank for all account having funded exposure of more than ₹ 5 Cr. Branches should obtain the stock audit report from the lead bank in cases where the bank is not leader of the consortium of working capital.

## Chapter - 13 : Government Audit and Audit of Local Bodies

**1.3****Expenditure Audit**

2023 - May [6] (b)

**Performance audit:** The scope of the audit has been extended to cover efficiency, economy and effectiveness audit or performance audit, or **full scope audit.**

**Efficiency audit:** looks into whether the various schemes/projects are executed and their operations conducted economically and whether they are yielding the results expected of them, i.e., the relationship between goods and services produced and resources used to produce them; and examination aimed to find out the extent to which operations are carried out in an economical and efficient manner.

**Economy audit:** looks into whether the government has acquired the financial, human and physical resources in an economical manner and whether the sanctioning and spending authorities have observed economy.

**Effectiveness audit** is an appraisal of the performance of programmes, schemes, projects with reference to the overall targeted objectives as well as efficiency of the means adopted for the attainment of the objectives.

**Efficiency:** cum-performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.

#### **Chapter - 15 : Miscellaneous Audit**

**3*****Audit of Charitable Institutions***

**2023 - May [6] (d)**

- (1) Check the day to day administration exp. Incurred along with necessary vouchers.
- (2) Verify whether expresses incurred are in conformity with budgets prepared internally or filed with relevant authorities.
- (3) Check the amount spent on provisions of Various items with reference to bills etc.
- (4) See the whether heavy expenditure has been incurred on the renovation etc. the same is accounted for properly.

#### **Chapter - 16 : Audit of Co-operative Societies**

**1*****Audit as per Sec. 17 of the Co-operative Societies Act, 1912*****2023 - May [1] {C} (g)**

**Correct:** As per State act-Co-operative Society are required to annually Contribute some amount to education funds such contribution is considered as a charge not appropriation.

**3*****Audit, Inquiry and Inspection of Multi-State Co-operative Societies*****2023 - May [5] (Or) (b)**

As per the Multi-State Co-operative Societies Act, 2002. A person who is CA within meaning of CA Act, Can only be appointed as auditor of Multi-State Co-operative Society.

However, the following person are not eligible as auditors:

- (1) A body corporate
- (2) An officer or employee of Multi-State Co-operative. Society
- (3) Member or who is in the employment of an officer or employee of Multi-State
- (4) Who is indebted to Multi-State exceeding ₹ 1000

If an auditor becomes subject, after his appointment to any, of the disqualifications specified above, he shall be deemed to have vacated his office.

In current case, Senior manager i.e employee of society is proposed to be appointed as auditor which is not correct as per law Thus, CA 2 can't be appointed as auditor.

**Chapter - 17 : SA and Guidance Notes**

**8*****SA - 505: External Confirmations*****2023 - May [3] (a)**

**If management refuses to allow the auditor to send a confirmation**

**request, the auditor shall:**

- (1) Inquire as to mgt's reasons for the refusal and seek audit evidence as their validity and reasonableness;
- (2) Evaluate the implications of mgt's refusal on the auditor's assessment of the relevant risks of material mis-statement, including the risk of Fraud, NTE of audit procedure. &
- 3i) Perform alternative audit procedure designed to obtain relevant & reliable audit evidence.

If the auditor concludes that mgt's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant & reliable audit evidence from alternative audit procedure, the auditor shall communicate with TCNG with SA 260.

Also determine implications in accordance with SA 705.

12

**SA - 570: Going Concern****2023 - May [5] (a)**

Assuming use of going concern Basis of Accounting is appropriate, but a Material Uncertainty Exists:

The identification of material uncertainty is a matter that is important to user's understanding of the F.S. the use of a Separate Section with a heading that includes reference to the fact that a material uncertainty related to going concern exists alerts users to this circumstance:

**(1) Adequate Disclosure of a Material Uncertainty is made in the financial Statements:**

If adequate disclosure about the material uncertainty is made in the Financial Statement the auditor shall express the unmodified opinion, and the auditor's report shall include a separate Section under the heading "Material Uncertainty related to Going Concern."

**(2) Adequate Disclosure of a Material Uncertainty is not made in the Financial Statement** If adequate disclosure about the material uncertainty is not made in Financial Statement the auditor shall:

- (1) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705 &
- (2) In the Basis for qualified opinion Section of the auditor's report state



that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as going concern & Financial Statement do not adequately disclose this matter.

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