1. (a)
2. (d)
3. (b)
4. (a)
5. (b)
6. (c)
7. (c)
8. (d)
9. (d)
10. (a)
11. (a)
12. (d)
13. (a)
14. (b)
15. (c)
16. (a)
17. (d)
18. (b)
19. (a)
20. (a)
21. (a)
22. (c)
23. (d)
24. (a)
25. (d)

Division B - Descriptive Answers

1. (i) Incorrect 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 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) **Correct:** When we are designing audit procedures to address an inherent risk or “what can go wrong”, we consider the nature of the risk of material misstatement in order to determine if a substantive analytical procedure can be used to obtain audit evidence. When inherent risk is higher, we may design tests of details to address the higher inherent risk. When significant risks have been identified, audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient.

(iii) **Incorrect:** According to SA 530 “Audit sampling”, ‘audit sampling’ refers to the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

(iv) **Correct:** Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

(v) **Incorrect:** Emphasis of Matter paragraph is a paragraph included in the auditor’s report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor’s judgment, is of such importance that it is fundamental to users’ understanding of the financial statements.

(vi) **Incorrect:** The auditor shall express a qualified opinion when:

(a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

(vii) **Incorrect:** The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit. The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement.

(viii) **Correct:** As per SA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, professional skepticism is an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence. Thus, it is necessary for the auditor to maintain professional skepticism throughout the audit.

2. (a) **Statements and Guidance Notes of ICAI – whether Mandatory or Recommendatory:**

(i) **Statements:** The ‘Statements’ have been issued with a view to securing compliance by members on matters which, in the opinion of the Council, are critical for the proper discharge of their functions. ‘Statements’ therefore are mandatory.

   Accordingly, while discharging their attest function, it will be the duty of the members of the Institute to ensure that statements are followed and complied with.

(ii) **Guidance Notes:** ‘Guidance Notes’ are primarily designed to provide guidance to members on matters which may arise in the course of their professional work and on which they may desire assistance in resolving issues which may pose difficulty. Guidance Notes are recommendatory in nature. A member should ordinarily follow recommendations in a guidance note relating to an auditing matter except where he is satisfied that in the circumstances of the case, it may not be necessary to do so.

   Similarly, while discharging his attest function, a member should examine whether the recommendations in a guidance note relating to an accounting matter have been followed or
not. If the same have not been followed, the member should consider whether keeping in view the circumstances of the case, a disclosure in his report is necessary.

There are, however, a few guidance notes in case of which the Council has specifically stated that they should be considered as mandatory on members while discharging their attest function.

(b) Inquiring from Management to Evaluate Subsequent Event: As per SA 560 “Subsequent Events”, in inquiring of management and, where appropriate, those charged with governance, as to whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire as to the current status of items that were accounted for on the basis of preliminary or inconclusive data and may make specific inquiries about the following matters:

(i) Whether new commitments, borrowings or guarantees have been entered into.
(ii) Whether sales or acquisitions of assets have occurred or are planned.
(iii) Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
(iv) Whether any assets have been appropriated by government or destroyed, for example, by fire or flood.
(v) Whether there have been any developments regarding contingencies.
(vi) Whether any unusual accounting adjustments have been made or are contemplated.
(vii) Whether any events have occurred or are likely to occur which will bring into question the appropriateness of accounting policies used in the financial statements as would be the case, for example, if such events call into question the validity of the going concern assumption.
(viii) Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.
(ix) Whether any events have occurred that are relevant to the recoverability of assets.

(c) The Discipline of Behavioural Science is Closely Linked with the Subject of Auditing: The field of auditing as a discipline involves review of various assertions; both in financial as well as in non-financial terms, with a view to prove the veracity of such assertions and expression of opinion by auditor on the same. Thus, it is quite logical and natural that the function of audit can be performed if and only if the person also possesses a good knowledge about the fields in respect of which he is conducting such a review.

The discipline of behavioural science is closely linked with the subject of auditing. While it may be said that an auditor, particularly the financial auditor, deals basically with the figures contained in the financial statements but he shall be required to interact with a lot of people in the organisation. As against the financial auditor, the internal auditor or a management auditor is expected to deal with human beings rather than financial figures. One of the basic elements in designing the internal control system is personnel. Howsoever, if a sound internal control structure is designed, it cannot work until and unless the people who are working in the organisation are competent and honest. The knowledge of human behaviour is indeed very essential for an auditor so as to effectively discharge his duties.

(d) Written Representations: As per SA 580, “Written Representation” is a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. These representations are an important source of audit evidence. If management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist. Further, a request for written, rather than oral, representations in many cases may prompt management to consider such matters more rigorously, thereby
enhancing the quality of the representations.

Requested Written Representations not provided by Management: 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.

3. (a) In order to achieve the objectives of the accountancy profession, professional accountants have to observe a number of prerequisites or fundamental principles as under:

Integrity: A professional accountant should be straightforward and honest in performing professional services.

Objectivity: A professional accountant should be fair and should not allow prejudice or bias, conflict of interest or influence of others to override objectivity.

Professional Competence and Due Care: A professional accountant should perform professional services with due care, competence and diligence and has a continuing duty to maintain professional knowledge and skill at a level required to ensure that a client or employer receives the advantage of competent professional service based on up-to-date developments in practice, legislation and techniques.

Confidentiality: A professional accountant should respect the confidentiality of information acquired during the course of performing professional services and should not use or disclose any such information without proper and specific authority or unless there is a legal or professional right or duty to disclose.

Professional Behaviour: A professional accountant should act in a manner consistent with the good reputation of the profession and refrain from any conduct which might bring discredit to the profession.

Technical Standards: A professional accountant should carry out professional services in accordance with the relevant technical and professional standards. Professional accountants have a duty to carry out with care and skill, the instructions of the client or employer insofar as they are compatible with the requirements of integrity, objectivity and, in the case of professional accountants in public practice, independence.

(b) Specific inquiries by auditor when deviations from controls are detected.

When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:

(a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;

(b) Additional tests of controls are necessary, or

(c) The potential risks of misstatement need to be addressed using substantive procedures.

(c) Factors that may affect the Identification of an Appropriate Benchmark in Determining Materiality: As per SA 320 “Materiality in Planning and Performing an Audit”, determining materiality involves the exercise of professional judgment. A percentage is often applied to a
chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following-

(i) The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
(ii) Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
(iii) The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
(iv) The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
(v) The relative volatility of the benchmark

(d) True & Fair view: This is correct that what constitutes a ‘true and fair’ view is a matter of an auditor's judgment in the particular circumstances of a case. In more specific terms, to ensure true and fair view, an auditor has to see:

(i) That the assets are neither undervalued nor overvalued, according to the applicable accounting principles.
(ii) No material asset is omitted.
(iii) The charge, if any, on assets are disclosed.
(iv) Material liabilities should not be omitted.
(v) The profit and loss account discloses all the matters required to be disclosed by Part II of Schedule III and the balance sheet has been prepared in accordance with Part I of Schedule III.
(vi) Accounting policies have been followed consistently.
(vii) All unusual, exceptional or non-recurring items have been disclosed separately.

4. (a) Areas where Surprise Checks can significantly improve the effectiveness of an Audit: Surprise checks constitute an important part of normal audit procedure. An element of surprise both with regard to the time of checking and selection of items, significantly improves the effectiveness of an audit. Normally, areas over which surprise check can be employed are-

(i) Verification of cash and investments.
(ii) Inventory.
(iii) Internal control and internal checks.
(iv) Books of prime entries and statutory registers.

(b) Test Checking in System Based Audit: System-based audit is done by evaluating the accounting system and internal control and ascertaining their reliability through audit tests. Depending upon the size and nature of the business concerned, an accounting system will incorporate necessary internal control to provide assurance that-

(i) All the transactions and information have been recorded,
(ii) Fraud and errors, if any, in preparing the accounts will be identified,
(iii) All the assets and liabilities recorded in the books of account do exist and are shown at correct amounts,
There is compliance with statutory regulations.

After the auditor has ascertained the client's accounting system, he should assess it to satisfy the above-mentioned requirements. The auditor, therefore, after evaluating internal control system, tests the same to ascertain whether it is actually in operation. For this purpose, he arranges to actual testing of the system in operation. This he does on a selective basis, i.e., he adopts test checking technique. He plans this testing in such a manner that all the important areas stated above are covered. The test checking is done by application of procedural test and/or by auditing in depth. This approach is adopted in system-based audit which is the modern audit approach. The system-based audit approach begins by evaluating the accounting system and internal control and then by testing them to ascertain their reliability. By this, the auditor first establishes how reliable the system is and then decides how much detailed checking of the transactions and verification of assets and liabilities he must undertake. If the system is found to be good, the detailed checking could be curtailed, but if system is weak, more detailed checking would be necessary. However, checking cannot be completely eliminated; it can only be scaled down if state of the system is satisfactory. In case the initial evaluation itself shows weaknesses, extensive checking should invariably be undertaken.

(c) Issue of Audit Engagement Letter in Recurring Audits: As per SA 210, “Agreeing the Terms of Audit Engagements”, on recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

It is not necessary to issue audit engagement letter each year for repetitive audit. It is enough if the same had been issued at the time of taking initial engagement. However, in the following situations it is appropriate to revise the terms of the audit engagement or to remind the entity of existing terms-

(i) Any indication that the entity misunderstands the objective and scope of the audit.
(ii) Any revised or special terms of the audit engagement.
(iii) A recent change in senior management or board of directors.
(iv) A significant change in ownership.
(v) A significant change in nature or size of the entity's business.
(vi) A change in legal or regulatory requirements.
(vii) A change in the financial reporting framework adopted in the preparation of the financial statements.
(viii) A change in other reporting requirements.

(d) Weaknesses in the Internal Control System: Following two essential features of internal control are relevant here-

(i) Breaking the chain of the work in a manner so that no single person can handle a transaction from the beginning to the end, and
(ii) Segregation of accounting and custodial functions.

Weakness in internal control system in the instant case-

(a) The accountant is receiving cash and also passing the entries in the books. The accountant should not have been allowed to effect recoveries.
(b) It also appears that system for issuing receipts for amount received - whether cash or cheque is also lacking.
(c) In a small and to some extent medium-size organization, the supervision of the owner offsets
the deficiencies in internal control system. But in this case, it appears, that supervision and personal control is also lacking.

Thus, in the given case, the main weakness of the system is that it is ignoring the basic requirements of a good internal control system.

5 (a) **Foreign Travel Expenses**:

(i) Examine Travelling Allowance bills submitted by the employees stating the details of tour, details of expenses, etc.

(ii) Verify that the tour programme was properly authorized by the competent authority.

(iii) Check the T.A. bills along with accompanying supporting documents such as air tickets, travel agents bill and hotel bills with reference to the internal rules for entitlement of the employees and also make sure that the bills are properly passed.

(iv) See that the tour report accompanies the T.A. bill. The tour report will show the purpose of the tour. Satisfy that the purpose of the tour as shown by the tour report conforms to the authorization for the tour.

(v) Check Reserve Bank of India’s permission, if necessary, for withdrawing the foreign exchange. For a company, the amount of foreign exchange spent is to be disclosed separately in the accounts as per requirement of Schedule III to the Companies Act, 2013 and Accounting Standard 11 “The Effects of Changes in Foreign Exchange Rates”.

(b) **Receipt of Capital Subsidy**:

(i) Refer to application made for the claim of subsidy to ascertain the purpose and the scheme under which the subsidy has been made available.

(ii) Examine documents for the grant of subsidy and note the conditions attached with the same relating to its use, etc.

(iii) See that conditions to be fulfilled and other terms especially whether the same is for a specific asset or is for setting up a factory at a specific location.

(iv) Check relevant entries for receipt of subsidy.

(v) Check compliance with requirements of AS 12 on “Accounting for Government Grants” i.e. whether it relates to specific amount or in the form of promoters’ contribution and accordingly accounted for as also compliance with the disclosure requirements.

(c) **Royalties received**:

(i) Verify the relevant contract and ascertain the provisions relating to the conditions of royalty such as rate, mode of calculation and due date.

(ii) Check the periodical statements received in respect of books printed, sold and inventory lying at different locations.

(iii) Check the computation in the royalty statement and ensure that any deduction or adjustment made from the royalty due is as per agreement conditions.

(iv) Verify the provisions for the royalty to be received as at the end of the year.

(d) **Goods Sent Out on Sale or Return Basis**:

(i) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
(ii) See that price of such goods is unloaded from the sales account and the trade receivable’s record. Refer to the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.

(iii) Ensure that the goods in respect of which the period of approval has expired at the close of the year either have been received back subsequently or customers’ accounts have been debited.

(iv) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the close of the year lying with the party, has been included in the closing inventory.

6. (a) **Removal of Auditor before Expiry of Term:** According to Section 140 (1) the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government.

(1) The application to the Central Government for removal of auditor shall be made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.

(2) The application shall be made to the Central Government within thirty days of the resolution passed by the Board.

(3) The company shall hold the general meeting within sixty days of receipt of approval of the Central Government for passing the special resolution.

   It may be noted that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard.

   By applying the above provisions, it may be concluded that the action of the company for removal of the auditor CA Z before expiry of term is not justified and auditor may be removed from his office only by following the above mentioned procedure.

(b) **Reporting requirements regarding Fixed Assets under CARO, 2016** are:

   (a) Whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

   (b) Whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

   (c) Whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof;

(c) **Alteration of Share Capital:** Section 61 of the Companies Act, 2013 lays down power of limited company to alter its share capital. According to the provision a limited company having a share capital may, if so authorised by its articles, alter its memorandum in its general meeting to—

   (a) increase its authorised share capital by such amount as it thinks expedient;

   (b) consolidate and divide all or any of its share capital into shares of a larger amount than its existing shares, however no consolidation and division which results in changes in the voting percentage of shareholders shall take effect unless it is approved by the Tribunal on an application made in the prescribed manner;

   (c) convert all or any of its fully paid-up shares into stock, and reconvert that stock into fully paid-up shares of any denomination;

   (d) sub-divide its shares, or any of them, into shares of smaller amount than is fixed by the memorandum, so, however, that in the sub-division the proportion between the amount paid and the amount, if any, unpaid on each reduced share shall be the same as it was in the case
of the share from which the reduced share is derived;

(e) cancel shares which, at the date of the passing of the resolution in that behalf, have not been taken or agreed to be taken by any person, and diminish the amount of its share capital by the amount of the shares so cancelled.

It may be noted that the cancellation of shares shall not be deemed to be a reduction of share capital.

Section 64 of the Companies Act, 2013 provides that within 30 days of the shares having been consolidated, converted, sub-divided, redeemed, or cancelled or the stock having been reconverted, notice should be given to the Registrar in the prescribed form along with an altered memorandum.

The auditor’s duties in the circumstances shall be:

(i) to verify that the alteration of capital is authorised by the Articles;

(ii) to inspect the minutes of the shareholders authorising the alteration;

(iii) to obtain Allotment Lists containing details of the new holdings of share or stock by each member and to verify the same with the entries;

(iv) to inspect the directors’ resolution in regard to allotment, consolidation, conversion or sub-division passed pursuant to the resolution of the members;

(v) to examine the cancelled share certificates, if any, and agree the same with the counterfoils of new certificates issued;

(vi) to see that the procedure, prescribed by the Articles in this regard, has been complied with;

(vii) to verify that the share capital account is correctly shown in the Balance Sheet; and

(viii) to see that the necessary intimation to the Registrar contemplated by Section 64 has been sent.

(d) Special Points in Audit of a Partnership Firm: Matters which should be specially considered in the audit of accounts of a partnership firm are as under:

(i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.

(ii) Examine the partnership deed signed by all partners and its registration with the registrar of firms. Also ascertain from the partnership deed about capital contribution, profit sharing ratios, interest on capital contribution, powers and responsibilities of the partners, etc.

(iii) Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans, purchase of assets, extraordinary contracts entered into and other such matters which are not of a routine nature.

(iv) Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.

(v) Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.

(vi) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreement.

(vii) Confirming that a provision for the firm’s tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners. Also see various
requirements of legislations applicable to the partnership firm like Section 44(AB) of the Income-tax Act, 1961 have been complied with.

(viii) Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

(e) Audit of receipts from Entry Fees of an Amusement Park:

(i) Evaluate the internal control system regarding entry and collection for entry tickets including rotation of staff.

(ii) Ensure that tickets are pre numbered.

(iii) Ensure that the deposit of cash collected into the bank account very same next day.

(iv) Compute analytical ratios in respect of the receipts pattern i.e. on weekends, holidays, etc. and make comparisons to draw conclusions.