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SUGGESTED SOLUTION

CA FINAL NOV'19

SUBJECT- AUDIT

Test Code – FNJ 7196

BRANCH - () (Date :)

Head Office : Shraddha, 3rd Floor, Near Chinai College, Andheri (E), Mumbai – 69.

Tel : (022) 26836666

Answer 1:

(1 mark x 10 = 10 marks)

- 1) A
- 2) A
- 3) A
- 4) A
- 5) D
- 6) B
- 7) D
- 8) A
- 9) C
- 10) B

Answer 2:

(A)

Attendance at Physical Inventory Counting Not Practicable: In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory, for example, where inventory is held in a location that may pose threats to the safety of the auditor. **The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable.** Further, as explained in SA 200 “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with standards on Auditing”, the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

Further, where attendance is impracticable, alternative audit procedures, for example, inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

In some cases, though, **it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures.** In such cases, SA 705 on Modifications to be Opinion in the Independent Auditor’s Report, requires the auditor to modify the opinion in the auditor’s report as a result of the scope limitation. **(5 marks)**

(B)

Review by Engagement Partner: As per SA 220, “Quality Control for an Audit of Financial Statements”, the engagement partner shall take responsibility for reviews being performed in accordance with the firm’s review policies and procedures. For audits of financial statements of listed entities, the engagement partner shall:

- Determine that an engagement quality control reviewer has been appointed;
- Discuss significant matters arising during the audit engagement, including those identified during the engagement quality control review, with the engagement quality control reviewer; and
- Not date the auditor’s report until the completion of the engagement quality control review.

SA 700, “Forming an Opinion and Reporting on Financial Statements”, requires the auditor’s report to be dated no earlier than the date on which the auditor has obtained

sufficient appropriate evidence on which to base the auditor's opinion on the financial statements. In cases of an audit of financial statements of listed entities where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

In the instant case, OP & Associates are the statutory auditors of a listed company BB Ltd. Which started its operations 5 years back. The field work during the audit of the financial statements of the company for the year ended March 31, 2018 got completed on May 1, 2018. The auditor's report was dated May 12, 2018. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on May 15, 2018.

Thus, in the given case, signing of auditor's report i.e. on May 12, 2018 which is before the completion of review engagement quality control review i.e. May 15, 2018, is not in order. **(5 marks)**

Answer 3:

(A)

Non-Compliance of Laws and Regulations: As per SA 250 "Consideration of Laws and Regulations in an Audit of Financial Statement", **it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations** that determine the reported amounts and disclosures in an entity's financial statements.

The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs.

If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, the auditor is required to report on certain matters specified in Para 3 of CARO, 2016 under section 143 of the Companies Act, 2013.

One of such matter is non-payment of dues to Government, on account of any dispute. As per **clause (vii)(b) of Para 3 of CARO, 2016**, in case dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned.

In the present case, there is Income Tax demand of Rs. 125 Lacs and the company has gone for an appeal, it needs considerations as to whether the entire demand is disputed, because it is difficult to presume that the demand by Income Tax authority is

without any basis. Therefore, as per **AS 29 “Provisions, Contingent Liabilities and Contingent Assets”**, partly to the extent the company considers that the demand is based on some logical basis, that amount may be provided for and the remaining may be disclosed as the contingent liability. Further, it should be brought to notice of the members by reporting.

Additionally, the demand notice has been received for Customs duty of Rs. 85 lakhs and is outstanding on the closure of financial year, for which no action has been taken by the management. Therefore, it should also be brought to notice of the members by reporting. **(6 marks)**

(B)

As per SA 330 on “The Auditor’s Responses to Assessed Risks”, changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance.

The auditor’s decision on whether to rely on audit evidence obtained in previous audits for control is a matter of professional judgement. In addition, the length of time between retesting such controls is also a matter of professional judgement.

Factors that may warrant a re – test of controls are –

- (i) A deficient control environment.
- (ii) Deficient monitoring of controls.
- (iii) A significant manual element to the relevant controls.
- (iv) Personnel changes that significantly affect the application of the control.
- (v) Changing circumstances that indicate the need for changes in the control.
- (vi) Deficient general IT – controls.

(4 marks)

Answer 4:

(A)

SA 320 “Materiality in Planning and Performing an Audit” prescribes the use of Benchmarks in Determining Materiality for the Financial Statements as a Whole.

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. **(6 marks)**

(B)

Important Points to be kept in Mind While Drafting Letter of Weakness: As per SA 265, "Communicating Deficiencies in Internal Control to Those who charged with Governance and Management", the auditor shall include in the written communication of significant deficiencies in internal control -

- (i) A description of the deficiencies and an explanation of their potential effects; and
- (ii) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

- (1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.
- (2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.
- (3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.

The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control. **(4 marks)**

Answer 5:

(A)

The form, content and extent of audit documentation depend on factors such as:

- The size and complexity of the entity.
- The nature of the audit procedures to be performed.
- The identified risks of material misstatement.
- The significance of the audit evidence obtained.
- The nature and extent of exceptions identified.
- The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
- The audit methodology and tools used. **(5 marks)**

(B)

In the instant case, Mr. P as an auditor of RST Ltd. has applied the concept of materiality of the financial statements as a whole. But he wants to re-evaluate the materiality concept on the basis of additional information of significant contractual arrangements which draws

attention to a particular aspect of the company's business.

As per SA 320 "Materiality on planning and performing audit", while establishing the overall audit-strategy, the auditor shall determine materiality for the financial statement as a whole. He should set the benchmark on the basis of which he performs his audit procedure. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than the materiality for the economic decisions of users taken on the basis of financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of the transactions, account balances or disclosures.

The auditor shall revise materiality for the financial statements in the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount initially.

If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revise performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

Thus, Mr. P can re-evaluate the materiality concepts after considering the necessity of such revision.

(5 marks)