

PAPER – 6: AUDITING AND ASSURANCE

PART – I : ACADEMIC UPDATE

Chapter 9 (Printed Copy)

At Page 10- Topic “Shares issued at a discount” is revised and being given hereunder. Students are advised to study this topic from here and not from printed copy of the study material.

Shares issued at a discount

According to Section 53 of the Companies Act, 2013,

- (1) a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under Section 54 of the Companies Act, 2013.
- (2) any share issued by a company at a discounted price shall be void.
- (2A) Notwithstanding anything contained in sub-sections (1) and (2), a company may issue shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.
- (3) Where any company fails to comply with the provisions of this section, such company and every officer who is in default shall be liable to a penalty which may extend to an amount equal to the amount raised through the issue of shares at a discount or five lakh rupees, whichever is less, and the company shall also be liable to refund all monies received with interest at the rate of twelve per cent. per annum from the date of issue of such shares to the persons to whom such shares have been issued.

The auditor needs to check

- (i) the movement in share capital during the year and wherever there is any issue,
- (ii) he should verify that the Company has not issued any of its shares at a discount by reading the minutes of meeting of its directors and shareholders authorizing issue of share capital and the issue price.
- (iii) Further, auditor should also verify that whether the company has issued shares at a discount to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949.

This topic has also been revised at page no. 10 of chapter 9 and students can refer at the link given below:

<https://resource.cdn.icai.org/66605bos53774-cp9.pdf>

Chapter 10 – COMPANY AUDIT

Chapter 10 (Printed Copy) At Page 10.61- Topic “Punishment for non-compliance” is revised and being given hereunder. Students are advised to study this topic from here and not from printed copy of the study material.

Punishment for non-compliance - Section 147 of the Companies Act, 2013 prescribes following punishments for contravention:

- (1) If any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than twenty-five thousand rupees, but which may extend to five lakh rupees and every officer of the company who is in default shall be punishable with fine which shall not be less than ten thousand rupees, but which may extend to one lakh rupees.
- (2) If an auditor of a company contravenes any of the provisions of section 139, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees, but which may extend to five lakh rupees or four times the remuneration of the auditor, whichever is less.

It may be noted that if an auditor has contravened such provisions knowingly or willfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than fifty thousand rupees but which may extend to twenty-five lakh rupees or eight times the remuneration of the auditor, whichever is less.

- (3) Where an auditor has been convicted under sub-section (2), he shall be liable to: -
 - (i) refund the remuneration received by him to the company.
 - (ii) and pay for damages to the company statutory bodies or authorities or to members or the creditors of the Company for loss arising out of incorrect or misleading statements of particulars made in his audit report.
- (4) The Central Government shall, by notification, specify any statutory body or authority of an officer for ensuring prompt payment of damages to the company or the persons under clause (ii) of sub-section (3) and such body, authority or officer shall after payment of damages such company or persons file a report with the Central Government in respect of making such damages in such manner as may be specified in the said notification.
- (5) Where, in case of audit of a company being conducted by an audit firm, it is proved that the partner or partners of the audit firm has or have acted in a fraudulent manner or abetted or colluded in an fraud by, or in relation to or by, the company or its directors or officers, the liability, whether civil criminal as provided in this Act or in any other law for the time being in force, for such act shall be the partner or partners concerned of the audit firm and

of the firm jointly and severally. However, in case of criminal liability of an audit firm, in respect of liability other than fine, the concerned partner or partners, who acted in a fraudulent manner or abetted or, as the case may be, colluded in any fraud shall only be liable.

This topic has also been revised at page no. 10.61 of chapter 10 and students can refer at the link given below:

<https://resource.cdn.icai.org/66606bos53774-cp10.pdf>

PART – II: QUESTIONS AND ANSWERS

PART – II A: Multiple Choice Questions based on Case Scenarios

Case Scenario - 1

SAM & Company, a Chartered Accountant firm, is in the process of finalising the audit of Health is Wealth Limited which is a Company listed on the Bombay Stock Exchange. Health is Wealth Limited has made its presence felt in over 10 countries, including India, making it a leader in the global fitness industry. It runs a chain of fitness centres that offers energetic group workouts and multiple workout formats to choose from. It also offers the best equipment, knowledgeable staff and personal advice in a welcoming environment.

SAM & Company being a very reputed firm, was appointed for the statutory audit of Health is Wealth Limited. The Engagement Partner CA A and her team of 8 members have conducted the audit in an efficient and effective manner. The senior manager in the team, CA K is of the opinion that they have obtained sufficient appropriate audit evidence, which concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements. One of the articled clerks, Mr. N, is a fresher and this audit is his first experience as an auditor in a limited company. He is a sharp boy and has grasped all the concepts and techniques very well. However, the term “pervasive” confused him so CA K patiently explained to Mr. N the pervasive effects on the financial statements as per the auditor’s judgement. He explained that - Pervasive effects on the financial statements are those that, in the auditor’s judgement:

- (i) Are not confined to specific elements, accounts or items of the financial statements;
- (ii) If so confined, represent or could represent a substantial proportion of the financial statements; or
- (iii) In relation to disclosures, are fundamental to users’ understanding of the financial statements.
- (iv) Are confined to specific elements, accounts or items of the financial statements.

Mr. N understood the term well and thanked CA K for clearing all his doubts.

CA A disagreed with CA K that they have obtained sufficient appropriate audit evidence, which concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements. So, the entire team held various meetings and discussions, and finally reached to a conclusion. They concluded that they have obtained reasonable assurance that the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion took into account:

- (a) Whether sufficient appropriate audit evidence had been obtained.
- (b) Whether uncorrected misstatements were material, individually or in aggregate.
- (c) The evaluations.

The Auditor's Report was prepared in writing and it was decided that an unmodified opinion would be expressed. The first section of the auditor's report included the auditor's opinion and had the heading "Opinion". Following the Opinion section was a section with the heading "Basis for Opinion". When expressing an unmodified opinion on financial statements, the auditor's opinion used the following phrase,

"In our opinion, the accompanying financial statements give a true and fair view of [...] in accordance with [the applicable financial reporting framework]."

During the audit, the audit team had observed that there was uncertainty in Health is Wealth Limited relating to the future outcome of a regulatory action. So, a paragraph was included in the auditor's report that referred to this matter which was appropriately disclosed in the financial statements and that, in the auditor's judgment, was of such importance that it was fundamental to users' understanding of the financial statements.

CA A also determined whether the financial statements included the comparative information required by the applicable financial reporting framework and whether such information was appropriately classified. One team member, Mr R was curious to know whether the auditor's opinion referred to the corresponding figures or not, whenever the corresponding figures are presented. CA A explained the circumstances to Mr R in which, when the corresponding figures are presented, auditor's opinion referred to the corresponding figures.

Based on the above information, answer the following questions:

- 1.1 CA K explained to Mr. N the pervasive effects on the financial statements in the auditor's judgement. Which of the following combination best answers as explained by CA K ?
- (a) (i) and (ii)
 - (b) (ii) and (iii)
 - (c) (iii) and (iv)
 - (d) (i), (ii) and (iii)

- 1.2 When expressing an unmodified opinion on financial statements, SAM & Company used the following phrase:
- “In our opinion, the accompanying financial statements **give a true and fair view of** [...] in accordance with [the applicable financial reporting framework].”
- Which is the other phrase which is regarded as being equivalent to the above phrase and could also be used by SAM & Company?
- (a) In our opinion, the accompanying financial statements give a true and correct view of [...] in accordance with [the applicable financial reporting framework];
 - (b) In our opinion, the accompanying financial statements present correctly, in all material respects, [...] in accordance with [the applicable financial reporting framework];
 - (c) In our opinion, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [the applicable financial reporting framework];
 - (d) In our opinion, the accompanying financial statements give a correct and fair view of [...] in accordance with [the applicable financial reporting framework].
- 1.3 Which of the following statements is not included in the section with the heading “Basis for Opinion” in the Auditor’s Report?
- (a) Audit was conducted in accordance with the Accounting Standards.
 - (b) Auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor’s other ethical responsibilities in accordance with these requirements.
 - (c) Description of the auditor’s responsibilities under the SAs.
 - (d) States whether the auditor believes that the audit evidence the auditor has obtained, is sufficient and appropriate to provide a basis for the auditor’s opinion.
- 1.4 A paragraph was included in the Auditor’s Report of Health is Wealth Limited that referred to a matter which was appropriately disclosed in the financial statements that, in the auditor’s judgment, was of such importance that it was fundamental to users’ understanding of the financial statements. What is this section of the Auditor’s Report called?
- (a) Other Matters.
 - (b) Emphasis of Matters.
 - (c) Key Audit Matters.
 - (d) Auditor’s Responsibilities for the Audit of the Financial Statements.

- 1.5 CA A explained the circumstances to Mr. R in which, when the corresponding figures are presented, auditor's opinion referred to the corresponding figures. Which of these circumstances did he mention to Mr. R?
- (a) If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which a modified opinion has been previously issued.
 - (b) If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is resolved.
 - (c) Prior Period Financial Statements are audited by another auditor.
 - (d) Prior Period Financial Statements not audited.

Case Scenario - 2

Bharat Bank, a nationalised bank, has branches all over India and has been the most popular public sector bank in India for the past few years. The bank is governed by the Banking Regulations Act, 1949 and the Central Statutory Auditors of the bank, ABC & Associates, were appointed according to the provisions of the relevant enactments. The engagement partner CA C commenced the audit with his team of seven members so that the audit is completed on time and all the documents are submitted before the due date. The audit at all the branches also started simultaneously and ABC & Associates was in constant touch with all the branch auditors to ensure timely completion of the audit.

As per the audit strategy and plan, CA Q along with Ms. R and Mr. P were assigned the audit of the advances of Bharat Bank. Advances constituted the largest item on the assets side of the balance sheet of the bank. Since audit of advances is one of the most important areas covered by auditors in a bank audit, it was assigned to CA Q since he was aware of the various functional areas of the bank/branches, its processes, procedures, systems and prevailing internal controls with regard to advances.

CA Q started with verifying whether the advances were classified as per RBI Prudential Norms. There were five categories of advances which were available to CA Q for verification. They were: Standard Regular, Sub Standard, Doubtful, Loss and Special Mention Accounts. An ageing analysis was available for doubtful advances and Special Mention Accounts which was examined in detail by CA Q.

Ms. R, on being instructed by CA Q, verified the securities offered by the borrowers for the bank finance. For a particular customer named Aquabross Pvt Ltd., the security was in the form of delivery of goods by Aquabross to Bharat Bank with the intention of creating a charge thereon as security for the advance. The legal ownership of the goods remained with Aquabross. In case of another customer named Prism Works, there was a transfer of a life insurance policy in favour of the bank as security. The bank had absolute right over the policy. Ms. R examined all the relevant documents for the above two cases in detail. She continued with her examination of other securities based on the sample selected by her.

While checking the classification of NPA, Mr. P came across a customer named Trustworthy whose term loan instalment was overdue for 90 days at the year-end, but it was 100% secured against the office building. The same was classified as a Substandard asset. There was another customer named Super40, who had a cash credit account and a term loan with the bank. Super40 had been paying the instalments on the term loan as well as the interest on the cash credit account regularly and there was no overdue amount. Mr. P verified the drawing power of Super40 and found it to be less than the sanctioned limit throughout the year. The outstanding balance of Super40 during the whole year exceeded the drawing power but was less than the sanctioned limit. Both the advances to Super40 were classified as Standard Advances since the recoveries were regular and outstanding balance in the cash credit was less than the sanctioned limit.

On examination of large advances, CA Q noticed that a customer named Stylish N Smart Private Limited had one funded loan (term loan) and one non funded loan (bank guarantee) sanctioned from the bank. CA Q checked in detail whether commission earned by the bank on the bank guarantee was provided for on accrual basis.

CA Q along with Ms. R and Mr. P verified the advances in detail and also recommended a few changes in the classification/provisions based on the examination of the sample selected by them.

Based on the above information, answer the following questions:

- 2.1 What are the sub categories of the special mention accounts?
 - (a) SMA 0 (accounts showing stress signals), SMA 1 (Overdue between 31-60 days) and SMA 2 (Overdue between 61-90 days)
 - (b) SMA 0 (accounts showing stress signals), SMA 1 (Overdue between 0-45 days) and SMA 2 (Overdue between 46-90 days)
 - (c) SMA 0 (accounts not yet due for payment), SMA 1 (Overdue between 31-60 days) and SMA 2 (Overdue between 61-90 days)
 - (d) SMA 0 (accounts not yet due for payment), SMA 1 (Overdue between 0-45 days) and SMA 2 (Overdue between 46-90 days)
- 2.2 Creation of security of Aquabross Private Ltd. and Prism Works was in the form of:
 - (a) Mortgage and Hypothecation.
 - (b) Lien and Set-off.
 - (c) Hypothecation and Pledge.
 - (d) Pledge and Assignment.
- 2.3 In your opinion is Trustworthy a standard asset or a substandard asset?
 - (a) Though it is due for 90 days, it is 100% secured so it is a standard asset.
 - (b) Since it is due for 90 days, it is a substandard asset irrespective of the security.

- (c) Since it is not due for more than 90 days, it is a standard asset irrespective of the security.
 - (d) Since it is not due for more than 90 days **and** it is 100 % secured, it is a standard asset.
- 2.4 Is Super40 correctly classified as a standard asset?
- (a) Yes, since the recoveries in both term loan and cash credit were regular and outstanding balance in the cash credit was less than the sanctioned limit.
 - (b) No, since the outstanding balance of the cash credit facility exceeded the drawing power for more than 90 days, so both the advances, that is, the term loan and cash credit facility will be classified as NPA.
 - (c) No, since the outstanding balance of the cash credit facility exceeded the drawing power for more than 90 days, the cash credit facility will be classified as NPA and term loan as standard.
 - (d) Yes, since the recoveries in both term loan and cash credit were regular, there is no relevance of sanctioning power/drawing power.
- 2.5 Which among the following is a non- funded loan?
- (a) Demand Loans
 - (b) Bills Discounted and Purchased
 - (c) Letter of Credit
 - (d) Participation on Risk Sharing basis

General MCQs

1. As per SA-210, preconditions for an audit do not include which of the following?
 - (a) Acceptability of financial reporting framework
 - (b) Responsibility of management regarding preparation of financial statements
 - (c) Making available records to the auditor
 - (d) Integrity of key management personnel
2. An auditor signs a false audit report knowingly. Which of the following fundamental principles of professional ethics is violated in such a case?
 - (a) Objectivity
 - (b) Integrity
 - (c) Professional Competence and due care
 - (d) Professional behaviour

3. Which of the following statements is MOST APPROPRIATE?
 - (a) Audit programme is a detailed plan of audit strategy
 - (b) Audit programme cannot be reviewed
 - (c) Audit programme is a detailed plan of applying audit procedures
 - (d) Audit programme is relevant for year for which it is prepared, it is useless for subsequent years.
4. A company is engaged in business of obtaining eggs from one day old chicks. Which of the following is NOT an example of an event or condition that may cast significant doubt on the ability of the company to continue as a going concern?
 - (a) Mortality of 90% of livestock of the company
 - (b) Decision by govt to ban commercial rearing of birds amidst protests by activists for preventing cruelty to animals
 - (c) Shifting of farm labour to respective villages due to MGNREGA scheme of Govt causing acute scarcity throughout the year
 - (d) Increase in cost of feed of chicks by 20% during the year
5. "Letters of credit" and "Foreign bills purchased and discounted" are examples of respectively:
 - (a) Funded facility and non- funded facility
 - (b) Non-funded facility and funded facility
 - (c) Funded facility and funded facility
 - (d) Non-funded facility and Non-funded facility

PART II B – DESCRIPTIVE QUESTIONS

1. State with reason (in short) whether the following statements are true or false:
 - (i) The level of sampling risk that the auditor is willing to accept will not affect the sample size.
 - (ii) There is no difference between "audit" and "review."
 - (iii) Negative assertions, encountered in the financial statements, may be expressed or implied.
 - (iv) Development of an audit plan is important before the establishment of the overall audit strategy to address the various matters.
 - (v) An unexplained decrease in GP Ratio may result due to fictitious sales.
 - (vi) An auditor has to report on the matters specified in section 143(1) of the Companies Act, 2013.

- (vii) There is an inverse relationship between detection risks and the combined level of inherent and control risks.
- (viii) For auditor's opinion, reasonable assurance is an absolute level of assurance.

Chapter 1 - Nature, Objective and Scope of Audit

2. (a) There are practical and legal limitations on the auditor's ability to obtain audit evidence. Explain giving examples. Also explain the difference between audit and investigation.
- (b) The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism. Explain.
3. (a) The firm should establish policies and procedures designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles. Explain stating clearly personnel issues addressed by such policies and procedures.
- (b) An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so. Explain the circumstances which may contribute towards a request from the client for the auditor to change the engagement.

Chapter 2 - Audit Strategy, Audit Planning and Audit Programme

4. (a) The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors. Discuss those factors.
- (b) Explain what do you mean by documentation of audit plan. Discuss the purpose served by it and also elaborate the tools used by the auditor to reflect the particular engagement circumstances.
5. While developing an audit programme, the auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. Explain stating clearly the points to be kept in mind while developing an audit programme.

Chapter 3 - Audit Documentation and Audit Evidence

6. (a) CA R comes to know some very critical information with regards to the business cycle of an entity for which he has issued the audit report, which become known to him as an auditor after the date of the auditor's report but which existed at that date and which, if known at that date, might have caused the financial statements to be amended or the auditor to modify the opinion in the auditor's report. He wants to perform additional audit procedures to satisfy himself. As an auditor what he shall

document, on the matters arising after the date of audit report?

- (b) The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor to understand significant matters arising during the audit. Explain the above statement and also give examples of significant matters.
7. (a) An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively. Explain.
- (b) Manya Textiles is manufacturer of bed sheets, curtain cloths, other handloom items etc. having its plant at Panipat. Auditors SJ & Co. is having doubts over the reliability of information given to him as audit evidence. Also, auditors observed inconsistent information while conducting audit. Guide the auditor as to how they should proceed in the given situation.
8. External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. Apart from confirmations for bank balances and accounts receivables, what are the other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement?

Chapter 4 - Risk Assessment and Internal Control

9. (a) Define Monitoring of Controls and in respect of monitoring of controls, answer the following questions:
- (i) How monitoring of controls would be helpful in assessing the effectiveness of controls?
 - (ii) How can management accomplish monitoring of controls?
 - (iii) What is included in the Management's monitoring activities?
- (b) Explain the matters which should be included for factors relevant to the auditors' judgement about whether a control is relevant to the audit.
10. The review of internal controls will enable the auditor to know the areas where control is weak. Explain stating clearly the benefits of evaluation of internal control to the auditor.

Chapter 5 - Fraud and Responsibilities of the Auditor in this Regard.

11. Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Illustrate techniques by which fraud can be committed by management overriding controls.
12. Write the examples of circumstances that indicate the possibility of fraud due to problematic or unusual relationship between the auditor and management.

Chapter 6 - Audit in an Automated Environment

13. List the points that an auditor should consider to obtain an understanding of the Company's automated environment.
14. Which are specific risks to the company's internal control having IT environment?

Chapter 7- Audit Sampling

15. Explain the meaning of Audit Sampling as per the relevant standard on auditing. State the requirements relating to audit sampling, sample design, sample size and selection of items for testing.
16. This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e. it is suitable for a homogeneous population having a similar range. Explain about that method.

Chapter 8 - Analytical Procedures

17. Explain the aspects to be considered by an auditor when designing and performing substantive analytical procedures, either alone or in combination with test of details, as substantive procedures in accordance with SA 330.
18. Discuss with examples the factors that are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures.

Chapter 9 - Audit of Items of Financial Statements

19. Name the assertions for the following audit procedures:
 - (i) Year end inventory verification.
 - (ii) Depreciation has been properly charged on all assets.
 - (iii) The title deeds of the lands disclosed in the Balance Sheet are held in the name of the company.
 - (iv) All liabilities are properly recorded in the financial statements.
 - (v) Related party transactions are shown properly.
20. PK Pvt Ltd, based in Moradabad, is engaged in export of brassware goods. The company has huge export receivables as on 31st March 2022. It is also analysed from Export Sales account of the company that large number of small shipments were almost despatched daily during month of March 2022. List out few audit procedures you would adopt as an auditor to verify completeness assertion of export trade receivables.

Chapter 10 - The Company Audit

21. XYZ Limited is engaged in the business of Shoes having geographical presence across India. Following details are available from the last audited financial statements of XYZ Limited for the financial year 2020-21:

Particulars	₹
Paid-up Capital as on 31 st March, 2021	9.8 Crores
Turnover for Financial Year 2020-21	98 Crores
Outstanding Loan from Bank as on 31 st March, 2021	25 Crores
Liability on Outstanding Debentures as on 31 st March, 2021	26 Crores

Comment on the applicability of constitution of Audit Committee for XYZ Limited for the financial year 2021-22 based on the above information.

22. S Private Limited has a paid-up share capital of ₹ 49 Crores and borrowings from bank of ₹ 99 Crores. The audit firm P & Company was appointed as statutory auditors of the Company for one term of five consecutive years. Whether the provision of rotation of auditors applicable to the company? Comment.
23. Enumerate the circumstances under which the retiring auditor can be re-appointed.

Chapter 11 - Audit Report

24. Mention the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph.
25. While drafting auditor's report of LK Ltd., what are the matter to be included by auditor in Opinion Section paragraph?

Chapter 12 - Bank Audit

26. CA. Puranjay is appointed as statutory branch auditor of two branches of a nationalized bank for year 2021-22. During the course of audit, he came across the following:
 - (a) While verifying advances of one semi-urban branch, he noticed substantial number of accounts categorized as SMA (Special mention accounts). In this context, explain the nature and significance of SMA.
 - (b) While verifying interest income of a mid-corporate branch of an urban centre having advances consisting of only cash credit limits for large borrowers, it was noticed that advances of ₹ 300 crores were outstanding as on balance sheet date carrying average interest rate @8% p.a.

One articled clerk in audit team makes quick back of the envelope calculations of interest income of ₹ 24 crores on advances. However, schedule of profit & loss a/c shows interest income on advances for ₹ 10 crores. Discuss any two probable reasons for such variation.

27. In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about amounts included in balance sheet in respect of advances which are outstanding. Explain stating clearly all the considerations in this context.

Chapter 13 - Audit of Different Types of Entities

28. (a) You have been appointed as an auditor of ABC Hotel, a three star hotel, for Financial Year 2021-22. As an auditor what are the special points that need to be considered in verifying the Inventories in the nature of food and beverages?
- (b) Cinescreen Multiplex Ltd. is operating cinemas in different locations in Mumbai and has appointed you as an internal auditor. What are the areas that need to be verified in relation to receipts from sale of Tickets?

SUGGESTED ANSWERS**Answer Key- Case Scenario - 1**

Question No.	Answer
1.1	(d) (i), (ii) and (iii)
1.2	(c) In our opinion, the accompanying financial statements present fairly, in all material respects, [...] in accordance with [the applicable financial reporting framework];
1.3	(a) Audit was conducted in accordance with the Accounting Standards.
1.4	(b) Emphasis of Matters.
1.5	(d) Prior Period Financial Statements not audited.

Answer Key- Case Scenario - 2

Question No.	Answer
2.1	(a) SMA 0 (accounts showing stress signals), SMA 1 (Overdue between 31-60 days) and SMA 2 (Overdue between 61-90 days)
2.2	(d) Pledge and Assignment.
2.3	(c) Since it is not overdue for more than 90 days, it is a standard asset irrespective of the security.
2.4	(b) No, since the outstanding balance of the cash credit facility exceeded the drawing power for more than 90 days, so both the advances, that is, the term loan and cash credit facility will be classified as NPA.
2.5	(c) Letter of Credit

Answer Key- General MCQ's

1. (d)
2. (b)
3. (c)
4. (d)
5. (b)

Descriptive Answers

1. (i) **Incorrect:** As per SA 530, "Audit Sampling" the level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.
- (ii) **Incorrect:** "Audit" and "Review" are two different terms. Audit is a reasonable assurance engagement, and its objective is reduction in assurance engagement risk to an acceptably low level in the circumstances of the engagement. However, "review" is a limited assurance engagement, and its objective is a reduction in assurance engagement risk to a level that is acceptable in the circumstances of the engagement
- (iii) **Correct:** Negative assertions are also encountered in the financial statements and the same may be expressed or implied. For example, if it is stated that there is no contingent liability it would be an expressed negative assertion; on the other hand, if in the balance sheet there is no item as "building", it would be an implied negative assertion that the entity did not own any building on the balance sheet date.
- (iv) **Incorrect: As per SA-300, "Planning an Audit of Financial Statements",** the auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.
- (v) **Incorrect:** A fictitious sale will increase the GP Ratio, instead of decreasing it. GP ratio normally comes down if there are unrecorded sales or reversal of fictitious sale entries recorded in the previous year or fictitious purchase or decrease in closing stock.
- (vi) **Incorrect:** The auditor is not required to report on the matters specified in section 143(1) of the Companies Act, 2013 unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. However, the auditor should make a report to the members in case he finds answer to any of these matters in adverse.
- (vii) **Correct:** There is an inverse relationship between detection risks and the combined level of inherent and control risks. For example, when inherent and control risks are

high. acceptable detection risks need to be low to reduce audit risk to an acceptably low level. On the other hand, when inherent and control risks are low, an auditor can accept a higher detection risks and still reduce audit risks to an acceptably low level.

(viii) **Incorrect:** Reasonable assurance is a high level but not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

2. (a) **The Nature of Audit Procedures:** There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:

1. There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.
2. Fraud may involve sophisticated and carefully organised schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.

We have to clearly understand that audit is distinct from investigation. Investigation is a critical examination of the accounts with a special purpose. For example, if fraud is suspected and it is specifically called upon to check the accounts whether fraud really exists, it takes character of investigation.

The objective of audit, on the other hand as we have already discussed, is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.

Therefore, audit is never started with a pre-conceived notion about state of affairs; about wrong-doing; about some wrong having been committed. The auditor seeks to report what he finds in normal course of examination of accounts. However, it is quite possible that sometimes investigation results from the prima facie findings of the auditor. It may happen that auditor has given some findings of serious concern. Such findings may prompt for calling an investigation.

- (b) The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated.

Professional skepticism includes being alert to, for example:

- ◆ Audit evidence that contradicts other audit evidence obtained.
- ◆ Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
- ◆ Conditions that may indicate possible fraud.
- ◆ Circumstances that suggest the need for audit procedures in addition to those required by the SAs.
- ◆ Maintaining professional skepticism throughout the audit is necessary if the auditor is to reduce the risks of:
 - ◆ Overlooking unusual circumstances.
 - ◆ Over generalising when drawing conclusions from audit observations.
 - ◆ Using inappropriate assumptions in determining the nature, timing, and extent of the audit procedures and evaluating the results thereof.

Professional skepticism is necessary to the critical assessment of audit evidence. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount.

The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud, the SAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter.

The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism.

3. (a) The firm should establish **policies and procedures** designed to provide it with reasonable assurance that it has sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to perform its engagements in accordance with professional standards and regulatory and legal

requirements, and to enable the firm or engagement partners to issue reports that are appropriate in the circumstances.

Such policies and procedures address the following personnel issues:

- (a) Recruitment.
- (b) Performance evaluation.
- (c) Capabilities.
- (d) Competence.
- (e) Career development.
- (f) Promotion;
- (g) Compensation; and
- (h) Estimation of personnel needs.

- (b) An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

A request from the client for the auditor to change the engagement may result from-

1. a change in circumstances affecting the need for the service,
2. a misunderstanding as to the nature of an audit or related service originally requested.
3. a restriction on the scope of the engagement, whether imposed by management or caused by circumstances.

4. (a) The nature, timing and extent of the direction and supervision of engagement team members and review of their work vary depending on many factors, including:
- The size and complexity of the entity.
 - The area of the audit.
 - The assessed risks of material misstatement (for example, an increase in the assessed risk of material misstatement for a given area of the audit ordinarily requires a corresponding increase in the extent and timeliness of direction and supervision of engagement team members, and a more detailed review of their work).
 - The capabilities and competence of the individual team members performing the audit work.

- (b) The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks.

It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance.

The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

5. While developing an audit programme, the auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts.

For the purpose of programme construction, the following points should be kept in mind:

- (1) Stay within the scope and limitation of the assignment.
 - (2) Prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.
 - (3) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
 - (4) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
 - (5) Include the audit objectives for each area and sufficient details which serve as a set of instructions for the assistants involved in audit and help in controlling the proper execution of the work.
 - (6) Consider all possibilities of error.
 - (7) Co-ordinate the procedures to be applied to related items.
6. (a) As per SA 230, "Audit Documentation", if, in exceptional circumstances, the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report, the auditor shall document:
- (i) The circumstances encountered;
 - (ii) The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and
 - (iii) When and by whom the resulting changes to audit documentation were made and reviewed.

- (b) The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

Judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include:

- ◆ Matters that give rise to significant risks.
 - ◆ Results of audit procedures indicating (a) that the financial statements could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
 - ◆ Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
 - ◆ Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter paragraph in the auditor's report.
7. (a) Auditing is a logical process. An auditor is called upon to assess the actualities of the situation, review the statements of account and give an expert opinion about the truth and fairness of such accounts. This he cannot do unless he has examined the financial statements objectively.

Objective examination connotes critical examination and scrutiny of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a true and fair view about the financial results and state of affairs. An opinion founded on a rather reckless and negligent examination and evaluation may expose the auditor to legal action with consequential loss of professional standing and prestige.

He needs evidence to obtain information for arriving at his judgement.

SA 500 – "Audit Evidence", explains what constitutes audit evidence in an audit of financial statements, and deals with the auditor's responsibility to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

- (b) If:
- (a) audit evidence obtained from one source is inconsistent with that obtained from another; or
 - (b) the auditor has doubts over the reliability of information to be used as audit evidence,

the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.

8. Other examples of situations where external confirmations may be used include the following:
- ◆ Inventories held by third parties at bonded warehouses for processing or on consignment
 - ◆ Property title deeds held by lawyers or financiers for safe custody or as security
 - ◆ Investments held for safekeeping by third parties, or purchases from stockbrokers but not delivered at the balance sheet date
 - ◆ Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
 - ◆ Accounts payable balances and terms
 - ◆ Long outstanding share application money.
9. (a) **Monitoring of controls Defined:** Monitoring of controls is a process to assess the effectiveness of internal control performance over time.
- (i) **Helps in assessing the effectiveness of controls on a timely basis:** It involves assessing the effectiveness of controls on a timely basis and taking necessary remedial actions.
 - (ii) **Management accomplishes through ongoing activities, separate evaluations etc.:** Management accomplishes monitoring of controls through ongoing activities, separate evaluations, or a combination of the two. Ongoing monitoring activities are often built into the normal recurring activities of an entity and include regular management and supervisory activities.
 - (iii) **Management's monitoring activities include:** Management's monitoring activities may include using information from communications from external parties such as customer complaints and regulator comments that may indicate problems or highlight areas in need of improvement.
- (b) **Controls Relevant to the Audit:** Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:
- (i) Materiality.
 - (ii) The significance of the related risk.
 - (iii) The size of the entity.
 - (iv) The nature of the entity's business, including its organisation and ownership characteristics.
 - (v) The diversity and complexity of the entity's operations.
 - (vi) Applicable legal and regulatory requirements.

- (vii) The circumstances and the applicable component of internal control.
- (viii) The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
- (ix) Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

10. Benefits of Evaluation of Internal Control to the Auditor

The review of internal controls will enable the auditor to know:

- (i) whether errors and frauds are likely to be located in the ordinary course of operations of the business;
- (ii) whether an adequate internal control system is in use and operating as planned by the management;
- (iii) whether an effective internal auditing department is operating;
- (iv) whether any administrative control has a bearing on his work (for example, if the control over worker recruitment and enrolment is weak, there is a likelihood of dummy names being included in the wages sheet and this is relevant for the auditor);
- (v) whether the controls adequately safeguard the assets;
- (vi) how far and how adequately the management is discharging its function in so far as correct recording of transactions is concerned;
- (vii) how reliable the reports, records and the certificates to the management can be;
- (viii) the extent and the depth of the examination that he needs to carry out in the different areas of accounting;
- (ix) what would be appropriate audit technique and the audit procedure in the given circumstances;
- (x) what are the areas where control is weak and where it is excessive; and
- (xi) whether some worthwhile suggestions can be given to improve the control system.

11. Techniques of frauds committed by Management: Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as:

- (1) Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives
- (2) Inappropriately adjusting assumptions and changing judgments used to estimate account balances
- (3) Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period

- (4) Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements
- (5) Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity
- (6) Altering records and terms related to significant and unusual transactions.

12. Examples of circumstances that indicate the possibility of fraud due to problematic or unusual relationship between the auditor and management are:

1. Denial of access to records, facilities, certain employees, customers, vendors, or others from whom audit evidence might be sought.
2. Undue time pressures imposed by management to resolve complex or contentious issues.
3. Complaints by management about the conduct of the audit or management intimidation of engagement team members, particularly in connection with the auditor's critical assessment of audit evidence or in the resolution of potential disagreements with management.
4. Unusual delays by the entity in providing requested information.
5. Unwillingness to facilitate auditor access to key electronic files for testing through the use of computer-assisted audit techniques.
6. Denial of access to key IT operations staff and facilities, including security, operations, and systems development personnel.
7. An unwillingness to add or revise disclosures in the financial statements to make them more complete and understandable.
8. An unwillingness to address identified deficiencies in internal control on a timely basis.
9. Unwillingness by management to permit the auditor to meet privately with those charged with governance
10. Accounting Policy that appears to be variance with industry norms
11. Frequent changes in accounting estimates that do not appear to result from changed circumstances
12. Tolerance of variations in the entity's code of conduct

13. Understanding of the Company's Automated Environment: Given below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment

- Information systems being used (one or more application systems and what they are)
- their purpose (financial and non-financial)
- Location of IT systems - local vs global

- Architecture (desktop based, client-server, web application, cloud based)
 - Version (functions and risks could vary in different versions of same application)
 - Interfaces within systems (in case multiple systems exist)
 - In-house vs Packaged
 - Outsourced activities (IT maintenance and support)
 - Key persons (CIO, CISO, Administrators)
14. IT poses specific risks to the Company's internal control, which include-
- (i) Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
 - (ii) Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or nonexistent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
 - (iii) The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
 - (iv) Unauthorised changes to data in master files.
 - (v) Unauthorised changes to systems or programs.
 - (vi) Failure to make necessary changes to systems or programs. Inappropriate manual intervention.
 - (vii) Potential loss of data or inability to access data as required.
15. **Audit Sampling:** As per SA 530 on "Audit Sampling", the meaning of the term Audit Sampling is – 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.
- The requirements relating to sample design, sample size and selection of items for testing are explained below-
- **Sample design** - When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.
 - **Sample Size** - The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.
 - **Selection of Items for Testing** - The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

- 16. Simple Random Sampling:** Under this method each unit of the whole population e.g. purchase or sales invoice has an equal chance of being selected. It is considered that random number tables are simple and easy to use and also provide assurance that the auditors' bias does not affect the selection. Each item in a population is selected by use of random number table either with a help of computer or picking up a number in a random way (may be randomly from a drum). Today random numbers are also generated using various applications on the cellphones like the random number generator.

This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e. it is suitable for a homogeneous population having a similar range.

- 17. Analytical procedures used as substantive tests:** When designing and performing substantive analytical procedures, either alone or in combination with test of details as, substantive procedures in accordance with SA 330, the auditor shall:
- (i) Determine the suitability of particular substantive analytical procedures for given assertions, taking account of the assessed risks of material misstatement and test of details, if any, for these assertions.
 - (ii) Evaluate the reliability of data from which the auditor's expectation of recorded amounts or ratios is developed, taking account of source, comparability, and nature and relevance of information available, and controls over preparation.
 - (iii) Develop an expectation of recorded amounts or ratios and evaluate whether the expectation is sufficiently precise to identify a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.
 - (iv) Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.
- 18.** The reliability of data is influenced by its source and nature and is dependent on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:
- (i) Source of the information available. **For example**, information may be more reliable when it is obtained from independent sources outside the entity;
 - (ii) Comparability of the information available. **For example**, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products;
 - (iii) Nature and relevance of the information available. **For example**, whether budgets have been established as results to be expected rather than as goals to be achieved; and

- (iv) Controls over the preparation of the information that are designed to ensure its completeness, accuracy and validity. **For example**, controls over the preparation, review and maintenance of budgets.
- 19.
- (i) Year-end inventory verification: Existence Assertion.
 - (ii) Depreciation has been properly charged on all assets: Valuation Assertion.
 - (iii) Title deed of lands disclosed in the Balance Sheet are held in the name of the Company: Rights & Obligations Assertion.
 - (iv) All liabilities are properly recorded in the financial statements: Completeness.
 - (v) Related party transactions are shown properly: Presentation & Disclosure.
20. Completeness assertion in respect of account balances means that all balances which should have been recorded have been recorded. The auditor needs to satisfy himself about cut off so that there is no understatement or overstatement in account balances of export receivables.

In this context, while verifying completeness assertion of export trade receivables, following audit procedures are required: -

- (1) Check that in respect of invoices raised in last few days nearing the cut off date, goods have been actually dispatched and not lying with the company.
 - (2) Check stock records, e-way bill, and transporter receipt regarding actual movement of goods. It would provide assurance that export invoices in respect of which revenue was booked have been actually moved out of company's premises.
 - (3) Ensure that all goods invoiced prior to cut off date/year end have been included in export receivables on test check basis.
 - (4) Ensure that no goods despatched after year end have been included in export receivables by tracing entries in export sales, stock records of next year. The same can be verified from e-way bills also.
 - (5) Match invoices to despatch/shipping details. Further match invoices dates to despatch dates to see if sales are being recorded in correct accounting period.
 - (6) Test invoices in receivable report. Select invoices from ageing report of export receivables and compare them with supporting documentation to ensure that these are billed with correct names, dates and amounts.
21. **Applicability of Constitution of Audit Committee:** According to Section 177 of the Companies Act, 2013, in addition to listed public companies, following classes of companies shall constitute and Audit Committee -
- (i) All public companies with a paid-up capital of ten crore rupees or more;
 - (ii) All public companies having turnover of one hundred crore rupees or more;

- (iii) All public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

Explanation - 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 last audited Financial Statements shall be taken into account for the purposes of this rule.

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

In the given case, XYZ Limited, engaged in the business of Shoes, is a public company and it's having paid-up capital of 9.8 crore rupees and turnover of 98 crore which is less than prescribed limit (i.e., 10 crores for paid-up capital and 100 crores for turnover). However, aggregate of its outstanding loan from bank (25 crores) and liability on outstanding debentures (26 crore) is exceeding the prescribed limit i.e., 50 crore rupees. Therefore, provisions relating to constitution of Audit Committee will be applicable for XYZ Limited.

22. As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the **class of companies** shall mean the following classes of companies excluding one person companies and small companies-
- (i) all unlisted public companies having paid up share capital of rupees ten crore or more;
 - (ii) all private limited companies having paid up share capital of rupees fifty crore or more;
 - (iii) all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

In the given case, S Private Limited is a private limited Company, having paid up share capital of ₹ 49 crore but having borrowing from banks of ₹ 99 crore, provision of rotation of auditor will be applicable on S Private Limited as borrowings from bank are exceeding the prescribed limit of 50 crore rupees.

Further, as per **section 139(2)**, appointment of audit firm can be made only for one term of five consecutive years and then another one more term of five consecutive years.

S Private Limited, appointed M/s P & Company, a Chartered Accountant firm, as the statutory auditor in its AGM for one term of five years. Here, the appointment of M/s P & Company is valid in accordance with section 139(2) of the Companies Act, 2013.

23. **Re-appointment of auditor:** A retiring auditor may be re-appointed at an annual general meeting, if-
- (i) he is not disqualified for re-appointment.
 - (ii) he has not given the company a notice in writing of his unwillingness to be re-appointed; and

- (iii) a special resolution has not been passed at that meeting appointing some other auditor or providing expressly that he shall not be re-appointed.
 - (iv) Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company.
- 24. Examples of circumstances to include Emphasis of Matter Paragraph:** As per SA 706 (Revised) on "Emphasis of Matter Paragraphs and Other Matter Paragraphs In The Independent Auditor's Report", the examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are;
- (a) An uncertainty relating to the future outcome of an exceptional litigation or regulatory action.
 - (b) A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
 - (c) Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
 - (d) A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
- 25. The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion".**
- Opinion Section of the Auditor's report shall also:**
- (i) Identify the entity whose financial statements have been audited;
 - (ii) State that the financial statements have been audited;
 - (iii) Identify the title of each statement that comprises the financial statements;
 - (iv) Refer to the summary of significant accounting policies and other explanatory information; and
 - (v) Specify the date or period covered by each financial statement comprising the financial statements.
- 26. (a)** Special Mention accounts (SMA) are those accounts which are resulting signs of incipient stress leading to the possibility that borrowers may default on debt obligations. These are in the nature of warning system to alert the banks about probable NPAs so that remedial action can be taken before accounts actually turn NPAs. Therefore, their significance lies in the fact that proper and timely identification of SMAs can help in preventing turning potential NPAs into actual NPAs.
- (b)** The probable reasons for difference in interest calculation could be due to following:
- (i) Cash credit accounts, by their very nature, are running accounts and their utilization depends upon needs of business. Further, interest on cash credit account is charged on the extent of funds utilized by the borrower. It could be

possible that all cash credit limits were not fully utilized during the year which resulted in lower interest income.

- (ii) Some large accounts may have been sanctioned during later part of the year resulting in lower interest income on advances for whole year.

27. Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:

- (a) Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
 - (b) Advances represent amount due to the bank.
 - (c) Amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of advances.
 - (d) There are no unrecorded advances.
 - (e) The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.
 - (f) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
 - (g) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.
28. (a) **Verification of inventories in the nature of food and beverages:** The inventories in any hotel are both readily portable and saleable particularly the food and beverage inventories. It is therefore extremely important that all movements and transfers of such inventories should be properly documented to enable control to be exercised over each individual stores' areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed. Therefore, following points may be noted in this regard:
- (a) All movement and transfer of inventories must be properly documented.
 - (b) Areas where inventories are kept must be kept locked and the key retained by the departmental manager.
 - (c) The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.
 - (d) Many hotels use specialized professional valuers to count and value the inventories on a continuous basis throughout the year.

- (e) The auditor should ensure that all inventories are valued at the year end and that he should himself be present at the year-end physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories.
- (b) **Audit of Cinema:** The special steps involved in the audit of receipts from sale of tickets are stated below-
- (i) Verify that entrance to the cinema-hall during show is only through printed tickets;
 - (ii) Verify that they are serially numbered and bound into books;
 - (iii) Verify that the number of tickets issued for each show and class, are different though the numbers of the same class for the show on the same day, each week, run serially;
 - (iv) Verify that for advance booking a separate series of tickets is issued;
 - (v) Verify that the inventory of tickets is kept in the custody of a responsible official.
 - (vi) Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it.
 - (vii) Verify that a record is kept of the 'free passes' and that these are issued under proper authority.
 - (viii) Reconcile the amount of Entertainment Tax collected with the total number of tickets issued for each class.
 - (ix) Vouch the entries in the Cash Book in respect of cash collected on sale of tickets for different shows on a reference to Daily Statements which have been test checked as aforementioned with record of tickets issued for the different shows held.