

May 2022 Exam

Suggested Answers Part II* (Descriptive Questions)

Q. No.	Questions	Marks
Q.1.	<p>Examine with reasons whether the following statements are correct or incorrect. (Answer any seven)</p> <p>(a) Pervasive is a term used, in the context of misstatements, to describe the effects on the financial statements of misstatements or the possible effects on the financial statements of misstatements, if any, that are detected by obtaining sufficient appropriate audit evidence.</p> <p>Ans.: Statement is correct.</p> <p>Pervasive effects on the F.S. are those that, in the auditor's judgment:</p> <ul style="list-style-type: none"> (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. 	2 × 7 = 14
	<p>(b) Audit findings and control deficiencies can be evaluated or assessed arbitrarily.</p> <p>Ans.: Statement is incorrect.</p> <p>When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements.</p>	
	<p>(c) Inappropriate management can override internal controls of any organization.</p> <p>Ans.: Statement is correct.</p> <ul style="list-style-type: none"> ◆ Internal controls in any organisation can be circumvented by the collusion of two or more people or inappropriate management override of internal control. ◆ For example, management may enter into side agreements with customers that alter the terms and conditions of the entity's standard sales contracts, which may result in improper revenue recognition. Also, edit checks in a software program that are designed to identify and report transactions that exceed specified credit limits may be overridden or disabled. 	
	<p>(d) Once the audit plan has been drafted and communicated, it is obligatory on the auditor to follow the same.</p>	

*Part I consists of Multiple Choice Questions are not available in public domain.

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	<p>Ans.: Statement is correct.</p> <ul style="list-style-type: none"> ◆ Planning enables an auditor to conduct an effective audit in an efficient and timely manner. Adequate planning benefits the audit of financial statements in several ways. ◆ Plans should be further developed and revised as necessary during the course of the audit. 	
(e)	<p>According to CARO, 2020, the company auditor is required to state that whether the title deeds of all immovable properties held in the name of the company are disclosed in its financial statements.</p> <p>Ans.: Statement is incorrect.</p> <p>As per Para 3(i)(c) of CARO, 2020, auditor is required to state in his report whether the title deeds of all the immovable properties (other than properties where the company is the lessee and the lease agreements are duly executed in favour of the lessee) disclosed in the financial statements are held in the name of the company, if not, provide the details thereof.</p>	
(f)	<p>SA 520 deals with the auditor's use of analytical procedures as substantive procedures ("substantive analytical procedures"), and as procedures near the end of the audit, that assist the auditor in preparation of the financial statements.</p> <p>Ans.: Statement is correct.</p> <p>The objectives of the auditor as stated in SA 520 are:</p> <ol style="list-style-type: none"> (a) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and (b) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity. 	
(g)	<p>Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged with proper authorization.</p> <p>Ans.: Statement is correct.</p> <p>Misappropriation of assets involves the theft of an entity's assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect.</p>	
(h)	<p>Materiality is not a matter of size.</p> <p>Ans.: Statement is incorrect.</p> <p>Judgments about materiality are made in the light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both.</p>	
Q.2.	<p>(a) G Pvt. Ltd. had fully paid-up Capital and Reserves of ₹ 1.20 crore as at the end of F.Y 2020-2021. During the F.Y. 2021-2022, business was interrupted due to Covid restrictions and therefore the company incurred losses to the tune of 25 lakh. During the year, the company also borrowed ₹ 55 lakh each from a bank and a financial institution independently. It had a turnover ₹ 850 lakh (other than revenue of ₹ 250 lakh from discontinuing operations). Ascertain whether CARO, 2020 is applicable to the company.</p> <p>Ans.: Applicability of CARO, 2020:</p> <ul style="list-style-type: none"> ◆ CARO, 2020 shall apply to every company including a foreign company as defined in Sec. 2(42) of the Companies Act, 2013, except: 	4

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	<p>(1) a banking company;</p> <p>(2) an insurance company;</p> <p>(3) a company licensed to operate u/s 8 of the Companies Act;</p> <p>(4) a One Person Company as defined in Sec. 2(62) of the Companies Act and a Small Company as defined in Sec. 2(85) of the Companies Act; and</p> <p>(5) a private limited company, not being a subsidiary or holding of a public company,</p> <ul style="list-style-type: none"> ■ having a Paid-up capital & Reserves & Surplus not more than ₹ 1 Cr. as on the balance sheet date, and ■ which does not have total borrowings exceeding ₹ 1 Cr. from any bank or financial institution at any point of time during the financial year, and ■ which does not have a total revenue as disclosed in Schedule III to the Companies Act, 2013 (including revenue from discontinuing operations) exceeding ₹ 10 Cr. during the financial year as per the financial statements. <ul style="list-style-type: none"> ◆ In case of debit balance of profit or loss, same shall be netted for computing reserves & surplus. In the present case, paid-up capital and reserves as at the end of F.Y. 2020-2021 was ₹ 1.20 Cr., and during the F.Y. 2021-22 company has incurred losses to the tune of 25 lakh, so, paid-up capital and reserves of the company as at the end of F.Y. 2021-22 will be considered as ₹ 0.95 Cr. ◆ As company has borrowed ₹ 55 lakh each from a bank and a financial institution independently, so total borrowings of the company will be ₹ 1.10 Cr. ◆ Total revenue including revenue from discontinuing operations will be ₹ 11 Cr. <p>Conclusion: CARO is applicable over the company as its borrowings exceeds ₹ 1 Cr. and total revenue exceeds ₹ 10 Cr.</p> <p>Note:</p> <p>As per Sec. 2(85) of the Companies Act, 2013, a company shall be classified as a small company if its paid-up share capital does not exceed ₹ 2 Cr. and turnover of which as per its last profit and loss account for the immediately preceding financial year does not exceed ₹ 20 crore. In the given case, G Pvt. Ltd. satisfies both the conditions, hence, it will be considered as a small company and therefore reporting under CARO, 2020 is not required.</p>	
(b)	<p>Tree Limited presented its financial statements for the F.Y. 2021-2022 to its auditor for expressing an opinion thereon. The auditor while carrying out the audit started comparing various items of profit and loss account of the year under audit with previous financial years. What is auditor trying to achieve by carrying out those comparisons?</p> <p>Ans.: Purposes of carrying out analytical procedures:</p> <ul style="list-style-type: none"> ◆ Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like comparisons, trend and ratio analysis in addition to reasonable tests. ◆ If balances included in the Statement of Profit and Loss of an entity are compared with that of the previous period, it would be possible to find out the reasons for increase or decrease in the amount of profits of those years. 	4