(GI-10, GI-11, VI-2(A) & AI-2(A), DI-1+2 & Drive)

DATE: 20.02.2024 **MAXIMUM MARKS: 100** **TIMING: 3¼ Hours**

AUDITING AND ETHICS

DIVISION – A (MULTIPLE CHOICE QUESTIONS)

ANSWERS (1-20) CARRY 1 MARK EACH

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

ANSWERS (21-25) CARRY 2 MARKS EACH

21. Ans. (a)
22. Ans. (c)
23. Ans. (b)
24. Ans. (a)
25. Ans. (b)

DIVISION B-DESCRIPTIVE QUESTIONS
QUESTION NO. 1 IS COMPULSORY
ATTEMPT ANY FOUR QUESTIONS THE REMAINING FIVE QUESTIONS

Answer 1:

Examine with reasons (in short) whether the following statements are correct or incorrect : (Attempt any 7 out of 8)

(i) **Incorrect:** Intimidation threats, which occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees.

Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests.

(ii) **Incorrect:** The auditor's opinion helps determination of the true and fair view of the financial position and operating results of an enterprise.

(iii) **Incorrect:** When establishing the overall audit strategy, the auditor shall determine materiality for the financial statements as a whole.

(iv) **Incorrect:** The policy of income recognition should be objective and based on record of recovery rather than on any subjective considerations. Income from non-performing assets (NPA) is not recognized on accrual basis but is booked as income only when it is actually received.

(v) **Incorrect:** The hypothecation is the creation of an equitable charge (i.e., a charge created not by an express enactment but by equity and reason), which is created in favor of the lending bank by execution of hypothecation agreement in respect of the moveable securities belonging to the borrower.
Assignment represents a transfer of an existing or future debt, right or property belonging to a person in favor of another person.

(vi) **Incorrect:** The primary responsibility for the prevention and detection of fraud rests with management. An auditor conducting an audit in accordance with SAs is responsible for obtaining reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

(vii) **Incorrect:** Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C&AG prescribe.
Article 151 requires that the reports of the C&AG relating to the accounts of the Union/State shall be submitted to the President/Governor who shall cause them to be laid before House of Parliament/State Legislature.

(viii) **Correct:** In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated.

{1 Mark for Correct or Incorrect and 1 Mark for Explanation}

Answer 2:

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

(i) Stay within the scope and limitation of the assignment.
(ii) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
(iii) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
(iv) Consider all possibilities of error.
(v) Co-ordinate the procedures to be applied to related items.

{1 M Each for Any 4 Points}

Answer:

(b) Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:

(i) Identify division of audit areas and common audit areas;
(ii) Ascertain the reporting objectives of the engagement;
(iii) Consider and communicate among all joint auditors the factors that are significant in directing the engagement team's efforts;
(iv) Consider the results of preliminary engagement activities, or similar engagements performed earlier.
(v) Ascertain the nature, timing and extent of resources necessary to accomplish the engagement.

{1 M Each for Any 4 Points}

Answer:

(c) The following points are included in scope of audit of financial statements: -

(1) Coverage of all aspects of entity

Audit of financial statements should be organized adequately to cover all aspects of the entity relevant to the financial statements being audited.

(2) Reliability and sufficiency of financial information

The auditor should be reasonably satisfied that information contained in underlying accounting records and other source data (like bills, vouchers, documents etc.) is reliable and sufficient basis for preparation of financial statements.

The auditor makes a judgment of reliability and sufficiency of financial information by making a study and assessment of accounting systems and internal controls and by carrying out appropriate tests, enquiries and procedures.

(3) Proper disclosure of financial information

The auditor should also decide whether relevant information is properly disclosed in the financial statements. He should also keep in mind applicable statutory requirements in this regard.

It is done by ensuring that financial statements properly summarize transactions and events recorded therein and by considering the judgments made by management in preparation of financial statements.

{1 M Each}

Answer:

(d) Independence implies that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him, or to his own self-interest.

There are two interlinked perspectives of independence of auditors, one, independence of mind and two, independence in appearance.

{1 M}

Independence is:

(a) Independence of mind – the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and

(b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

{1 M Each}

Answer 3:

(a) Such working papers should include his notes on the following, amongst other matters:

(a) work done while conducting the audit and by whom;

(b) explanation and information given to him during the course of the audit and by whom;

(c) decision on the various points taken;

(d) the judicial pronouncements relied upon by him while drafting the audit report; and

(e) certificates issued by the client / management letters.

{1 M Each for Any 4 Points}

Answer:

(b) In determining whether it is appropriate to use audit evidence about the operating effectiveness of controls obtained in previous audits, and, if so, the length of the time period that may elapse before retesting a control, the auditor shall consider the following:

(a) The effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process
(b) The risks arising from the characteristics of the control, including whether it is manual or automated
(c) The effectiveness of general IT-controls
(d) The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control
(e) Whether the lack of a change in a particular control poses a risk due to changing circumstances and
(f) The risks of material misstatement and the extent of reliance on the control.

{1 M Each for Any 4 Points}

Answer:

(c) The important objectives of audit are:

(a) reporting on the fairness of the content and presentation of financial statements;
(b) reporting upon the strengths and weaknesses of systems of financial control;
(c) reporting on the adherence to legal and/or administrative requirements;
(d) reporting upon whether value is being fully received on money spent; and
(e) detection and prevention of error, fraud and misuse of resources.

{1 M Each for Any 3 Points}

Answer:

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

1. The size and complexity of the entity.
2. The nature of the audit procedures to be performed.
3. The identified risks of material misstatement.
4. The significance of the audit evidence obtained.
5. The nature and extent of exceptions identified.
6. 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.
7. The audit methodology and tools used.

{1/2 M Each for Any 6 Points}

Answer 4:

(a) The following are the disclosure requirements as per CARO 2020, with respect to the moneys raised by the company by way of initial public offer or further public offer and where the company has made any preferential allotment or private placement of shares.

(a) whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;
(b) whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the

{2 M Each}

funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of noncompliance;

Answer:

(b) The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas: -

(a) The classes of transactions in the entity's operations that are significant to the financial statements

(b) The procedures by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements

(c) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions

(d) How the information system captures events and conditions that are significant to the financial statements

(e) The financial reporting process used to prepare the entity's financial statements

(f) Controls surrounding journal entries.

{1 M Each for Any 4 Points}

Answer:

(c) If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.
Before agreeing to change an audit engagement to a review or a related service, an auditor who was engaged to perform an audit in accordance with SAs may also need to assess any legal or contractual implications of the change. **{1 M}**

If the auditor concludes that there is reasonable justification to change the audit engagement to a review or a related service, the audit work performed to the date of change may be relevant to the changed engagement. However, the work required to be performed and the report to be issued would be those appropriate to the revised engagement. In order to avoid confusing the reader, the report on the related service would not include reference to: **{1 M}**

(a) The original audit engagement or

(b) Any procedures that may have been performed in the original audit engagement, except where the audit engagement is changed to an engagement to undertake agreed- upon procedures and thus reference to the procedures performed is a normal part of the report.

{1/2 M Each}

If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.

Answer:

(d) An account should be treated as 'out of order' if:-

- the outstanding balance remains continuously in excess of the sanctioned limit/drawing power or
- In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet ; or
- credits are there but are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

{1 M Each}

Answer 5:

(a) Shares issued at discount:

(i) As per section 53 of the Companies Act, 2013, a company shall not issue share at a discount, except in the case of an issue of sweat equity shares given under section 54 of the Companies Act, 2013. Any share issued by a company at a discounted price shall be void.

(ii) The auditor needs to 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 authorising issue of share capital and the issue price.

(iii) Where a company contravenes the provisions of this section, the company shall be punishable with fine which shall not be less than one lakh rupees but which may extend to five lakh rupees: and

(iv) every officer who is in default shall be punishable with imprisonment for a term which may extend to six months or with fine which shall not be less than one lakh rupees, or with both.

{1 M Each for Any 3 Points}

Answer:

(b) Ensure whether the following disclosures as required under Schedule III (Part I) to Companies Act, 2013 are made for each amount disclosed under each of the following headings:

Long- Term Borrowings

(i) Long-term borrowings shall be classified as:

- (a) Bonds/debentures;
- (b) Term loans:
  - (A) from banks.
  - (B) from other parties.
- (c) Deferred payment liabilities;
- (d) Deposits;
- (e) Loans and advances from related parties;
- (f) Long term maturities of finance lease obligations;
- (g) Other loans and advances (specify nature).

{1/2 M Each}

Answer:

(c) In the given case of Amrit Ltd, the auditor wanted to send confirmation request to a few large trade receivables but the management did not want the auditor to send confirmation request.

If the management refuses to allow the auditor to send a confirmation request, the auditor shall-

1. Inquire as to management's reasons for the refusal and seek audit evidence as to their validity and reasonableness.
2. Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and
3. Perform alternative audit procedures designed to obtain relevant and reliable evidences.
4. If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidences from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260.

{1 M Each}

The auditor shall also determine the implication for the audit and the auditor's opinion in accordance with SA 705.

Answer:

(d) (i) **Stratification –** The process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value).

(ii) **Tolerable misstatement –** A monetary amount set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the monetary amount set by the auditor is not exceeded by the actual misstatement in the population.

(iii) **Tolerable rate of deviation –** A rate of deviation from prescribed internal control procedures set by the auditor in respect of which the auditor seeks to obtain an appropriate level of assurance that the rate of deviation set by the auditor is not exceeded by the actual rate of deviation in the population.

{1 M Each}

Answer 6:

(a) When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern.
In so doing, the auditor shall determine whether management has already performed a preliminary assessment of the entity's ability to continue as a going concern, and: **{1 M}**

(i) If such an assessment has been performed, the auditor shall discuss the assessment with management and determine whether management has identified events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern and, if so, management's plans to address them; or **{$1^{1/2}$ M}**

(ii) If such an assessment has not yet been performed, the auditor shall discuss with management the basis for the intended use of the going concern basis of accounting, and inquire of management whether events or conditions exist that, individually or collectively, may cast significant doubt on the entity's ability to continue as a going concern. **{$1^{1/2}$ M}**

Answer:

(b) In addition to the written representation about management's responsibilities regarding preparation of financial statements, the auditor may consider it necessary to request other written representations about the financial statements. Such written representations may supplement, but do not form part of, the written representation relating to management's responsibilities regarding preparation of financial statements. They may include representations about the following: -

- Whether the selection and application of accounting policies are appropriate; and
- Whether matters such as the following, where relevant under the applicable financial reporting framework, have been recognized, measured, presented or disclosed in accordance with that framework: -
  - Plans or intentions that may affect the carrying value or classification of assets and liabilities;
  - Liabilities, both actual and contingent;
  - Title to, or control over, assets, the liens or encumbrances on assets, and assets pledged as collateral; and
  - Aspects of laws, regulations and contractual agreements that may affect the financial statements, including non-compliance.

{1 M Each for Any 3 Points}

Answer:

(c) Assertions about presentation and disclosure:

(i) Occurrence and rights and obligations – disclosed events, transactions, and other matters have occurred and pertain to the entity.

(ii) Completeness – all disclosures that should have been included in the financial statements have been included.

(iii) Classification and understandability – financial information is appropriately presented and described, and disclosures are clearly expressed.

(iv) Accuracy and valuation – financial and other information are disclosed fairly and at appropriate amounts.

{1 M Each for Any 3 Points}

Answer:

(d) When information to be used as audit evidence has been prepared using the work of a management's expert, the nature, timing and extent of audit procedures may be affected by such matters;

- The nature and complexity of the matter to which the management's expert relates.
- The risks of material misstatement in the matter.
- The availability of alternative sources of audit evidence.
- The nature, scope and objectives of the management's expert's work.
- Whether the management's expert is employed by the entity, or is a party engaged by it to provide relevant services.
- The extent to which management can exercise control or influence over the work of the management's expert.
- Whether the management's expert is subject to technical performance standards or other professional or industry requirements.
- The nature and extent of any controls within the entity over the management's expert's work.
- The auditor's knowledge and experience of the management's expert's field of expertise.
- The auditor's previous experience of the work of that expert.

{1 M Each for Any 3 Points}

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