

Intermediate Course: Group – II

DATE: 06.08.2024

MAXIMUM MARKS: 100

(Mock Test Paper : 1)

TIMING: 3¼ Hours

PAPER 5 : AUDITING AND ETHICS**DIVISION – A (MULTIPLE CHOICE QUESTIONS)**

Case Scenario 1 carries 10 Marks

Case Scenario 2 carries 08 Marks

Case Scenario 3 carries 06 Marks

General MCQs (3 MCQs x 2 Marks Each = 06 Marks)

Total 30 Marks

Ans. 1 to Ans. 5:

CASE SCENARIO 1:

1. Ans. (c)
2. Ans. (b)
3. Ans. (c)
4. Ans. (a)
5. Ans. (c)

MCQ [5 MCQ of 2 Marks Each : Total 10 Marks]

Ans. 6 to Ans. 9:

CASE SCENARIO 2:

6. Ans. (a)
7. Ans. (b)
8. Ans. (c)
9. Ans. (c)

MCQ [4 MCQ of 2 Marks Each : Total 8 Marks]

Ans. 10 to Ans. 12:

CASE SCENARIO 3:

10. Ans. (b)
11. Ans. (d)
12. Ans. (a)

MCQ [3 MCQ of 2 Marks Each : Total 6 Marks]

13. Ans. (b)
14. Ans. (d)
15. Ans. (a)

{2 M Each}

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

- (a) The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant. Preliminary identification of material classes of transactions, account balances and disclosures help auditor in establishing overall audit strategy. More energies need to be devoted to significant matters to obtain desired outcomes. Few examples are listed as under:-

- Volume of transactions which may determine whether it is more efficient for the auditor to rely on internal control
- Significant industry developments such as changes in industry regulations and new reporting requirements.
- Significant changes in the financial reporting framework, such as changes in accounting standards.
- Other significant relevant developments, such as changes in the legal environment affecting the entity.

{1 M
Each}

Answer:

(b) The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

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

{1 M
Each for
Any 4
Points}

Answer:

(c) As per **SA 600, "Using the Work of another Auditor"**, when using the work of another auditor, the principal auditor should ordinarily perform the following procedures:

{1/2 M}

- (a) Advise the other auditor of the use that is to be made of the other auditor's work and report and make sufficient arrangements for co-ordination of their efforts at the planning stage of the audit. The principal auditor would inform the other auditor of matters such as are as requiring special consideration, procedures for the identification of inter -component transactions that may require disclosure and the time-table for completion of audit; and
- (b) Advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.

{2 M}

{1/2 M}

Answer:

(d) The objectives of the auditor are: -

- (a) To communicate clearly with those charged with governance the responsibilities of the auditor in relation to the financial statement audit, and an overview of the planned scope and timing of the audit;
- (b) To obtain from those charged with governance information relevant to the audit;
- (c) To provide those charged with governance with timely observations arising from the audit that are significant and relevant to their responsibility to oversee the financial reporting process and
- (d) To promote effective two-way communication between the auditor and those charged with governance.

{1 M
Each for
Any 3
Points}

Answer 2:

(a) Audit procedures when events or conditions have been identified that may cast significant doubt on the entity's ability to continue as going concern

- Analysing and discussing cash flow, profit and other relevant forecasts with management
- Analysing and discussing the entity's latest available interim financial statements
- Reading the terms of debentures and loan agreements and determining whether any have been breached
- Reading minutes of the meetings of shareholders, those charged with governance and relevant committees for reference to financing difficulties
- Inquiring of the entity's legal counsel regarding the existence of litigation and claims and the reasonableness of management's assessments of their outcome and the estimate of their financial implications
- Confirming the existence, legality and enforceability of arrangements to provide or maintain financial support with related and third parties and assessing the financial ability of such parties to provide additional funds
- Evaluating the entity's plans to deal with unfilled customer orders
- Performing audit procedures regarding subsequent events to identify those that either mitigate or otherwise affect the entity's ability to continue as a going concern
- Confirming the existence, terms and adequacy of borrowing facilities
- Obtaining and reviewing reports of regulatory actions
- Determining the adequacy of support for any planned disposals of assets

{1 M
Each for
Any 4
Points}

Answer:

(b) Factors to be Considered While Designing Confirmation Request: As per SA-505 "External Confirmations", the design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses. The following factors should be considered while designing a confirmation request:-

- (i) The assertions being addressed.
- (ii) Specific identified risks of material misstatement, including fraud risks.
- (iii) The layout and presentation of the confirmation request.
- (iv) Prior experience on the audit or similar engagements.
- (v) The method of communication.
- (vi) Management's authorisation to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation.
- (vii) The ability of the confirming party to provide the requested information.

{1 M
Each for
Any 4
Points}

Answer:

(c) The U.N. Handbook on Government Auditing and Developing Countries defines government auditing in a comprehensive manner which is as follows:

Government Audit is the objective, systematic, professional and independent examination of financial, administrative and other operations of a public entity, made subsequently to their execution for the purpose of evaluating and verifying them, presenting a report containing explanatory comments on audit findings together with conclusions and recommendations for future action by the responsible officials and in the case of examination of financial statements, expressing the appropriate professional opinion regarding the fairness of the presentation.

{1 M}

OBJECTIVES of the Govt Audit are :

1. Accounting for Public Funds: It serves as a mechanism or process for public accounting of government funds.

- | | | |
|--|---|-------------------------|
| <ul style="list-style-type: none"> 2. Appraisal of Govt. Policies: It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them. 3. Corrective Actions: Audit observations based on factual data collection also serve to highlight the lapses of the lower hierarchy, thus helping supervisory level officers to take corrective measures. 4. Administrative Accountability: The main objective of audit is a combination of ensuring accountability of administration to legislature and functioning as an aid to administration. | } | {1/2 M
Each} |
|--|---|-------------------------|

Answer:

- | | | |
|---|---|-------------------------|
| <p>(d) Tests of controls: Test of controls may be defined as an audit procedure designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.
The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:</p> <ul style="list-style-type: none"> (a) The auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing and extent of substantive procedures); or (b) Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level. <p>A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.</p> | } | {1/2 M
Each} |
|---|---|-------------------------|

Answer 3:

- | | | |
|---|---|-----------------------|
| <p>(a) The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the activities Relating to Internal Control:</p> <ul style="list-style-type: none"> (i) Evaluation of internal control: The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit. (ii) Examination of financial and operating information: The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures. (iii) Review of operating activities: The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including nonfinancial activities of an entity. (vi) Review of compliance with laws and regulations: The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements. | } | {1 M
Each} |
|---|---|-----------------------|

Internal audit has a very strong relation with internal control of a company. Internal Audit analyzes the effectiveness with which the internal control of a company is operating and also makes suggestions for improvement in that internal control.

Answer:

(b) The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory, these advantages are given below:

- (a) It safeguards the financial interest of persons who are not associated with the management of the entity, whether they are partners or shareholders, bankers, FI's, public at large etc.
- (b) It acts as a moral check on the employees from committing defalcations or embezzlement.
- (c) Audited statements of account are helpful in settling liability for taxes, negotiating loans and for determining the purchase consideration for a business.
- (d) These are also useful for settling trade disputes for higher wages or bonus as well as claims in respect of damage suffered by property, by fire or some other calamity.
- (e) An audit can also help in the detection of wastages and losses to show the different ways by which these might be checked, especially those that occur due to the absence or inadequacy of internal checks or internal control measures.
- (f) Audit ascertains whether the necessary books of account and allied records have been properly kept and helps the client in making good deficiencies or inadequacies in this respect.
- (g) As an appraisal function, audit reviews the existence and operations of various controls in the organisations and reports weaknesses, inadequacies, etc., in them. Audited accounts are of great help in the settlement of accounts at the time of admission or death of partner.
- (h) Government may require audited and certified statement before it gives assistance or issues a license for a particular trade.

**{1 M
Each for
Any 4
Points}**

Answer:

(c) The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:

- (i) Size of the organisation under audit.
- (ii) State of the internal control.
- (iii) Adequacy and reliability of books and records.
- (iv) Tolerable error range.
- (v) Degree of the desired confidence.

**{1 M
Each for
Any 3
Points}**

Answer:

(d) Endowment Policies:

- (i) Ascertain the specific purpose for which the endowment policy is taken, e.g., Sinking Fund policies for redemption of debentures, redemption of leases or policies taken for other similar purposes, etc.
- (ii) Verify the terms and conditions of policies and ensure that all such conditions are in force and being followed.
- (iii) Check that premium has been deposited in time and the policy is in force.
- (iv) Examine that proper disclosures have been made in the financial statements in respect of items for which the policy has been taken.

**{1 M
Each for
Any 3
Points}**

Answer 4:

- (a) Analytical procedures include the consideration of comparisons of the entity's financial information with, for example:
- Comparable information for prior periods.
 - Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
 - Similar industry information, such as a comparison of the entity's ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry.
- Analytical procedures also include consideration of relationships, for example:
- Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
 - Between financial information and relevant non-financial information, such as payroll costs to number of employees.

{2 M}

{2 M}

Answer:

- (b) Obtaining Knowledge of the Business: The auditor needs to obtain a level of knowledge of the client's business that will enable him to identify the events, transactions and practices that, in his judgment, may have significant effect on the financial information among other things.
- As per SA 315 – "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", the auditor shall obtain an understanding of the following:
- (a) Relevant industry, regulatory, and other external factors including the applicable financial reporting framework
 - (b) The nature of the entity, including:
 - (i) its operations;
 - (ii) its ownership and governance structures;
 - (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
 - (iv) the way that the entity is structured and how it is financed;
 - (c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.
 - (d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.
 - (e) The measurement and review of the entity's financial performance.
- In addition to the importance of knowledge of the client's business in establishing the overall audit plan, such knowledge helps the auditor to identify areas of special audit consideration, to evaluate the reasonableness both of accounting estimates and management representations, and to make judgment regarding the appropriateness of accounting policies and disclosures.

{1 M}

{1/2 M Each}

{1/2 M}

Answer:

- (c) Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the

- entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. {1/2 M}
- Written representations are requested from those responsible for the preparation and presentation of the financial statements.
- Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions. {1/2 M}
- The objectives of the auditor regarding written representation
- The objectives of the auditor are:
- (a) To obtain written representations
To obtain written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
 - (b) To support other evidence
To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations; and
 - (c) To respond appropriately
To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor. {2 M}

Answer:

- (d) In the context of recurring audits, as per SA-300, "Planning an Audit of Financial Statements", Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as: {1/2 M}
- 1. The analytical procedures to be applied as risk assessment procedures.
 - 2. Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
 - 3. The determination of materiality.
 - 4. The involvement of experts.
 - 5. The performance of other risk assessment procedures. {1/2 M Each}

Answer 5:

- (a) Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS). {1/2 M}
- A financial statement audit comprises the examination of an entity's financial statements and accompanying disclosures by an independent auditor. The result of this examination is a report by the auditor, attesting to the truth and fairness of presentation of the financial statements and related disclosures.
- In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding:

- completeness;
- cut-off;
- existence/ occurrence;
- valuation/ measurement;
- rights and obligations; and
- presentation and disclosure

{1/4 M
Each}

of assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards.

Example:

If Company X's balance sheet shows building with carrying amount of Rs. 50 lakh, the auditor shall assume that the management has claimed/ asserted that:

- The building recognized in the balance sheet exists as at the period- end (existence assertion);
- Company X owns and controls such building (Rights and obligations assertion);
- The building has been valued accurately in accordance with the measurement principles (Valuation assertion);
- All buildings owned and controlled by Company X are included within the carrying amount of Rs. 50 lakh (Completeness assertion).

{1/2 M
Each}

Answer:

- (b)** Background of Local Bodies: A municipality can be defined as a unit of local self-government in an urban area. By the term 'local self-government' is ordinarily understood the administration of a locality – a village, a town, a city or any other area smaller than a state – by a body representing the local inhabitants, possessing fairly large autonomy, raising at least a part of its revenue through local taxation and spending its income on services which are regarded as local and, therefore, distinct from state and central services.

Municipal government in India covers five distinct types of urban local authorities, viz., the municipal corporations, the municipal councils, the notified area committees, the town area committees and the cantonment committees.

Audit Programme for Local Bodies:

- (i) The Local Fund Audit Wing of the State Govt. is generally in charge of the audit of municipal accounts. Sometimes bigger municipal corporations e.g. Delhi, Mumbai etc. have power to appoint their own auditors for regular external audit. So the auditor should ensure authenticity of his appointment.
- (ii) The auditor while auditing the local bodies should report on the fairness of the contents and presentation of financial statements, the strengths and weaknesses of system of financial control, the adherence to legal and/or administrative requirements; upon whether value is being fully received on money spent. His objective should be to detect errors and fraud and misuse of resources.
- (iii) The auditor should ensure that the expenditure incurred conforms to the relevant provisions of the law and is in accordance with the financial rules and regulations framed by the competent authority.
- (iv) He should ensure that all types of sanctions, either special or general, accorded by the competent authority.
- (v) He should ensure that there is a provision of funds and the expenditure is incurred from the provision and the same has been authorized by the competent authority.
- (vi) The auditor should check that the different schemes, programmes and projects, where large financial expenditure has been incurred, are running economically and getting the expected results.

{1 M
Each for
Any 4
Points}

Answer:

- (c) Ownership of Working Papers: As per SA 230 "Audit Documentation", working papers are the property of the auditor. He may at his discretion, make available portions or extracts from his working paper to his client. The auditor should adopt reasonable procedures for custody and confidentiality of his working papers. {1 M}
- An auditor is not required to provide the clients or other auditors' access to his working papers. Main auditor of the company does not have right of access to the working papers of the branch auditor. {1 M}
- In the case of a company, the main auditor has to consider the report of the branch auditor and has a right to seek clarification and to visit the branch but cannot ask for the copy of working paper and therefore, the branch auditor is under no compulsion to give photocopies of his working paper to the principal auditor. {1 M}

Answer:**(d) Reduction of Capital**

For verifying reduction of capital, the auditor needs to undertake the following procedures:

- (i) Verify that the meeting of the shareholders held to pass the special resolution was properly convened and that the proposal was circularized in advance to all the shareholders;
- (ii) Verify that the Articles of Association authorises reduction of capital;
- (iii) Examine the order of the Tribunal confirming the reduction and verify that a copy of the order and the minutes have been registered and filed with the Registrar of Companies;
- (iv) Check the Registrar's Certificate as regards to reduction of capital;
- (v) Vouch the accounting entries recorded to reduce the capital and to write down the assets by reference to the resolution of shareholders and other documentary evidence; also check whether the requirements of Schedule III, Part I, have been complied with in relation to presentation;
- (vi) Confirm whether the revaluation of assets has been properly disclosed in the Balance Sheet;
- (vii) Verify the adjustment made in the members' accounts in the Register of Members and confirm that either the paid up amount shown on the old share certificates has been altered or new certificates have been issued in lieu of the old, and the old ones have been cancelled;
- (viii) Confirm that the words "and reduced", if required by the order of the Tribunal, have been added to the name of the company in the Balance Sheet.
- (ix) Verify that the Memorandum of Association of the company has been suitably amended.

{1 M
Each for
Any 3
Points}

Answer 6:

- (a) Auditing Income and Expenditure Account of a Charitable Institution Running a Hospital: While auditing the Income and Expenditure Account of a charitable institution running a hospital, following special points may be examined-
- (i) Verify the register of patients with duplicate copy of bills and patients admission record to see that bills have been properly and correctly prepared for all the services, tests and treatments.
 - (ii) Check cash collections from patients by tracing the receipt issued in to cashbook.
 - (iii) Check receipt of interest, rent, dividend etc., with receipt counterfoil into cash book and bank book and ensure that all such income has been duly accounted for.

- (iv) Check collection of subscription, donations from the receipt issued, correspondence etc., into cashbook.
- (v) Verify that all grants from government and other bodies have been duly accounted for and have been applied in the manner as specified.
- (vi) Verify all recurring nature of revenue expenditure, with necessary evidence like bill, authority, period etc.
- (vii) Examine the internal check as regards the receipt and issue of stores, medicines, linen etc., to ensure that these have been properly recorded and issued/consumed only on proper authorisation.
- (viii) See that depreciation has been written off in respect of all the assets at appropriate rate and method as in the earlier year.
- (ix) Verify the receipts from supply of food and canteen receipts and compare the same with previous year as regards number of patients.
- (x) Ensure that all outstanding liabilities have been adequately provided for and similarly all accrued incomes and receipts have been duly accounted for.
- (xi) Obtain inventory of stock and stores as at the end of the year and physically check a percentage of items.

{1 M
Each for
Any 4
Points}

Answer:

- (b) **Classification as NPA** should be based on the record of recovery. Availability of security or net worth of borrower/guarantor is not to be taken into account for purpose of treating an advance as NPA or otherwise. Further, asset classification would be borrower-wise and not facility-wise. All facilities including investments in securities would be termed as NPA.

There are different provisioning requirements as regards to categories of NPA such as Sub-standard assets, Doubtful assets and loss assets which are given below:

Categories of Non-Performing Assets:		Provision required
(i) Substandard Assets:		
	Would be one, which has remained NPA for a period less than or equal to 12 months.	15%
(ii) Doubtful Assets:		
	Would be one, which has remained in the substandard category for a period of 12 months.	Secured+ Unsecured
(i) Sub-categories:		
	Doubtful up to 1 Year (D1)	25% + 100%
	Doubtful 1 to 3 Years (D2)	40% + 100%
	Doubtful more than 3 Years (D3)	100% + 100%
(ii) Loss Assets:		
	Would be one, where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly.	100%

{1 M
Each
Points}

Answer:

- (c) The firm should **establish policies and procedures** designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements.

{1 M}

The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:

- (a) Adherence to professional standards and regulatory and legal requirements;
 - (b) Whether the quality control system has been appropriately designed and effectively implemented; and
 - (c) Whether the firm's quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.
- Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures.

{2 M}

Answer:

- (d)** The Assistant Engaged – Be Encouraged to Keep an Open Mind:

To start with, an auditor having regard to the nature, size and composition of the business and the dependability of the internal control and the given scope of work, should frame a programme which should aim at providing for a minimum essential work which may be termed as a standard programme. As experience is gained by actually carrying out the work, the programme may be altered to take care of situations which were left out originally, but are found relevant for the particular concern. Similarly, if any work originally provided for proves beyond doubt to be unnecessary or irrelevant, it may be dropped. The assistant engaged in the job should be encouraged to keep an open mind beyond the programme given to him. He should be instructed to note and report significant matters coming to his notice, to his seniors or to the partners or proprietor of the firm engaged for doing the audit. In the given case, the attitude of assistants of GK & Co. is not justified. They should keep an open mind and go beyond the programme to take care of newer areas of the business of DBR Ltd. into which the Company has diversified.

{2 M}

{1 M}

— ** —