

- 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. 100 lakh (Completeness assertion).
- (iii) **Incorrect:** The securities premium account may be applied by the Company:
- (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
 - (b) in writing off the preliminary expenses of the Company;
 - (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
 - (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
 - (e) for the purchase of its own shares or other securities under section 68.
- (iv) **Incorrect:** The auditor shall modify the opinion in the auditor's report when:
- (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
 - (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.
- (v) **Correct:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
- (vi) **Incorrect:** The auditor should not go by the assumption that the system generated information is correct and can be relied upon without evidence that demonstrates that the system driven information is based on validation of the required parameters for the time being in force and applicable.
- (vii) **Incorrect:** Equitable mortgage, on the other hand, is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof.
- (viii) **Correct:** According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.

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

Answer 2:

- (a) The assertions are as follows:
- (i) the firm owns the plant and machinery;
 - (ii) the historical cost of plant and machinery is Rs. 2 lacs; } {1 M}
 - (iii) the plant and machinery physically exists;
 - (iv) the asset is being utilised in the business of the company productively; } {1 M}
 - (v) total charge of depreciation on this asset is Rs. 83,000 to date on which Rs. 13,000 relates to the year in respect of which the accounts are drawn up; and } {1 M}
 - (vi) the amount of depreciation has been calculated on recognised basis and the calculation is correct. } {1 M}

Answer:

- (b) The advantages of an audit programme are:
- (a) It provides the assistant carrying out the audit with total and clear set of instructions of the work generally to be done. } {Any 8 Points Each 1/2 Mark}
 - (b) It is essential, particularly for major audits, to provide a total perspective of the work to be performed.
 - (c) Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.

- (d) Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, the danger is significantly less and the audit can proceed systematically.
- (e) The assistants, by putting their signature on programme, accept the responsibility for the work carried out by them individually and, if necessary, the work done may be traced back to the assistant.
- (f) The principal can control the progress of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
- (g) It serves as a guide for audits to be carried out in the succeeding year.
- (h) A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of professional auditor.

Answer:

- (c) 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. {2 M}
- Applying the above to the given problem, the auditor would further request the management to provide him with the Banker's certificate in support of fixed deposits held by the company. {1 M}

Answer:

- (d) Obtain an understanding of entity's process of charging depreciation and amortization. Obtain the fixed asset register maintained by the entity. There is always a risk that an entity could capitalize expense of revenue nature to increase its profit or charge capital expenditure directly in income and expense statement to reduce its profit. To address this risk, the auditor may choose to check the nature of asset from fixed asset register and further, there is always a risk that fake asset has been capitalized in the books and to mitigate this risk, auditors should physically verify the fixed assets, atleast the ones that are material in value. {1 M}
- Obtain a list of all additions/ deletions along with their proper approval from the authorised person for the same.
- Select the sample of assets from the Fixed Assets Register, on materiality considerations and verify the rates of depreciation, depreciation calculation.
- Obtain the list of all the components identified by the management.
 - Ensure Intangible assets like patents, goodwill, copy rights have been properly amortized over the period.
 - Ensure depreciation is charged on the assets from the date when it is ready to use.
 - Ensure depreciation on revalued amount has been properly accounted from revaluation reserve.
 - Depreciation computation as per Income tax Act, 1961- Ensure that additions are tallying with the additions as per Companies Act and the opening WDV to the Tax audit schedule for the assessment year preceding the previous year under audit.
- {Any 4 Points Each 1/2 Mark}**

- Perform analytical procedures to obtain audit evidence as to overall reasonableness of depreciation and amortisation expense- check the arithmetical accuracy of records and perform independent calculations example- compute or re-compute the depreciation expense for the year (Refer the format below that could be used for compiling reasonability of the expenditure for the year).

Answer 3:

(a) (1)

Advertisement Expenses:

- (i) Verify the bills/invoices from advertising agency to ensure that rates charged for different types of advertisement are as per the contract. {1 M}
- (ii) See that the advertisement relates to client’s business.
- (iii) Inspect the receipt issued by the agency.
- (iv) Ascertain the nature of expenditure – revenue or capital expenditure and see that it has been recorded properly. {1 M}
- (v) Ascertain the period for which payment is made and see that prepaid amount, if any, is carried to the balance sheet. {1 M}
- (vi) See that all outstanding advertisement bills have been provided for.

(2)

Sale of Scrap:

- (i) Review the internal control as regards generation, storage and disposal of scrap.
- (ii) Check whether the organization is maintaining reasonable record for generation of scrap.
- (iii) Analyze the raw material used, production and generation pattern of scrap and compare the same with figures of earlier year. {Any 6 Points Each 1/2 Mark}
- (iv) Check the rates at which scrap has been sold and compare the rate with previous year.
- (v) Vouch sales, with invoices raised, advertisement for tender, rate contract with scrap dealers.
- (vi) Ensure that there exists a proper control procedure to identify scrap and good units and they are not mixed up and sold as scrap.
- (vii) Make an overall assessment of the value of realization from scrap as to its reasonableness.

Answer:

- (b)** Objective of the Auditor- To Express Clearly an Appropriately modified Opinion As per Standard on Auditing (SA) 705 “Modifications To The Opinion In The Independent Auditor’s Report”, the objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:
- (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or {2 M}
 - (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. {2 M}

Answer:

- (c)** When corresponding figures are presented, the auditor’s opinion shall not refer to the corresponding figures except in the following circumstances.
1. 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 unresolved, the auditor shall modify the auditor’s opinion on the current period’s financial statements. In the Basis for {2 M}

- Modification paragraph in the auditor’s report, the auditor shall either:
- (a) Refer to both the current period’s figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period’s figures are material; or
 - (b) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period’s figures and the corresponding figures.
2. If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor’s report on the current period financial statements, modified. {1 M}
3. Prior Period Financial Statements Not Audited- If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor’s report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period’s financial statements. {1 M}

Answer 4:

- (a) As per the guidelines, Agricultural Advances are of two types,
- (1) Agricultural Advances for “long duration” crops and
 - (2) Agricultural Advances for “short duration” crops
- The “long duration” crops would be crops with crop season longer than one year and crops, which are not “long duration” crops would be treated as “short duration” crops. The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers’ Committee in each State.
- The following NPA norms would apply to agricultural advances (including Crop Term Loans): {2 M}
- A loan granted for short duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for two crop seasons and,
 - A loan granted for long duration crops will be treated as NPA, if the installment of principal or interest thereon remains overdue for one crop season.

Answer:

- (b) The special steps involved in its audit are stated below-
- (1) Verify the internal control mechanism-
 - (a) That entrance to the cinema-hall during show is only through printed tickets;
 - (b) That they are serially numbered and bound into books;
 - (c) 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;
 - (d) That for advance booking a separate series of tickets is issued; and
 - (e) That the inventory of tickets is kept in the custody of a responsible official.{Any 8 points each 1/2 marks}

- (2) Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it.
- (3) Verify that a record is kept of the 'free passes' and that these are issued under proper authority.
- (4) Reconcile the amount of Entertainment Tax collected with the total number of tickets issued for each class and vouch and verify the entertainment tax returns filed each month.
- (5) 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.
- (6) Verify the charges collected for advertisement slides and shorts by reference to the Register of Slides and Shorts Exhibited kept at the cinema as well with the agreements, entered into with advertisers in this regard.
- (7) Vouch the expenditure incurred on advertisement, repairs and maintenance. No part of such expenditure should be capitalized.
- (8) Confirm that depreciation on machinery and furniture has been charged at an appropriate rate.
- (9) Vouch payments on account of film hire with bills of distributors and in the process, the agreements concerned should be referred to.
- (10) Examine unadjusted balance out of advance paid to the distributors against film hire contracts to see that they are good and recoverable. If any film in respect of which an advance was paid has already run, it should be enquired as to why the advance has not been adjusted. The management should be asked to make a provision in respect of advances that are considered irrecoverable.
- (11) The arrangement for collection of the share in the restaurant income should be enquired into either a fixed sum or a fixed percentage of the taking may be receivable annually. In case the restaurant is run by the Cinema, its accounts should be checked. The audit should cover sale of various items of foodstuffs, purchase of foodstuffs, cold drink, etc. as in the case of club.

Answer:

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

- (1) Stay within the scope and limitation of the assignment. } {1 M}
- (2) Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction. }
- (3) Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation. } {1 M}
- (4) Consider all possibilities of error. }
- (5) Co-ordinate the procedures to be applied to related items. } {1 M}

Answer:

- (d)**
- (a) Relevant industry, regulatory and other external factors including the applicable financial reporting framework. } {1/2 M}
 - (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;
 To enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial statements. } {1 M}

- (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. } {1/2 M}
- (d) The entity’s objectives and strategies, and those related business risks that may result in risks of material misstatement. } {1/2 M}
- (e) The measurement and review of the entity’s financial performance. } {1/2 M}

Answer 5:

- (a) Substantive Analytical Procedure: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor’s assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated. } {2 M}
- In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform tests of details on the payroll. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts. } {1 M}

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.
- (h) Audited accounts are of great help in the settlement of accounts at the time of admission or death of partner.
- (i) Government may require audited and certified statement before it gives assistance or issues a license for a particular trade.

{Any 8 points each 1/2 Mark}

Answer:

- (c) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. The inherent limitations of an audit arise from:
 - (i) The Nature of Financial Reporting: The preparation of financial statements involves judgment by management in applying the requirements of the entity’s applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.

{Each Point 1 Mark}

- (ii) 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.
- (iii) Timeliness of Financial Reporting and the Balance between Benefit and Cost: The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.
- Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.
- (iv) Other Matters that Affect the Limitations of an Audit: In the case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:
- Fraud, particularly fraud involving senior management or collusion.
 - The existence and completeness of related party relationships and transactions.
 - The occurrence of non-compliance with laws and regulations.
 - Future events or conditions that may cause an entity to cease to continue as a going concern.

Answer:

- (d) Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:
1. Helping the auditor to devote appropriate attention to important areas of the audit.
 2. Helping the auditor identify and resolve potential problems on a timely basis.
 3. Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
 4. Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
 5. Facilitating the direction and supervision of engagement team members and the review of their work.
 6. Assisting, where applicable, in coordination of work done by auditors of components and experts.

{Each Point 1/2 Mark}

Answer 6:

- (a) Duty of Auditor to Inquire on certain matters: It is the duty of auditor to inquire into the following matters-
- (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
 - (b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
 - (c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
 - (d) whether loans and advances made by the company have been shown as deposits;
 - (e) whether personal expenses have been charged to revenue account;
 - (f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

{Any 4 points 1 Mark Each}

Answer:

- (b) The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false.
- The auditor's ability to detect a fraud depends on factors such as the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. While the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas such as accounting estimates are caused by fraud or error.

{2 M}

{1 M}

Answer:

- (c) Emphasis of Matter paragraph – A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements.
- Emphasis of Matter Paragraphs in the Auditor's Report**
- If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided:
- (a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and
 - (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor's report.

{1 M}

{1 M}

Separate section for Emphasis of Matter paragraph

When the auditor includes an Emphasis of Matter paragraph in the auditor's report, the auditor shall:

- Include the paragraph within a separate section of the auditor's report with an appropriate heading that includes the term "Emphasis of Matter";
- Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and
- Indicate that the auditor's opinion is not modified in respect of the matter emphasized.

{2 M}

Answer:

- (d)** Defalcation of Cash: Defalcation of cash has been found to perpetrate generally in the following ways:

**(a) By inflating cash payments.**

Examples of inflation of payments:

- Making payments against fictitious vouchers.
- Making payments against vouchers, the amounts whereof have been inflated.
- Manipulating totals of wage rolls either by including therein names of dummy workers or by inflating them in any other manner.
- Casting a larger totals for petty cash expenditure and adjusting the excess in the totals of the detailed columns so that cross totals show agreement.

{Any 2 points
1/2 Mark Each}

(b) By suppressing cash receipts.

Few techniques of how receipts are suppressed are:

- Teeming and Lading:** Amount received from a customer being misappropriated; also to prevent its detection the money received from another customer subsequently being credited to the account of the customer who has paid earlier. Similarly, moneys received from the customer who has paid thereafter being credited to the account of the second customer and such a practice is continued so that no one account is outstanding for payment for any length of time, which may lead the management to either send out a statement of account to him or communicate with him.
- Adjusting unauthorised or fictitious rebates, allowances, discounts, etc. to customer' accounts and misappropriating amount paid by them.

{Any 2 points
1/2 Mark Each}

- (3) Writing off as debts in respect of such balances against which cash has already been received but has been misappropriated.
 - (4) Not accounting for cash sales fully.
 - (5) Not accounting for miscellaneous receipts, e.g., sale of scrap, quarters allotted to the employees, etc.
 - (6) Writing down asset values in entirety, selling them subsequently and misappropriating the proceeds.
- (c) By casting wrong totals in the cash book. } **{1 M}**

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