

(CA ALL INTERMEDIATE BATCHES)

DATE: 12.01.2021

MAXIMUM MARKS: 100

TIMING: 3¼ Hours

PAPER : AUDITING**DIVISION – A (MULTIPLE CHOICE QUESTIONS)****ANSWER (1-20) CARRY 1 MARK EACH**

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

ANSWER (21-25) CARRY 2 MARKS EACH

- (21) Ans. c
- (22) Ans. c
- (23) Ans. c
- (24) Ans. d
- (25) Ans. d

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

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

- (i) Incorrect: The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business.
- (ii) Incorrect: SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files. An appropriate time limit within which to complete the

- assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.
- (iii) Incorrect: 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.
- (iv) Incorrect: The auditor may include copies of the entity's records (for example, significant and specific contracts and agreements) as part of audit documentation. Audit documentation is not a substitute for the entity's accounting records.
- (v) Incorrect: 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.
- (vi) Incorrect: When the auditor has determined that an assessed risk of material misstatement at the assertion level is a significant risk, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach to a significant risk consists only of substantive procedures, those procedures shall include tests of details.
- (vii) Correct: According to 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.
- (viii) Incorrect: 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.

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

Answer 2:

- (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):
- 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.

{2 M}

{2 M}

Answer:

- (b) Not prudent to follow stages of asset classification. It should be straight-away classified as doubtful or loss asset as appropriate.
- (i) Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straight-away classified under doubtful category and provisioning should be made as applicable to doubtful assets.

{1^{1/2} M}

- (ii) If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored and the asset should be straight-away classified as loss asset. It may be either written off or fully provided for by the bank. {1^{1/2} M}

Answer:

- (c) **Propriety audit** - 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. With the passage of time, it was felt that regularity audit alone was not sufficient to protect properly the public interest in the spending of money by the executive authorities. A transaction may satisfy all the requirements of regularity audit insofar as the various formalities regarding rules and regulations are concerned, but may still be highly wasteful. A building may be constructed for installing a telephone exchange but may not be used for the same purpose resulting in infructuous expenditure or a school building may be constructed but used after five years of its completion is a case of avoidable expenditure. {1 M}
- Audit should, therefore, try to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions. These considerations have led to the evolution of audit against propriety which is now being combined by the audit authorities with their routine function of regularity audit. It is hard to frame any precise rules for regulating the course of audit against propriety. Such an objective of audit depends for its acceptance on its appeal to the common sense and straight logic of the auditors and of those whose financial transactions are subjected to propriety audit. However, some general principles have been laid down in the Audit Code, which have for long been recognised as standards of financial propriety. Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows: {1 M}
- (a) The expenditure should not be prima facie more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.
- (b) No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.
- (c) Public moneys should not be utilised for the benefit of a particular person or section of the community unless: {1 M}
- (i) The amount of expenditure involved is insignificant; or
 - (ii) A claim for the amount could be enforced in a Court of law; or
 - (iii) The expenditure is in pursuance of a recognised policy or custom; and
 - (iv) The amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.

Answer:

- (d) Role of C&AG is prescribed under sub section (5), (6) and (7) of section 143 of the Companies Act, 2013. Section 143(5) of the Act states that, in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub- {1 M}

section (7) of section 139 i.e. appointment of First Auditor or Subsequent Auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report have a right to,

(a) conduct a supplementary audit under section 143(6)(a), of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and {1^{1/2} M}

(b) comment upon or supplement such audit report under section 143(6)(b). Any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report. {1^{1/2} M}

Test Audit under section 143(6)(b): Further, without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

Answer 3:

(a) Provisions and Explanation: Section 141(3)(c) of the Companies Act, 2013 prescribes that any person who is a partner or in employment of an officer or employee of the company will be disqualified to act as an auditor of a company. Sub-section (4) of Section 141 provides that an auditor who becomes subject, after his appointment, to any of the disqualifications specified in sub-sections (3) of Section 141, he shall be deemed to have vacated his office as an auditor. {2 M}

Conclusion: In the present case, Mr. A, an auditor of Laxman Ltd., joined as partner with Mr. B, who is Manager Finance of Laxman Limited. The given situation has attracted sub-section (3)(c) of Section 141 and, therefore, he shall be deemed to have vacated office of the auditor of Laxman Limited in accordance with sub-section (4) of section 141. {2 M}

Answer:

(b) Provisions and Explanation: For non-compliance of sub-section (2) of section 140 of the Companies Act, 2013, the auditor shall be punishable with fine, which shall not be less than fifty thousand rupees or the remuneration of the auditor, whichever is less but which may extend to five lakh rupees, under section 140(3) of the said Act. {2 M}

Conclusion: Thus, the fine under section 140(3) of the Companies Act, 2013 shall not be less than Rs. 30,000 but which may extend to Rs. 5,00,000. {2 M}

Answer:

- (c) Provisions and Explanation: In the case of a Government Company, the appointment of first auditor is governed by the provisions of Section 139(7) of the Companies Act, 2013 which states that in the case of a Government company, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company. **{2 M}**
- Hence, in the case of Bhartiya Petrol Ltd., being a government company, the first auditor shall be appointed by the Comptroller and Auditor General of India. **{1 M}**
- Conclusion: Thus, the appointment of first auditor made by the Board of Directors of Bhartiya Petrol Ltd., is null and void.

Answer:

- (d) Permission of Central Government for Removal of Auditor Under Section 140(1) of the Companies Act, 2013: Removal of auditor before expiry of his term i.e. before he has submitted his report is a serious matter and may adversely affect his independence. **{1 M}**
- Further, in case of conflict of interest the shareholders may remove the auditors in their own interest.
- Therefore, law has provided this safeguard so that central government may know the reasons for such an action and if not satisfied, may not accord approval. **{1 M}**
- On the other hand if auditor has completed his term i.e. has submitted his report and thereafter he is not re-appointed then the matter is not serious enough for central government to call for its intervention.
- In view of the above, the permission of the Central Government is required when auditors are removed before expiry of their term and the same is not needed when they are not re-appointed after expiry of their term. **{1 M}**

Answer 4:

- (a) 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: **{1 M}**
- (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. **{1 M}**
- (ii) The Nature of Audit Procedures: There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example: **{1 M}**
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.] {1 M}
- (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:] {1 M}
- ◆ 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:

- (b) The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy and the object of the audit may be altogether lost in the mass of entries and vouchers. It is also important for him to know whether the system is actually in operation. Often, after installation of a system, no proper follow up is there by the management to ensure compliance. The auditor, in such circumstances, may be led to believe that a system is in operation which in reality may not be altogether in operation or may at best operate only partially. This state of affairs is probably the worst that an auditor may come across and he would be in the midst of confusion, if he does not take care.] {2 M}
- It would be better if the auditor can undertake the review of the internal control system of client. This will give him enough time to assimilate the controls and implications and will enable him to be more objective in the framing of the audit programme. He will also be in a position to bring to the notice of the management the weaknesses of the system and to suggest measures for improvement. At a further interim date or in the course of the audit, he may ascertain how far the weaknesses have been removed.] {1 M}
- From the foregoing, it can be concluded that the extent and the nature of the audit programme is substantially influenced by the internal control system in operation. In deciding upon a plan of test checking, the existence and operation of internal control system is of great significance.
- A proper understanding of the internal control system in its content and working also enables an auditor to decide upon the appropriate audit procedure to be applied in different areas to be covered in the audit programme.] {2 M}
- In a situation where the internal controls are considered weak in some areas, the auditor might choose an auditing procedure or test that otherwise might not be required; he might extend certain tests to cover a large number of transactions or other items than he otherwise would examine and at times he may perform additional tests to bring him the necessary satisfaction.

Answer:

- (c) Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit. It may, however, also include information obtained from other sources such as previous audits. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence. Also, information that may be used as audit evidence may have been prepared using the work of a management's expert. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, also constitutes audit evidence. **{2 M}**
- Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. Audit procedures to obtain audit evidence can include inspection, observation, confirmation, recalculation, re-performance and analytical procedures, often in some combination, in addition to inquiry. Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls. **{1 M}**
- As explained in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. The sufficiency and appropriateness of audit evidence are interrelated. **{1 M}**

Answer 5:

- (a) While planning the audit of an NGO, the auditor may concentrate on the following:
- (i) Knowledge of the NGO's work, its mission and vision, areas of operations and environment in which it operate.
 - (ii) Updating knowledge of relevant statutes especially with regard to recent amendments, circulars, judicial decisions related to the statutes.
 - (iii) Reviewing the legal form of the Organisation and its Memorandum of Association, Articles of Association, Rules and Regulations.
 - (iv) Reviewing the NGO's Organisation chart, then Financial and Administrative Manuals, Project and Programme Guidelines, Funding Agencies Requirements and formats, budgetary policies if any.
 - (v) Examination of minutes of the Board/Managing Committee/Governing Body/Management and Committees thereof to ascertain the impact of any decisions on the financial records.
 - (vi) Study the accounting system, procedures, internal controls and internal checks existing for the NGO and verify their applicability.
 - (vii) Setting of materiality levels for audit purposes.
 - (viii) The nature and timing of reports or other communications.
 - (ix) The involvement of experts and their reports.
 - (x) Review the previous year's Audit Report.
- Each 1/2 Mark = Total 5 Marks**

Answer:

- (b) 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. } {2 M}
3. The identified risks of material misstatement.
4. The significance of the audit evidence obtained. } {1 M}
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. } {1 M}
7. The audit methodology and tools used.

Answer:

- (c) The auditor should plan his work to enable him to conduct an effective audit in an efficient and timely manner. Plans should be based on knowledge of the client's business. } {1 M}
- Plans should be made to cover, among other things:
- (a) acquiring knowledge of the client's accounting systems, policies and internal control procedures; } {1 M}
 - (b) establishing the expected degree of reliance to be placed on internal control; } {1 M}
 - (c) determining and programming the nature, timing, and extent of the audit procedures to be performed; and } {1 M}
 - (d) coordinating the work to be performed. } {1 M}

Answer 6:

- (a) The auditor shall document:
- (a) the overall audit strategy;
 - (b) the audit plan; and
 - (c) any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes. } {1 M}
- The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team.
- For example, the auditor may summarize the overall audit strategy in the form of a memorandum that contains key decisions regarding the overall scope, timing and conduct of the audit. } {2 M}
- 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.
- A record of the significant changes to the overall audit strategy and the audit plan, and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made, and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit. } {2 M}
- For instance-
- The following things should form part of auditor's documentation:
- A summary of discussions with the entity's key decision makers
 - Documentation of audit committee pre-approval of services, where required

- Audit documentation access letters
- Other communications or agreements with management or those charged with governance regarding the scope, or changes in scope, of our services
- Auditor’s report on the entity’s financial statements.
- Other reports as specified in the engagement agreement (e.g., debt covenant compliance letter)

Answer:

(b) In today’s digital age when companies rely on more and more on IT systems and networks to operate business, the amount of data and information that exists in these systems is enormous. A famous businessman recently said, “Data is the new Oil”.

The combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is called data analytics. While it is true that companies can benefit immensely from the use of data analytics in terms of increased profitability, better customer service, gaining competitive advantage, more efficient operations, etc., even auditors can make use of similar tools and techniques in the audit process and obtain good results. The tools and techniques that auditors use in applying the principles of data analytics are known as Computer Assisted Auditing Techniques or CAATs in short.

Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the following,

- check completeness of data and population that is used in either test of controls or substantive audit tests
- selection of audit samples – random sampling, systematic sampling
- re-computation of balances – reconstruction of trial balance from transaction data
- reperformance of mathematical calculations – depreciation, bank interest calculation.

Answer:

(c) 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.