

DATE: 16.04.2022

**(GI-7, VI-VDI-SI-3)**

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

**ANSWER (21-25) CARRY 2 MARKS EACH**

21. Ans. d
22. Ans. d
23. Ans. d

**24. CORRECT:**

Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the audit's resources. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.

**25. CORRECT:**

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.

**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) **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.
- (ii) **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.
- (iii) **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.
- (iv) **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.
- (v) **INCORRECT:**  
"Sweat Equity Shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.
- (vi) **INCORRECT:**  
If Company X's balance sheet shows building with carrying amount of Rs. 100 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. 100 lakh (Completeness assertion).
- (vii) **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.
- (viii) **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

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

- 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.

**Answer 2:**

(a) 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.
- (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.

{Any 6  
Points  
Each  
1/2  
Mark}

**Answer:**

(b) Audit documentation: SA 230 on "Audit Documentation", audit documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. (terms such as "working papers" or "work papers" are also sometimes used.)

**Nature of Audit Documentation**

Audit documentation provides:

- (a) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and
- (b) evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

{1 M}

**Purpose of Audit Documentation**

The following are the purpose of Audit documentation:

1. Assisting the engagement team to plan and perform the audit.
2. Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.
3. Enabling the engagement team to be accountable for its work.
4. Retaining a record of matters of continuing significance to future audits.
5. Enabling the conduct of quality control reviews and inspections.
6. Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

{Any 4 points  
1/2 Mark Each}

**Answer:**

- (c) The functioning of banking industry in India is regulated by the Reserve Bank of India (RBI) which acts as the Central Bank of our country. RBI is responsible for development and supervision of the constituents of the Indian financial system (which comprises banks and non-banking financial institutions) as well as for determining, in conjunction with the Central Government, the monetary and credit policies keeping in with the need of the hour. {2 M}
- Important functions of RBI are issuance of currency; regulation of currency issue; acting as banker to the central and state governments; and acting as banker to commercial and other types of banks including term-lending institutions. Besides, RBI has also been entrusted with the responsibility of regulating the activities of commercial and other banks. No bank can commence the business of banking or open new branches without obtaining licence from RBI. The RBI also has the power to inspect any bank. {2 M}

**Answer:**

- (d) **Using the Work of another Auditor:** When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole; also, there is great necessity for a proper rapport between these two auditors for the purpose of an effective audit. In recognition of these needs, the Council of the Institute of Chartered Accountants of India has dealt with these issues in **SA 600, "Using the Work of another Auditor"**. It makes clear that in certain situations, the statute governing the entity may confer a right on the principal auditor to visit a component and examine the books of account and other records of the said component, if he thinks it necessary to do so. Where another auditor has been appointed for the component, the principal auditor would normally be entitled to rely upon the work of such auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. Further, it requires that the principal auditor should perform procedures to obtain sufficient appropriate audit evidence, that the work of the other auditor is adequate for the principal auditor's purposes, in the context of the specific assignment. When using the work of another auditor, the principal auditor should ordinarily perform the following procedures: {2 M}
- (i) 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 areas requiring special consideration, procedures for the identification of inter-component transactions that may require disclosure and the time-table for completion of audit; and {1 M}
- (ii) Advise the other auditor of the significant accounting, auditing and reporting requirements and obtain representation as to compliance with them.
- The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor. This knowledge may have been enhanced from the review of the previous audit work of the other auditor. {1 M}

**Answer 3:**

- (a) Professional skepticism is necessary to the critical assessment of audit evidence. It also includes consideration of the sufficiency and appropriateness of audit evidence obtained in the light of the circumstances, for example in the case where fraud risk factors exist and a single document, of a nature that is susceptible to fraud, is the sole supporting evidence for a material financial statement amount. {1 M}
- The auditor may accept records and documents as genuine unless the auditor has reason to believe the contrary. Nevertheless, the auditor is required to consider the reliability of information to be used as audit evidence. In cases of doubt about the reliability of information or indications of possible fraud, the SAs require that the auditor investigate further and determine what modifications or additions to audit procedures are necessary to resolve the matter. {1 M}
- The auditor cannot be expected to disregard past experience of the honesty and integrity of the entity's management and those charged with governance. Nevertheless, a belief that management and those charged with governance are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism. {1 M}

**Answer:****(b) Duties of the C&AG:**

- (i) **Compile and submit Accounts of Union and States** - The Comptroller and Auditor General shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account. The Comptroller and Auditor General shall, from the accounts compiled by him or [by the Government or any other person responsible in that behalf] prepare in each accounts (including, in the case of accounts compiled by him, appropriation accounts) showing under the respective heads the annual receipts and disbursements for the purpose of the Union, of each State and of each Union Territory having a Legislative Assembly, and shall submit those accounts to the President or the Governor of a State or Administrator of the Union Territory having a Legislative Assembly, as the case may be, on or before such dates as he may, with the concurrence of the Government concerned, determine. {1/2 M}
- The C&AG Act of 1971 has provisions for relieving him of this responsibility to give information and render assistance to the Union and States: The Comptroller and Auditor General shall, in so far as the accounts, for the compilation or keeping of which he is responsible, enable him so to do, give to the Union Government, to the State Government or to the Governments of Union Territories having Legislative Assemblies, as the case may be, such information as they may, from time to time, require and render such assistance in the preparation of the annual financial statements as they may reasonably ask for.
- (ii) **General Provisions Relating to Audit** - It shall be the duty of the Comptroller and Auditor General—
- (a) To audit and report on all expenditure from the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to ascertain whether the moneys shown in the accounts as having been disbursed were legally available for and applicable to the service or purpose to which they have been applied or charged and whether the expenditure conforms to the authority which governs it; {1 M}

- (b) To audit and report all transactions of the Union and of the States relating to Contingency Funds and Public Accounts;
- (c) To audit and report on all trading, manufacturing and profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State.
- (iii) **Audit of Receipts and Expenditure** - Where anybody or authority is substantially financed by grants or loans from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly, the Comptroller and Auditor General shall, subject to the provisions of any law for the time being in force applicable to the body or authority, as the case may be, audit all receipts and expenditure of that body or authority and to report on the receipts and expenditure audited by him. {1/2 M}  
Where the grant or loan to a body or authority from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly in a financial year is not less than rupees twenty-five lakhs and the amount of such grant or loan is not less than seventy-five per cent of the total expenditure of that body or authority, such body or authority shall be deemed, for this purpose to be substantially financed by such grants or loans as the case may be.
- (iv) **Audit of Grants or Loans** - Where any grant or loan is given for any specific purpose from the Consolidated Fund of India or of any State or of any Union Territory having a Legislative Assembly to any authority or body, not being a foreign State or international organisation, the Comptroller and Auditor General shall scrutinise the procedures by which the sanctioning authority satisfies itself as to the fulfillment of the conditions subject to which such grants or loans were given and shall for this purpose have right of access, after giving reasonable previous notice, to the books and accounts of that authority or body. {1/2 M}
- (v) **Audit of Receipts of Union or States** - It shall be the duty of the Comptroller and Auditor General to audit all receipts which are payable into the Consolidated Fund of India and of each State and of each Union Territory having a Legislative Assembly and to satisfy himself that the rules and procedures in that behalf are designed to secure an effective check on the assessment, collection and proper allocation of revenue and are being duly observed and to make for this purpose such examination of the accounts as he thinks fit and report thereon. {1/2 M}
- (vi) **Audit of Accounts of Stores and Inventory** - The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State. {1/2 M}
- (vii) **Audit of Government Companies and Corporations** - The duties and powers of the Comptroller and Auditor General in relation to the audit of the accounts of government companies shall be performed and exercised by him in accordance with the provisions of the Companies Act, 2013. The Comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-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. {1/2 M}

Answer:

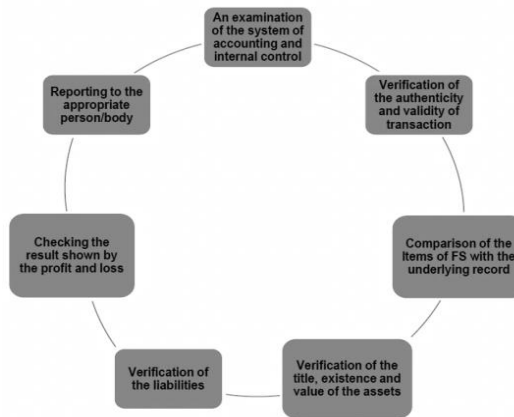
(c) IT also poses specific risks to an entity’s internal control, including, for example:

- ◆ Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- ◆ Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
- ◆ The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- ◆ Unauthorised changes to data in master files.
- ◆ Unauthorised changes to systems or programs.
- ◆ Failure to make necessary changes to systems or programs.
- ◆ Inappropriate manual intervention.
- ◆ Potential loss of data or inability to access data as required.

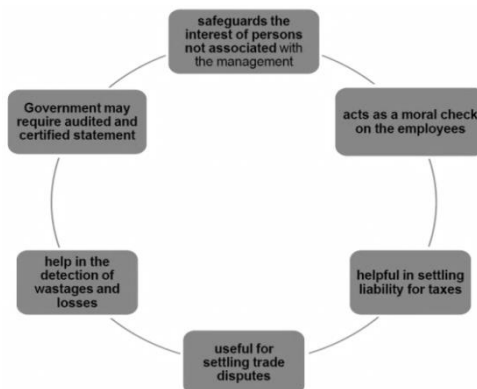
} Any 6 Point Each 1/2 Mark }

Answer:

(d) 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 4:**

- (a) 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.  
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.

} 2 M }

} 1 M }

**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
  - (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 }

} 2 M }

**Answer :**

- (c) 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.
- (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.

{Any 8  
points  
each 1/2  
marks}

**Answer:**

**(d) Responsibilities of the Auditor**

There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements.

The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances.

The auditor needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude whether the financial statements, insofar as they are affected by those relationships and transactions:

- (a) Achieve a true and fair presentation; or
- (b) Are not misleading (for compliance frameworks).

{1 M}

In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether fraud risk factors are present as required by SA 240. This is because fraud may be more easily committed through related parties.

Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs. In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following:

- Management may be unaware of the existence of all related party relationships.
- Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.
- Planning and performing the audit with professional skepticism as required by SA 200 is therefore particularly important in this context, given the potential for undisclosed related party relationships and transactions. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions, and in designing audit procedures to respond to the assessed risks.

{2 M}

**Answer 5:**

**(a)** Auditor Holding Securities of a Company: As per sub-section (3)(d)(i) of Section 141 of the Companies Act, 2013 read with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. However, the relative may hold security or interest in the company of face value not exceeding Rs. 1 lakh.

{1 M}

Also, as per sub-section 4 of Section 141 of the Companies Act, 2013, where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

{1 M}

In the present case, Mr. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd. Therefore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd., which is the holding company of Shiva Ltd., because one of the partners Mr. Hanuman is holding equity shares of its subsidiary.

{1 M}

**Answer:**

**(b) Sufficiency of Audit Evidence:** Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (the higher the quality, the less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. **Auditor's judgment as to sufficiency may be affected by the factors such as:**

{2 M}

- (i) Materiality
- (ii) Risk of material misstatement
- (iii) Size and characteristics of the population.

- (i) **Materiality** may be defined as the significance of classes of transactions, account balances and presentation and disclosures to the users of the financial statements. Less evidence would be required in case assertions are less material to users of the financial statements. But on the other hand if assertions are more material to the users of the financial statements, more evidence would be required.
- (ii) **Risk of material misstatement** may be defined as the risk that the financial statements are materially misstated prior to audit. This consists of two components described as follows at the assertion level (a) Inherent risk—The susceptibility of an assertion to a misstatement that could be material before consideration of any related controls. (b) Control risk—The risk that a misstatement that could occur in an assertion that could be material will not be prevented or detected and corrected on a timely basis by the entity's internal control. Less evidence would be required in case assertions that have a lower risk of material misstatement. But on the other hand if assertions have a higher risk of material misstatement, more evidence would be required. {2 M}
- (iii) **Size of population** refers to the number of items included in the population. Less evidence would be required in case of smaller, more homogeneous population but on the other hand in case of larger, more heterogeneous populations, more evidence would be required.

**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) Techniques available as substantive analytical procedures: The design of a substantive analytical procedure is limited only by the availability of reliable data and the experience and creativity of the audit team. Substantive analytical procedures generally take one of the following forms:
- **Trend analysis** — A commonly used technique is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. We evaluate whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change. {1 M}
  - **Ratio analysis** — Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts. An individual balance sheet account is difficult to predict on its own, but its relationship to another account is often more predictable (e.g., the trade receivables balance related to sales). Ratios can also be compared over time or to the ratios of separate entities within the group, or with the ratios of other companies in the same industry. {1 M}
    - For example, Financial ratios may include:
    - Trade receivables or inventory turnover
    - Freight expense as a percentage of sales revenue

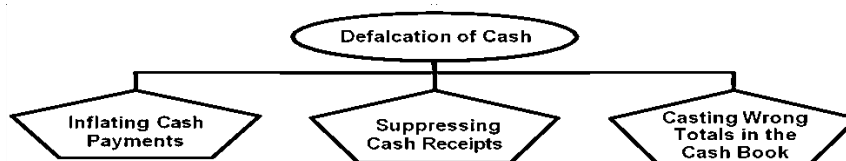
- Reasonableness tests — Unlike trend analysis, this analytical procedure does not rely on events of prior periods, but upon non-financial data for the audit period under consideration (e.g., occupancy rates to estimate rental income or interest rates to estimate interest income or expense). These tests are generally more applicable to income statement accounts and certain accrual or prepayment accounts. { 1 M }
- Structural modelling — A modelling tool constructs a statistical model from financial and/or non-financial data of prior accounting periods to predict current account balances (e.g., linear regression). { 1 M }

**Answer 6:**

- (a)** If, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor’s ability to continue performing the audit, the auditor shall:
- (a) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities; { 1 M }
  - (b) Consider whether it is appropriate to withdraw from the engagement, where withdrawal is possible under applicable law or regulation; and { 1 M }
  - (c) If the auditor withdraws:
    - (i) Discuss with the appropriate level of management and those charged with governance the auditor’s withdrawal from the engagement and the reasons for the withdrawal; and
    - (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor’s withdrawal from the engagement and the reasons for the withdrawal. { 2 M }

**Answer:**

- (b)** 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:
- (1) Making payments against fictitious vouchers.
  - (2) Making payments against vouchers, the amounts whereof have been inflated.
  - (3) Manipulating totals of wage rolls either by including therein names of dummy workers or by inflating them in any other manner.
  - (4) 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.
- (b) By suppressing cash receipts.**  
 Few techniques of how receipts are suppressed are:
- (1) 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
- { Any 2 points  
1/2 Mark Each }

- 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.
- (2) Adjusting unauthorised or fictitious rebates, allowances, discounts, etc. to customer' accounts and misappropriating amount paid by them.
  - (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}
- {Any 2 points  
1/2 Mark Each}

**Answer:**

- (c) 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- 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
  - (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.
- 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
- {1 M}
- {1<sup>1/2</sup> M}
- {1<sup>1/2</sup> M}

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:**

- (d) (i) **Rent expense-** Obtain a month wise expense schedule along with the rent agreements. Verify if expense has been recorded for all 12 months and whether the rent amount is as per the underlying agreement. Specific consideration should be given to escalation clause in the agreement to verify if the rent was to be increased/ adjusted during the period under audit. Also, verify if the agreement is in the name of the entity and whether the expense pertains to premises used for running business operations of the entity. ] {1<sup>1/2</sup> M}
- (ii) **Power and fuel expense-** Obtain a month wise expense schedule along with the power bills. Verify if expense has been recorded for all 12 months. Also, compile a month wise summary of power units consumed and the applicable rate and check the arithmetical accuracy of the bill raised on monthly basis. In relation to the units consumed, analyse the monthly power units consumed by linking it to units of finished goods produced and investigate reasons for variance in monthly trends. ] {1<sup>1/2</sup> M}

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