

(GI-1, GI-2, VI-VDI-SI-1,2)

DATE: 16.09.2022

MAXIMUM MARKS: 100

TIMING: 3¼ Hours

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

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

ANSWERS (21-25) CARRY 2 MARKS EACH

21. Ans. c
22. Ans. b
23. Ans. d
24. Ans. c
25. Ans. c

**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) **True-**

Sampling risk arises from possibility that auditor conclusion based upon sample may be different from conclusion that would have been reached, if same audit procedure were applied on entire population. If acceptable sampling risk is low, large sample is needed.

- (ii) **Incorrect-**
If the purpose of an audit procedure is to test for overstatement in the existence or valuation of accounts payable, testing the recorded accounts payable may be a relevant audit procedure.
On the other hand, when testing for understatement in the existence or valuation of accounts payable, testing the recorded accounts payable would not be relevant, but testing such information as subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports may be relevant.
- (iii) **Correct-**
Audit notes can serve as a guide in framing audit programme in the future as they indicate the weaknesses in the system of the client which specially need to be watched.
- (iv) **Incorrect-**
The auditor's substantive procedures at the assertion level may be tests of details, substantive analytical procedures, or a combination of both. The decision about which audit procedures to perform, including whether to use substantive analytical procedure, is based on the auditor's judgment about the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level.
- (v) **Incorrect-**
As per Section 139(8), any casual vacancy in the office of an auditor shall in the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days.
- (vi) **False-**
Client and auditor should agree on terms of engagement by way of an audit engagement letter, to avoid any misunderstanding. Thus, auditor should send an engagement letter, preferably before commencement of engagement.
- (vii) **Incorrect-**
The policy of income recognition should be objective and based on record of recovery rather than on any subjective considerations. Income from non-performing assets (NPA) is not recognized on accrual basis but is booked as income only when it is actually received.
- (viii) **Incorrect-**
Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C&AG prescribe.
Article 151 requires that the reports of the C&AG relating to the accounts of the Union/State shall be submitted to the President/Governor who shall cause them to be laid before House of Parliament/State Legislature.

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

Answer 2:

- (a) Risk of Material Misstatement at the Assertion Level: According to SA 315 "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", risks of material misstatement at the assertion level for classes of transactions, account balances, and disclosures need to be considered because such consideration directly assists in determining the nature, timing, and extent of further audit procedures at the assertion level necessary to obtain sufficient appropriate audit evidence. In identifying and assessing risks of material misstatement at the assertion level, the auditor may conclude that the identified risks relate more pervasively to the financial statements as a whole and potentially affect many assertions.

{1 M}

Assertions used by the auditor to consider the different types of potential misstatements that may occur fall into the following three categories and may take the following forms-

- (a) Assertions about classes of transactions and events for the period under audit:
 - (i) Occurrence—transactions and events that have been recorded have occurred and pertain to the entity.
 - (ii) Completeness—all transactions and events that should have been recorded have been recorded. **{1 M}**
 - (iii) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately.
 - (iv) Cut-off—transactions and events have been recorded in the correct accounting period.
 - (v) Classification—transactions and events have been recorded in the proper accounts.

- (b) Assertions about account balances at the period end:
 - (i) Existence—assets, liabilities, and equity interests exist.
 - (ii) Rights and obligations—the entity holds or controls the rights to assets, and liabilities are the obligations of the entity.
 - (iii) Completeness—all assets, liabilities and equity interests that should have been recorded have been recorded. **{1 M}**
 - (iv) Valuation and allocation—assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and any resulting valuation or allocation adjustments are appropriately recorded.

- (c) Assertions about presentation and disclosure:
 - (i) Occurrence and rights and obligations—disclosed events, transactions, and other matters have occurred and pertain to the entity.
 - (ii) Completeness—all disclosures that should have been included in the financial statements have been included.
 - (iii) Classification and understandability—financial information is appropriately presented and described, and disclosures are clearly expressed. **{1 M}**
 - (iv) Accuracy and valuation—financial and other information are disclosed fairly and at appropriate amounts.

Answer:

- (b) (a) Board's Powers to Appoint an Auditor: As per Section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall-
 - (i) In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days. **{1 M}**
 If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting;
 - (ii) In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor- General of India within 30 days.

It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period the Board of Directors shall fill the vacancy within next 30 days.

In the given case, the Board of directors of X Ltd. has appointed Mr. Hari as the auditor due to resignation of the existing auditor(s). The appointment made by the Board is correct, however, such appointment should be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and newly appointed auditor shall hold office till the conclusion of the next annual general meeting.

{1 M}

- (b) Restrictions on Powers of Statutory Auditors: Section 143(1) of the Companies Act, 2013 provides that an auditor of a company shall have right of access at all times to the books and accounts and vouchers of the company whether kept at the Head Office or other places and shall be entitled to require from the offices of the company such information and explanations as the auditor may think necessary for the purpose of his audit. These specific rights have been conferred by the statute on the auditor to enable him to carry out his duties and responsibilities prescribed under the Act, which cannot be restricted or abridged in any manner. Hence, any such resolution even if passed by entire body of shareholders is ultra vires and there for evold.

{2 M}

Answer:

- (c) Formation of Audit Committee: As per section 177 of the Companies Act, 2013 read with the Companies (Meeting of Board and its Powers) Rules, 2014, audit committee is to be formed by every listed companies and following classes of companies:

{1 M}

- (i) all public companies with a paid up capital of ten crore rupees or more,
- (ii) all public companies having turnover of one hundred crore rupees or more,
- (iii) all public companies having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more.

{1/2 M
Each}

Further, the auditor shall have the right to be heard in the meetings of the Audit Committee when it considers the Auditor’s Report but shall not have the right to vote.

{1/2 M}

Answer:

- (d) Purpose of communicating key audit matters
As per SA 701, “Communicating Key Audit Matters in the Auditor’s Report”, the purpose of communicating key audit matters is to enhance the communicative value of the auditor’s report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor’s professional judgment, were of most significance in the audit of the financial statements of the current period.

{3 M}

Answer 3:

- (a) Factors that may affect the Identification of an Appropriate Benchmark in Determining Materiality: As per SA 320 “Materiality in Planning and Performing an Audit”, determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole. Factors that may affect the identification of an appropriate benchmark include the following-

- (i) The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);

- (ii) Whether there are items on which the attention of the users of the particular entity’s financial statements tends to be focused (for example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);
- (iii) The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
- (iv) The entity’s ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity’s earnings); and
- (v) The relative volatility of the benchmark.

{1 M
Each
Any 4
points}

Answer:

(b) Misappropriation of Assets:

It involves the theft of an entity’s assets and is often perpetrated by employees in relatively small and immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect. Misappropriation of assets can be accomplished in a variety of ways including:

{1 M}

- Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
- Stealing physical assets or intellectual property(for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).
- Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity’s purchasing agents in return for inflating prices, payments to fictitious employees).

{1 M}

Example

Vineet is a manager in Zed Ex Ltd. He is having authority to sign cheques up to Rs. 10,000. While performing the audit, Rajan, the auditor, noticed that there were many cheques of Rs. 9,999 which had been signed by Vineet. Further Vineet had split large payments (amounting to more than Rs. 10,000 each, into two or more cheques less than Rs. 10,000 each so that he may authorize the payments). This raised suspicion in the auditor.

{1 M}

The auditor found that the cheques of Rs. 9,999 were deposited in Vineet’s personal accounting. Vineet had misappropriated the amount.

Splitting the cheques into lower amounts involves manipulation of accounts.

The fraud was committed by an employee.

- Using an entity’s assets for personal use(for example, using the entity’s assets as collateral for a personal loan or a loan to a related party).

{1 M}

Misappropriation of assets is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization.

Answer:

(c) The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. However, the municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit.

{1/2 M}

The important objectives of audit are:

- (a) reporting on the fairness of the content and presentation of financial statements;

- (b) reporting upon the strengths and weaknesses of systems of financial control;
 - (c) reporting on the adherence to legal and/or administrative requirements;
 - (d) reporting upon whether value is being fully received on money spent; and
 - (e) detection and prevention of error, fraud and misuse of resources.
- } {1/2 M Each}

Answer:

- (d) Right to obtain information and explanation from officers - This right of the auditor to obtain from the officers of the company such information and explanations as he may think necessary for the performance of his duties as auditor is a wide and important power. In the absence of such power, the auditor would not be able to obtain details of amount collected by the directors, etc. from any other company, firm or person as well as of any benefits in kind derived by the directors from the company, which may not be known from an examination of the books. It is for the auditor to decide the matters in respect of which information and explanations are required by him. When the auditor is not provided the information required by him or is denied access to books, etc., his only remedy would be to report to the members that he could not obtain all the information and explanations he had required or considered necessary for the performance of his duties as auditors.
- } {3 M}

Answer 4:

- (a) Auditing Through the Computer: There are several circumstances where auditing through the Computer must be used-
- (i) The application system processes large volumes of input and produces large volumes of output that makes extensive direct examination of the validity of input and output difficult.
 - (ii) Significant parts of the internal control system are embodied in the computer system.
 - (iii) The logic of the system is complex and there are portions that facilitate use of the system or efficient processing.
 - (iv) Because of cost-benefit considerations, there are substantial gaps in the visible audit trail.
- } {1 M Each}

Answer:

- (b) Fee from Students :-
1. Check names entered in the Students Fee Register for each month or term, with the respective Class Registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
 2. Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
 3. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
 4. Check admission fees with admission slips signed by the head of the institution and confirm that the amount has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
 5. See that free studentship and concessions have been granted by a person authorised to do so, having regard to the Rules prepared by the Managing Committee.
- } {1 M Each for 4 points}

- 6. Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority.
- 7. Confirm that hostel dues were recovered before student’s accounts were closed and their deposits of caution money refunded.

Answer:

- (c) The firm should **establish policies and procedures** designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm’s system of quality control, including a periodic inspection of a selection of completed engagements. {1 M}
- The purpose of monitoring compliance with quality control policies and procedures is to provide an evaluation of:
- (a) Adherence to professional standards and regulatory and legal requirements;
 - (b) Whether the quality control system has been appropriately designed and effectively implemented; and
 - (c) Whether the firm’s quality control policies and procedures have been appropriately applied, so that reports that are issued by the firm or engagement partners are appropriate in the circumstances.
- Follow-up by appropriate firm personnel so that necessary modifications are promptly made to the quality control policies and procedures. {1/2 M}

Answer:

- (d) **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. {1 M}

Answer 5:

- (a) 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 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. {1 M Each for 4 points}
 - (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.

Answer:

(b) Audit testing done through this approach is more scientific than testing based entirely on the auditor’s own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. Statistical sampling has reasonably wide application where a population to be tested consists of a large number of similar items and more in the case of transactions involving compliance testing, trade receivables’ confirmation, payroll checking, vouching of invoices and petty cash vouchers.

The advantages of statistical sampling may be summarized as follows –

- (1) The amount of testing (sample size) does not increase in proportion to the increase in the size of the area (universe) tested.
- (2) The sample selection is more objective and thereby more defensible.
- (3) The method provides a means of estimating the minimum sample size associated with a specified risk and precision.
- (4) It provides a means for deriving a “calculated risk” and corresponding precision (sampling error) *i.e.* the probable difference in result due to the use of a sample in lieu of examining all the records in the group (universe), using the same audit procedures.
- (5) It may provide a better description of a large mass of data than a complete examination of all the data, since non-sampling errors such as processing and clerical mistakes are not as large.

**{1 M Each
for 4
points}**

Answer:

(c) Cost of Inventories: As per Accounting Standard 2 “Valuation of Inventories”, cost of inventories comprises all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition. However, it makes clear that interest and other borrowing costs are usually not included in the cost of inventories because generally such costs are not related in bringing the inventories to their present location and condition. Therefore, the proposal of CC Ltd. to include interest on bank overdraft as an element of cost is not acceptable because it does not form part of cost of production.

{3 M}

Answer:

(d) Risks of Material Misstatement at Two levels

The risks of material misstatement may exist at two levels:

- (i) The overall financial statement level- Risks of material misstatement at the overall financial statement level refer to risks of material misstatement that relate pervasively to the financial statements as a whole and potentially affect many assertions.
- (ii) The assertion level for classes of transactions, account balances, and disclosures- Risks of material misstatement at the assertion level are assessed in order to determine the nature, timing, and extent of further audit procedures necessary to obtain sufficient appropriate audit evidence. This evidence enables the auditor to express an opinion on the financial statements at an acceptably low level of audit risk.

{1^{1/2} M}

{1^{1/2} M}

Answer 6:

(a) Verification of Building:

- (i) Examine the title deeds of buildings to see whether the client holds the title on the balance sheet date. If the property has been mortgaged, the title deeds will be in the possession of the mortgagee, from whom a certificate should be obtained to that effect.

- (ii) Verify the original cost of buildings by reference to the deed of conveyance. If the building is constructed by the client, verify the original cost by reference to the cost as recorded in the books of account of the year in which the construction was completed.
 - (iii) Verify that appropriate depreciation has been provided against the buildings. In case no depreciation is provided on the buildings, a note to this effect should be given in the Statement of Profit and Loss.
 - (iv) See the appropriate lease deed, if the building is leasehold, to ascertain the cost, amortisation, etc. Also ensure that all covenants in the lease deed have been fulfilled by the client.
 - (v) See that the buildings have been valued at cost less depreciation. If any revaluation has taken place, see the basis of revaluation and ensure that the disclosure of the same has been made. In case of a company, the requirements of Schedule II and III to the Companies Act, 2013 shall also be complied with.
 - (vi) See that the relevant particulars of buildings have been entered in the fixed assets record maintained by the client.
- {1 M Each for 4 points}**

Answer:

(b) Reversal of Income:

If any advance, including bills purchased and discounted, becomes NPA as at the close of any year, the entire interest accrued and credited to income account in the past periods, should be reversed or provided for if the same is not realised. This will apply to Government guaranteed accounts also. **{1 M}**

In respect of NPAs, fees, commission and similar income that have accrued should cease to accrue in the current period and should be reversed or provided for with respect to past periods, if uncollected. **{1 M}**

Further, in case of banks which have wrongly recognised income in the past should reverse the interest if it was recognised as income during the current year or make a provision for an equivalent amount if it was recognized as income in the previous year(s). **{1 M}**

Furthermore, the auditor should enquire if there are any large debits in the Interest Income account that have not been explained. It should be enquired whether there are any communications from borrowers pointing out differences in interest charge and whether appropriate action has been taken in this regard. **{1 M}**

Answer:

(c) If analytical procedures performed in accordance with SA 520 identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, the auditor shall investigate such differences by: **{1 M}**

(i) Inquiring of management and obtaining appropriate audit evidence relevant to management’s responses: Audit evidence relevant to management’s responses may be obtained by evaluating those responses taking into account the auditor’s understanding of the entity and its environment, and with other audit evidence obtained during the course of the audit. **{1 M}**

(ii) Performing other audit procedures as necessary in the circumstances: The need to perform other audit procedures may arise when, for example, management is unable to provide an explanation, or the explanation, together with the audit evidence obtained relevant to management’s response, is not considered adequate. **{1 M}**

Answer:

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

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