

DATE: 10.04.2023

**(GI-8, FMT)**  
MAXIMUM MARKS: 100

TIMING: 3¼ Hours

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

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

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

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

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

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**Answer 1:**

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

**Answer:**

(i) **Incorrect :**

Depreciation is a fall in value of asset due to obsolescence, usage and effluxion of time, Therefore, depreciation is charged when the asset is ready for use . Active use of asset is not a mandatory criteria for charge of depreciation.

(ii) **Incorrect :**

SA 210 requires the auditor to agree management's responsibilities in an engagement letter or other suitable form of written agreement.

(iii) **Incorrect :**

Government audit serves as a mechanism or process for public accounting of government funds. It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.

(iv) **Incorrect :**

Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable.

(v) **Incorrect :**

As per SA 210 "Agreeing the Terms of Audit Engagements", the Audit engagement letter is sent by the auditor to his client.

(vi) **Incorrect :**

Under provisions of Section 143 of the companies Act, 2013, auditor has to report whether the company has adequate internal financial controls with reference to financial statements in place and operating effectiveness of such controls. The auditor has to report on adequacy and effectiveness of internal financial controls only and not internal controls.

(vii) **Incorrect :**

An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.

(viii) **Incorrect :**

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.

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

**Answer 2:**

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

**Answer:**

- (b) **Control Environment – Component of Internal Control:** The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether: {1/2 M}
- (i) Management has created and maintained a culture of honesty and ethical behavior; and
  - (ii) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

**What is included in Control Environment?**

The control environment includes:

- (i) the governance and management functions and
- (ii) the attitudes, awareness, and actions of those charged with governance and management.
- (iii) The control environment sets the tone of an organization, influencing the control consciousness of its people. {1/2 M}

**Elements of the Control Environment:** Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:

- (a) **Communication and enforcement of integrity and ethical values –** These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.
- (b) **Commitment to competence –** Matters such as management's consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.
- (c) **Participation by those charged with governance –** Attributes of those charged with governance such as: {2 M}
  - ◆ Their independence from management.
  - ◆ Their experience and stature.
  - ◆ The extent of their involvement and the information they receive, and the scrutiny of activities.
  - ◆ The appropriateness of their actions, including the degree to which difficult questions are raised and pursued with management, and their interaction with internal and external auditors.
- (d) **Management's philosophy and operating style – Characteristics such as management's:**
  - ◆ Approach to taking and managing business risks.

- ◆ Attitudes and actions toward financial reporting.
  - ◆ Attitudes toward information processing and accounting functions and personnel.
- (e) **Organisational structure** – The framework within which an entity’s activities for achieving its objectives are planned, executed, controlled, and reviewed.
- (f) **Assignment of authority and responsibility** - Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorisation hierarchies are established. {1 M}
- (g) **Human resource policies and practices** – Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counseling, promotion, compensation, and remedial actions. }

**Answer:**

- (c) **Joint Audit:** The practice of appointing Chartered Accountants as joint auditors is quite widespread in big companies and corporations. Joint audit basically implies pooling together the resources and expertise of more than one firm of auditors to render an expert job in a given time period which may be difficult to accomplish acting individually. It essentially involves sharing of the total work. This is by itself a great advantage. {1 M}

In specific terms the **advantages** that flow may be the following:

- (i) Sharing of expertise.
- (ii) Advantage of mutual consultation.
- (iii) Lower workload.
- (iv) Better quality of performance.
- (v) Improved service to the client.
- (vi) Displacement of the auditor of the company taken over in a takeover often obviated. {1/2 M
- (vii) In respect of multi-national companies, the work can be spread using the expertise of the local firms which are in a better position to deal with detailed work and the local laws and regulations. Each Point}
- (viii) Lower staff development costs.
- (ix) Lower costs to carry out the work.
- (x) A sense of healthy competition towards a better performance.

**Answer 3:**

- (a) Having obtained an understanding of the IT systems and the automated environment of a company, the auditor should now understand the risks that arise from the use of IT systems.

Given below are some such risks that should be considered:

- ◆ Inaccurate processing of data, processing inaccurate data, or both.
  - ◆ Unauthorized access to data.
  - ◆ Direct data changes (backend changes).
  - ◆ Excessive access / Privileged access (super users).
  - ◆ Lack of adequate segregation of duties.
  - ◆ Unauthorized changes to systems or programs.
  - ◆ Failure to make necessary changes to systems or programs.
  - ◆ Loss of data.
- {1/2 M Each Point}

**Answer:**

- (b) No conscious effort in human society is divested of economic considerations and auditing is no exception. There is a growing realisation that the traditional approach to audit is economically wasteful because all efforts are directed to check all transactions without exception. This invariably leads to more emphasis on routine {2 M}

checking, which often is not necessary in view of the time and the cost involved. With the shift in favour of formal internal controls in the management of affairs of organisations, the possibilities of routine errors and frauds have greatly diminished and auditors often find extensive routine checking as nothing more than a ritual because it seldom reveals anything material.

Now the approach to audit and the extent of checking are undergoing a progressive change in favour of more attention towards the questions of principles and controls with a curtailment of non-consequential routine checking. By routine checking we traditionally think of extensive checking and vouching of all entries.

{2 M}

**Answer:**

(c) **Since an Intangible Asset is an identifiable non-monetary asset**, without physical substance, for establishing the existence of such assets, the auditor should verify whether such intangible asset is in active use in the production or supply of goods or services, for rental to others, or for administrative purposes.

{1<sup>1/2</sup> M}

Example- for verifying the existence of software, the auditor should verify whether such software is in active use by the entity and for the purpose, the auditor should verify the sale of related services/ goods during the period under audit, in which such software has been used.

{1<sup>1/2</sup> M}

Example- For verifying the existence of design/ drawings, the auditor should verify the production data to establish if such products for which the design/drawings were purchased, are being produced and sold by the entity.

{1<sup>1/2</sup> M}

In case any intangible asset is not in active use, deletion should have been recorded in the books of account post approvals by the entity's management and amortization charge should have ceased to be charged beyond the date of deletion Chapter 10 - The Company Audit.

{1<sup>1/2</sup> M}

**Answer 4:**

(a) Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence.

{1/2 M}

Written representations are requested from those responsible for the preparation and presentation of the financial statements.

Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.

{1/2 M}

**The objectives of the auditor regarding written representation**

The objectives of the auditor are:

(a) **To obtain written representations**

To obtain written representations from management. Also that management believes that it has fulfilled its responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;

{1 M}

(b) **To support other evidence**

To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations; and

{1 M}

- (c) **To respond appropriately**  
To respond appropriately to written representations provided by management or if management does not provide the written representations requested by the auditor. {1 M}

**Answer:**

- (b) In considering the qualitative aspects of the entity's accounting practices, the auditor may become aware of possible bias in management's judgments. The auditor may conclude that lack of neutrality together with uncorrected misstatements causes the financial statements to be materially misstated. Indicators of a lack of neutrality include the following: {2 M}
- (i) The selective correction of misstatements brought to management's attention during the audit. {2 M}
- Example**
- ◆ Correcting misstatements with the effect of increasing reported earnings, but not correcting misstatements that have the effect of decreasing reported earnings.
  - ◆ The combination of several deficiencies affecting the same significant account or disclosure (or the same internal control component) could amount to a significant deficiency (or material weakness if required to be communicated in the jurisdiction). This evaluation requires judgment and involvement of audit executives. {2 M}
- (ii) Possible management bias in the making of accounting estimates.

**Answer:**

- (c) **Duties of C&AG: The Comptroller & Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 lays down duties of the C&AG as under-** {1 M}
- (i) **Compile and submit Accounts of Union and States** - The C&AG 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. {1 M}
- (ii) **General Provisions Relating to Audit - It shall be the duty of the C&AG-**
- (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;
  - (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 profit and loss accounts and balance-sheets and other subsidiary accounts kept in any department of the Union or of a State. {1 M}
- (iii) **Audit of Receipts and Expenditure** - Where any body 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.

- (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 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 this purpose such examination of the accounts as he thinks fit and report thereon.
- (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.
- (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 M}

**Answer 5:**

- (a) **Audit of Advances:** Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors. In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following: {2<sup>-1/2</sup> M}
- (a) Amounts included in balance sheet in respect of advances are outstanding at the date of the balance sheet.
- (b) Advances represent amount due to the bank.
- (c) Amounts due to the bank are appropriately supported by Loan documents and other documents as applicable to the nature of advances.
- (d) There are no unrecorded advances.
- (e) The stated basis of valuation of advances is appropriate and properly applied, and that the recoverability of advances is recognised in their valuation. {1/2 M  
Each  
Point}
- (f) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
- (g) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

**Answer:**

- (b) Many related party transactions are in the normal course of business. In such circumstances, they may carry no higher risk of material misstatement of the financial statements than similar transactions with unrelated parties. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. {1 M}

**Example**

- ◆ Related parties may operate through an extensive and complex range of relationships and structures, with a corresponding increase in the complexity of related party transactions.
  - ◆ Information systems may be ineffective at identifying or summarising transactions and outstanding balances between an entity and its related parties.
  - ◆ Related party transactions may not be conducted under normal market terms and conditions; for example, some related party transactions may be conducted with no exchange of consideration.
- {1 M Each Point}

**Answer:**

- (c) Given below are some of the points that an auditor should consider to obtain an understanding of the company's automated environment:
- ◆ Information systems being used (one or more application systems and what they are).
  - ◆ Their purpose (financial and non-financial).
  - ◆ Location of IT systems - local vs global.
  - ◆ Architecture (desktop based, client-server, web application, cloud based).
  - ◆ Version (functions and risks could vary in different versions of same application).
  - ◆ Interfaces within systems (in case multiple systems exist).
  - ◆ In-house vs Packaged.
  - ◆ Outsourced activities (IT maintenance and support).
  - ◆ Key persons (CIO, CISO, Administrators).
- {1/2 M Any Eight Point}

**Answer 6:**

- (a) When testing in an automated environment, some of the more common methods are as follows: {1 M}
- ◆ Obtain an understanding of how an automated transaction is processed by doing a walkthrough of one end-to-end transaction using a combination of inquiry, observation and inspection. {1 M Each Point}
  - ◆ Observe how a user processes transactions under different scenarios.
  - ◆ Inspect the configuration defined in an application.

**Answer:**

- (b) **Reporting to the Central Government:** As per sub-section (12) of section 143 of the Companies Act, 2013, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed. {1<sup>1/2</sup> M}



In this regard, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 has been prescribed. Sub-rule (1) of the said rule states that if an auditor of a company, in the course of the performance of his duties as statutory auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of Rs. 1 crore or above, is being or has been committed against the company by its officers or employees, the auditor shall report the matter to the Central Government.

{1<sup>1/2</sup> M}

The manner of reporting the matter to the Central Government is as follows:

- (a) the auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days;
- (b) on receipt of such reply or observations, the auditor shall forward his report and the reply or observations of the Board or the Audit Committee along with his comments (on such reply or observations of the Board or the Audit Committee) to the Central Government within 15 days from the date of receipt of such reply or observations;
- (c) in case the auditor fails to get any reply or observations from the Board or the Audit Committee within the stipulated period of 45 days, he shall forward his report to the Central Government along with a note containing the details of his report that was earlier forwarded to the Board or the Audit Committee for which he has not received any reply or observations;
- (d) the report shall be sent to the Secretary, Ministry of Corporate Affairs in a sealed cover by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same;
- (e) the report shall be on the letter-head of the auditor containing postal address, e-mail address and contact telephone number or mobile number and be signed by the auditor with his seal and shall indicate his Membership Number; and
- (f) the report shall be in the form of a statement as specified in Form ADT-4.

{1/2 M  
Each  
Point}**Answer**

(c) The auditor can obtain sufficient appropriate audit evidence about advances by study and evaluation of internal controls relating to advances, and by:

- ◆ examining the validity of the recorded amounts;
- ◆ examining loan documentation;
- ◆ reviewing the operation of the accounts;
- ◆ examining the existence, enforce ability and valuation of the security;
- ◆ checking compliance with RBI norms including appropriate classification and provisioning; and
- ◆ carrying out appropriate analytical procedures.

{2 M}

In carrying out his substantive procedures, the auditor should examine all large advances while other advances may be examined on a sampling basis. The accounts identified to be problem accounts however need to be examined in detail unless the amount involved is insignificant.

{2 M}

Advances which are sanctioned during the year or which are adversely commented by RBI inspection team, concurrent auditors, bank's internal inspection, etc. should generally be included in the auditor's review.

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