

**(GI-2, GI-6, GI-7, VI-1, VDI-1, DRIVE & FMT)**

DATE: 27.08.2023

MAXIMUM MARKS: 100

TIMING: 3¼ Hours

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

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

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

- (21) Ans. d
- (22) Ans. a
- (23) Ans. b
- (24) Ans. a
- (25) Ans. b

---

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

---

**Answer 1:**

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

- (i) **Incorrect-**  
The auditor should 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.
- (ii) **FALSE-**  
Any material weakness in the internal control noticed by the auditor should be communicated in writing to the management in a timely manner. However such communication should mention that the audit has not been conducted to determine the adequacy of internal controls.
- (iii) **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.
- (iv) **Incorrect-**  
In the planning stage, analytical procedures assist the auditor in understanding the client's business and in identifying areas of potential risk by indicating aspects of and developments in the entity's business of which he was previously unaware. This information will assist the auditor in determining the nature, timing and extent of his other audit procedures. Analytical procedures in planning the audit use both financial data and non-financial information, such as number of employees, square feet of selling space, volume of goods produced and similar information.
- (v) **TRUE-**  
Lenders can rely on audited financial statements while making decision about credit worthiness of loan applicant & later on, they can judge recoverability of their funds.
- (vi) **Incorrect-**  
RBI has been entrusted with the responsibility of regulating the activities of commercial and other banks.
- (vii) **Incorrect-**  
As per Section 139(6), the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.
- (viii) **Incorrect-**  
Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Analytical procedures are used for the following purposes:  
(i) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and  
(ii) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

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

**Answer 2:**

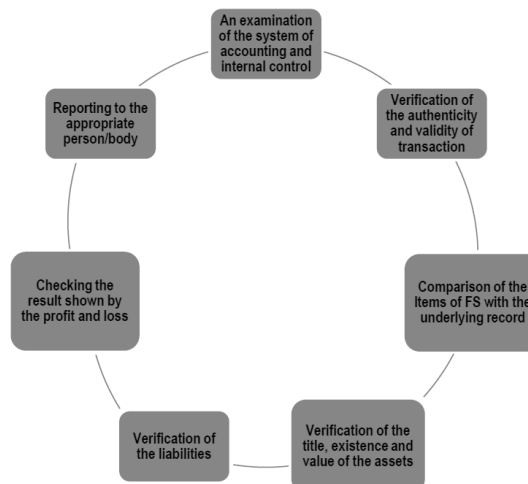
- (a) The Standard on Auditing (SA) 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" defines the term 'fraud' as- "an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage". { 2 M }
- Although fraud is a broad legal concept, for the purposes of the SAs, the auditor is concerned with fraud that causes a material misstatement in the financial statements.
- Two types of intentional misstatements are relevant to the auditor-
- misstatements resulting from fraudulent financial reporting and
  - misstatements resulting from misappropriation of assets.
- Although the auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred. { 2 M }

**Answer:**

- (b) Evaluating the Operating Effectiveness of Controls: When evaluating the operating effectiveness of relevant controls, the auditor shall evaluate whether misstatements that have been detected by substantive procedures indicate that controls are not operating effectively. The absence of misstatements detected by substantive procedures, however, does not provide audit evidence that controls related to the assertion being tested are effective. { 1 M }
- When deviations from controls upon which the auditor intends to rely are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether:
- (a) The tests of controls that have been performed provide an appropriate basis for reliance on the controls;
  - (b) Additional tests of controls are necessary; or
  - (c) The potential risks of misstatement need to be addressed using substantive procedures.
- A material misstatement detected by the auditor's procedures is a strong indicator of the existence of a significant deficiency in internal control. { 2 M }

**Answer:**

- (c) The principal aspects to be covered in an audit concerning final statements of account are the following:



- (i) An examination of the system of accounting and internal control to ascertain whether it is appropriate for the business and helps in properly recording all transactions.
- (ii) Reviewing the system and procedures to find out whether they are adequate and comprehensive and incidentally whether material inadequacies and weaknesses exist to allow frauds and errors going unnoticed.
- (iii) Checking of the arithmetical accuracy of the books of account by the verification of postings, balances, etc.
- (iv) Verification of the authenticity and validity of transaction entered into by making an examination of the entries in the books of accounts with the relevant supporting documents.
- (v) Ascertaining that a proper distinction has been made between items of capital and of revenue nature and that the amounts of various items of income and expenditure adjusted in the accounts corresponding to the accounting period.
- (vi) Comparison of the balance sheet and profit and loss account or other statements with the underlying record in order to see that they are in accordance therewith.
- (vii) Verification of the title, existence and value of the assets appearing in the balance sheet.
- (viii) Verification of the liabilities stated in the balance sheet.  
 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.
  - (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.
- (ix) Checking the result shown by the profit and loss and to see whether the results shown are true and fair.
- (x) Where audit is of a corporate body, confirming that the statutory requirements have been complied with.
- (xi) Reporting to the appropriate person/body whether the statements of account examined do reveal a true and fair view of the state of affairs and of the profit and loss of the organisation.

{Any 8  
Points  
Each  
1/2  
Mark}

**Answer:**

- (d) Independence" implies that the judgment of a person is not subordinate to the wishes or direction of another person who might have engaged him. The auditor should be independent of the entity subject to the audit. There are two interlinked perspective of independence of auditors, one independence of mind and two, independence in appearance. The Code of Ethics for Professional Accountants issued by International Federation of Accountants (IFAC) defines the term "Independence" as comprising both-
- (a) Independence of mind – the state of mind that permits the provision of an opinion without being affected by influences allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and
  - (b) Independence in appearance – the avoidance of facts and circumstances that are so significant that a third party would reasonably conclude an auditor's integrity, objectivity or professional skepticism had been compromised." Independence of the auditor has not only to exist in fact, but also appear to so exist to all reasonable persons.

{1 M}

{1 M  
Each}

**Answer 3:**

- (a)** Development of an Overall Plan: The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit-
- The terms of his engagement and any statutory responsibilities.
  - The nature and timing of reports or other communication.
  - The applicable legal or statutory requirements.
  - The accounting policies adopted by the client and changes in those policies.
  - The effect of new accounting or auditing pronouncements on the audit.
  - The identification of significant audit areas
  - The setting of materiality levels for audit purposes.
  - Conditions requiring special attention, such as the possibility of material error or fraud or the involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely.
  - The degree of reliance he expects to be able to place on accounting system and internal control.
  - Possible rotation of emphasis on specific audit areas.
  - The nature and extent of audit evidence to be obtained.
  - The work of internal auditors and the extent of their involvement, if any, in the audit.
  - The involvement of other auditors in the audit of subsidiaries or branches of the client.
  - The involvement of experts.
  - The allocation of work to be undertaken between joint auditors and the procedures for its control and review.
  - Establishing and coordinating staffing requirements.

{Any 8  
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  
Each}

**Answer:**

- (c)** An automated environment basically refers to a business environment where the processes, operations, accounting and even decisions are carried out by using computer systems – also known as Information Systems (IS) or Information Technology(IT) systems. Nowadays, it is very common to see computer systems being used in almost every type of business.
- For example, think about how banking transactions are carried out using ATMs (Automated Teller Machines), or how tickets can be purchased using "apps" on mobile phones, etc. In these examples, you can see how these computer systems enable us to transact business at any time and any day.
- Some of the key features of an automated environment are as follows:

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

**Key features of an Automated Environment**



The fundamental principle of an automated environment is the ability to carry out business with less manual intervention and more system driven. The complexity of a business environment depends on the level of automation i.e., if a business environment is more automated, it is likely to be more complex.

For example, if a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.

Similarly, there are several other aspects that an auditor should consider to determine the level of automation and complexity of a business environment which we will look at in the following sections

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

**Answer:**

**(d)** 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.

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.

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.

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.

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

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

**Answer 4:**

**(a)** Developing the Audit Programme :

1. Written Audit Programme: The auditor should prepare a written audit programme setting forth the procedures that are needed to implement the audit plan.

{1 M}

- 2. Audit objective and instruction to assistants: The programme may also contain the audit objectives for each area and should have sufficient details to serve as a set of instructions to the assistants involved in the audit and as a means to control the proper execution of the work. }
- 3. Reliance on Internal Controls: In preparing the audit programme, the auditor, having an understanding of the accounting system and related internal controls, may wish to rely on certain internal controls in determining the nature, timing and extent of required auditing procedures. The auditor may conclude that relying on certain internal controls is an effective and efficient way to conduct his audit. However, the auditor may decide not to rely on internal controls when there are other more efficient ways of obtaining sufficient appropriate audit evidence. The auditor should also consider the timing of the procedures, the coordination of any assistance expected from the client, the availability of assistants, and the involvement of other auditors or experts. } **{1 M}**
- 4. Timings of performance of audit procedures: The auditor normally has flexibility in deciding when to perform audit procedures. However, in some cases, the auditor may have no discretion as to timing, for example, when observing the taking of inventories by client personnel or verifying the securities and cash balances at the year-end. } **{1 M}**
- 5. Audit planning: The audit planning ideally commences at the conclusion of the previous year’s audit, and along with the related programme, it should be reconsidered for modification as the audit progresses. Such consideration is based on the auditor’s review of the internal control, his preliminary evaluation thereof, and the results of his compliance and substantive procedures. } **{1 M}**

**Answer:**

- (b)** Understanding of the Company’s Automated Environment: 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)
- {Any 8 Points Each 1/2 Mark}**

**Answer:**

- (c)** Correct- The existence of a Satisfactory Control environment can be a positive factor when an auditor assesses the risk of material misstatement. } **{1<sup>1/2</sup> M}**  
 However, although it may help reduce the risk of fraud, a satisfactory Control environment is not an absolute deterrent to fraud. } **{1<sup>1/2</sup> M}**

**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.
- 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. {2 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).

**Answer 5:**

- (a) 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:
- (i) Materiality
- (ii) Risk of material misstatement
- (iii) Size and characteristics of the population. {1/2 M}
- (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. {1/2 M}
- (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. {1/2 M}



- (iii) Size of a 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. {1/2 M}

**Answer:**

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

**Answer:**

- (c) 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 {2 M}
- (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.

**Answer:**

**(d)** 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.

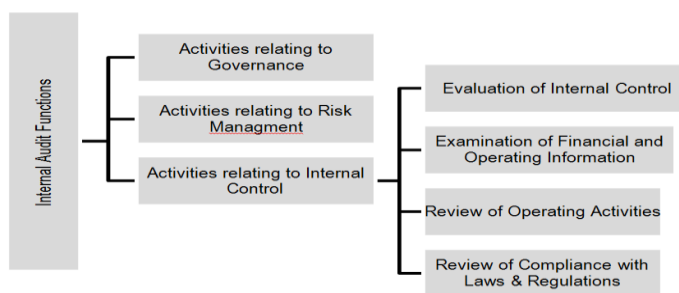
**Answer 6:**

**(a)** Who can be appointed as Internal Auditor? As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not), or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies. The internal auditor may or may not be an employee of the company. {1 M}

Internal audit function: A function of an entity that performs assurance and consulting activities designed to evaluate and improve the effectiveness of the entity’s governance, risk management and internal control processes.

The objectives and scope of internal audit functions: As per SA-610, “Using the Work of an Internal Auditor”, the objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance. {1 M}

The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity’s governance processes, risk management and internal control such as the following:



1. Activities Relating to Governance: The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management. {1/2 M}
2. Activities Relating to Risk Management: The internal audit function may assist the entity by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and internal control (including effectiveness of the financial reporting process). The internal audit function may perform procedures to assist the entity in the detection of fraud. {1/2 M}

3. Activities Relating to Internal Control
- (i) Evaluation of internal control. The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit. {1/2 M}
  - (ii) Examination of financial and operating information. The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to. {1/2 M}

**Answer:**

- (b) Incorrect: SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. {1 1/2 M}
- He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel. {1 1/2 M}

**Answer:**

- (c) The auditor shall evaluate-
- (a) The results of the sample; and
  - (b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.
- For tests of controls, an unexpectedly high sample deviation rate may lead to an increase in the assessed risk of material misstatement, unless further audit evidence substantiating the initial assessment is obtained. For tests of details, an unexpectedly high misstatement amount in a sample may cause the auditor to believe that a class of transactions or account balance is materially misstated, in the absence of further audit evidence that no material misstatement exists. {1 M}
- In the case of tests of details, the projected misstatement plus anomalous misstatement, if any, is the auditor's best estimate of misstatement in the population. When the projected misstatement plus anomalous misstatement, if any, exceeds tolerable misstatement, the sample does not provide a reasonable basis for conclusions about the population that has been tested. The closer the projected misstatement plus anomalous misstatement is to tolerable misstatement, the more likely that actual misstatement in the population may exceed tolerable misstatement. Also, if the projected misstatement is greater than the auditor's expectations of misstatement used to determine the sample size, the auditor may conclude that there is an unacceptable sampling risk that the actual misstatement in the population exceeds the tolerable misstatement. Considering the results of other audit procedures helps the auditor to assess the risk that actual misstatement in the population exceeds tolerable misstatement, and the risk may be reduced if additional audit evidence is obtained. {1 M}
- In case the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may request management to investigate misstatements that have been identified and the potential for further misstatements and to make any necessary adjustments; or tailor the nature, timing and extent of those further audit procedures to best achieve the required {1 M}

assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures. }

**Answer:**

**(d)** Depreciation and Amortisation Expenses: Auditor needs to consider the following attributes while verifying for depreciation and amortisation expenses:

- Obtain the understanding of entity's accounting policy related to depreciation and amortisation.
- Ensure that the Company's policy for charging depreciation and amortisation is as per the relevant provisions of Companies Act and applicable accounting standards.
- Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.
- Whether depreciation and amortisation charges are valid.
- Whether depreciation and amortisation charges are accurately calculated and recorded.
- Whether all depreciation and amortisation charges are recorded in the appropriate period.
- Ensure the parts (components) of each item of property, plant and equipment that are to be depreciated separately has been properly identified.
- Whether the most appropriate depreciation method for each separately depreciable component has been used.

{8  
Points  
Each  
1/2  
Mark}

\_\_\*\*\_\_