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**CA INTERMEDIATE**

**SUBJECT-AUDITING & ASSURANCE**

**Test Code – CIM 8683**

**BRANCH - () (Date :)**

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## PART I

### ANSWER NO.:

- 1) A (1 Mark)
- 2) D (1 Mark)
- 3) C (1 Mark)
- 4) A (1 Mark)
- 5) B (1 Mark)
- 6) C (1 Mark)
- 7) C (1 Mark)
- 8) D (1 Mark)
- 9) A (1 Mark)
- 10) A (1 Mark)
- 11) C (2 Mark)
- 12) B (2 Mark)
- 13) B (2 Mark)
- 14) A (2 Mark)
- 15) C (2 Mark)
- 16) C (2 Mark)
- 17) C (2 Mark)
- 18) D (2 Mark)
- 19) D (2 Mark)
- 20) B (2 Mark)

## PART II

### ANSWER NO.1

Answer any 7 out of 8 (Correct or Incorrect with reasons in short)

- (i) **Incorrect:** all public companies, having in aggregate, outstanding loans or borrowings or debentures or deposits exceeding fifty crore rupees or more shall constitute an Audit Committee.
- (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:** 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'.
- (v) **Incorrect:** The purpose of an audit is to enhance the degree of confidence of intended users

of the financial statements. The aforesaid purpose is achieved by the expression of an independent reporting by the auditor as to whether the financial statements exhibit a true and fair view of the affairs of the entity.

Thus, an Audit report is an opinion drawn on the entity's financial statements to make sure that the records are true and fair representation of the transactions they claim to represent.

**(vi) 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.

**(vii) 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.

**(viii) Incorrect:** Risk assessment procedures refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

**(14 Marks = 7 x 2)**

### **ANSWER NO.2**

**(A)** As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

- (a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement; and
- (b) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

**(3 Marks)**

**(B)** Plans should be further developed and revised as necessary during the course of the audit. SA-300, "Planning an Audit of Financial Statements" further expounds this principle. According to it, planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

**(3 Marks)**

**(C)** Information which assist the Auditor in accepting and continuing of relationship with Client: As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. The following information would assist the auditor in accepting and continuing of relationship with the client:

- (i) The integrity of the principal owners, key management and those charged with governance of the entity;
- (ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
- (iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and
- (iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

**(4 Marks)**

- (D)** It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Procedural tests simply mean testing of the compliance with the procedures laid down by the management in respect of initiation, authorisation, recording and documentation of transaction at each stage through which it flows.

For example, the procedure for sales requires the following:

1. Before acceptance of any order the position of inventory of the relevant article should be known to ascertain whether the order can be executed in time.
2. An advice under the authorisation of the sales manager should be sent to the party placing the order, internal reference number, and the acceptance of the order. This advice should be prepared on a standardised form and copy thereof should be forwarded to inventory section to enable it to prepare for the execution of the order in time.
3. The credit period allowed to the party should be the normal credit period. For any special credit period a special authorisation of the sales manager would be necessary.
4. The rate at which the order has been accepted and other terms about transport, insurance, etc., should be clearly specified.
5. Before deciding upon the credit period, a reference should be made to the credit section to know the creditworthiness of the party and particularly whether the party has honoured its commitments in the past.

**(4 Marks)**

### **ANSWER NO.3**

- (A)** Inquiry – Audit Procedure to obtain Audit Evidence: Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.

Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.

Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support

management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry. In respect of some matters, the auditor may consider it necessary to obtain written representations from management and, where appropriate, those charged with governance to confirm responses to oral inquiries. **(3 Marks)**

**(B)** When inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

**(1)** Attendance at physical inventory counting, unless impracticable, to:

- (i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
- (ii) Observe the performance of management's count procedures;
- (iii) Inspect the inventory; and
- (iv) Perform test counts; and

**(2)** Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results. **(3 Marks)**

**(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.

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 Chapter 10 - The Company Audit.

**(4 Marks)**

**(D)** Substantive Analytical Procedure: Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. The application of planned analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. However, the suitability of a particular analytical procedure will depend upon the auditor's assessment of how effective it will be in detecting a misstatement that, individually or when aggregated with other misstatements, may cause the financial statements to be materially misstated.

In some cases, even an unsophisticated predictive model may be effective as an analytical procedure. For example, where an entity has a known number of employees at fixed rates of pay throughout the period, it may be possible for the auditor to use this data to estimate the total payroll costs for the period with a high degree of accuracy, thereby providing audit evidence for a significant item in the financial statements and reducing the need to perform

tests of details on the payroll. The use of widely recognised trade ratios (such as profit margins for different types of retail entities) can often be used effectively in substantive analytical procedures to provide evidence to support the reasonableness of recorded amounts.

**(4 Marks)**

**ANSWER NO.4**

**(A)** The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

The process of establishing the overall audit strategy assists the auditor to determine, subject to the completion of the auditor's risk assessment procedures, such matters as:

1. The resources to deploy for specific audit areas, such as the use of appropriately experienced team members for high risk areas or the involvement of experts on complex matters;
2. The amount of resources to allocate to specific audit areas, such as the number of team members assigned to observe the inventory count at material locations, the extent of review of other auditors' work in the case of group audits, or the audit budget in hours to allocate to high risk areas;
3. When these resources are to be deployed, such as whether at an interim audit stage or at key cut-off dates; and
4. How such resources are managed, directed and supervised, such as when team briefing and debriefing meetings are expected to be held, how engagement partner and manager reviews are expected to take place (for example, on-site or off-site), and whether to complete engagement quality control reviews.

**(4 Marks)**

**(B)** Before the commencement of the audit, the joint auditors should discuss and develop a joint audit plan. In developing the joint audit plan, the joint auditors should:

1. identify division of audit areas and common audit areas;
2. ascertain the reporting objectives of the engagement;
3. consider and communicate among all joint auditors the factors that are significant
4. in directing the engagement team's efforts;
5. consider the results of preliminary engagement activities, or similar engagements performed earlier.
6. ascertain the nature, timing and extent of resources necessary to accomplish the engagement.

**(3 Marks)**

**(C)** The auditors of a company are entitled to attend any general meeting of the company and the right is not only restricted to those at which the accounts audited by them are to be discussed, he is also entitled to receive all the notices and other communications relating to the general meetings, which members are entitled to receive and to be heard at any general meeting in any part of the business of the meeting which concerns them as auditors.

According to the section 146 of the Companies Act 2013, "all notices of, and other communications relating to, any general meeting shall be forwarded to the auditor of the company, and the auditor shall, unless otherwise exempted by the company, attend either by

himself or through his authorised representative, who shall also be qualified to be an auditor, any general meeting and shall have right to be heard at such meeting on any part of the business which concerns him as the auditor.”

Thus, it is right of the auditor to receive notices and other communications relating to any general meeting and to be heard at such meeting, relating to the matter of his concern, however, it is duty of the auditor to attend the same or through his authorised representative unless otherwise exempted.

**(4 Marks)**

**(D)** Examples of Analytical Procedures having consideration of comparisons of the entity’s financial information with are:

1. Comparable information for prior periods.
2. Anticipated results of the entity, such as budgets or forecasts, or expectations of the auditor, such as an estimation of depreciation.
3. Similar industry information, such as a comparison of the entity’s ratio of sales to accounts receivable with industry averages or with other entities of comparable size in the same industry

**(3 Marks)**

**ANSWER NO.5**

**(A)** Unqualified Opinion:

1. An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view in accordance with the financial reporting framework used for the preparation and presentation of the financial statements.
2. An unqualified opinion indicates, implicitly, that any changes in the accounting principles or in the method of their application, and the effects thereof, have been properly determined and disclosed in the financial statements.
3. An unqualified opinion also indicates that:
  - (i) the financial statements have been prepared using the generally accepted accounting principles, which have been consistently applied;
  - (ii) the financial statements comply with relevant statutory requirements and regulations; and
  - (iii) there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable.

**(3 Marks)**

**(B)** Matters to be included in the auditor's report- statutory dues and repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders (CARO, 2016)–

**Clause (vii)** (a) whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise

or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not constitute a dispute).

**Clause (viii)** whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).

**(4 Marks)**

**(C) Filling of a Casual Vacancy**

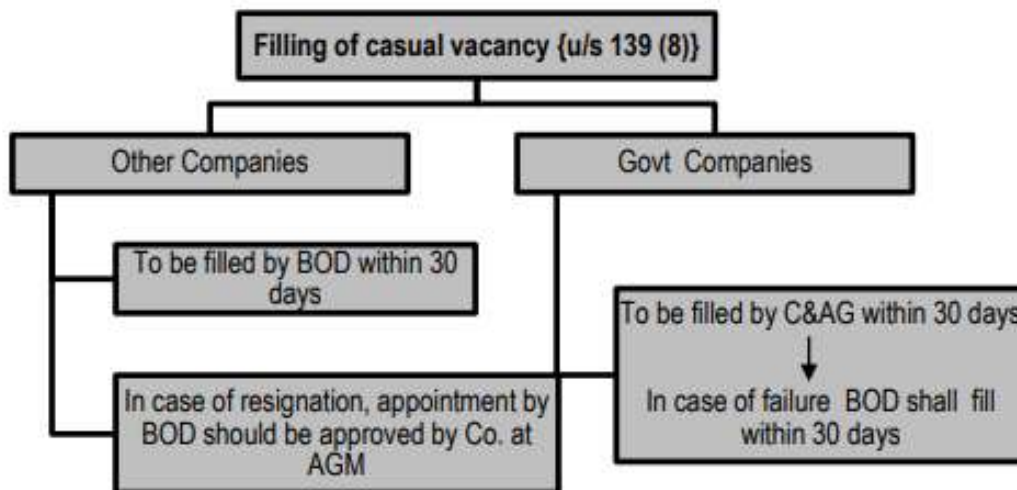
As per Section 139(8), any casual vacancy in the office of an auditor shall-

- (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.

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 three 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.



Casual Vacancy by Resignation: As per section 140(2) the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed Form ADT-3 (as per Rule 8 of CAAR) with the company and the Registrar, and in case of the companies referred to in section 139(5) i.e. Government company, the auditor shall also file such statement with the Comptroller and Auditor-General of India, indicating the reasons and other facts as may be relevant with regard to his resignation. In case of failure the auditor shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees as per section 140(3).



(4 Marks)

(D) Discrepancies in the accounting records, including:

- Transactions that are not recorded in a complete or timely manner or are improperly recorded as to amount, accounting period, classification, or entity policy.
- Unsupported or unauthorized balances or transactions.
- Last-minute adjustments that significantly affect financial results.
- Evidence of employees' access to systems and records inconsistent with that necessary to perform their authorized duties.
- Tips or complaints to the auditor about alleged fraud.

(3 Marks)

**ANSWER NO.6**

(A) Evaluation of Internal Controls over Advances: The auditor should examine the efficacy of various internal controls over advances to determine the nature, timing and extent of his substantive procedures. In general, the internal controls over advances should include, inter alia, the following:

1. The bank should make an advance only after satisfying itself as to the credit worthiness of the borrower and after obtaining sanction from the appropriate authorities of the bank.
2. All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be executed by the parties before advances are made.
3. The compliance with the terms of sanction and end use of funds should be ensured.
4. Sufficient margin as specified in the sanction letter should be kept against securities taken so as to cover for any decline in the value thereof. The availability of sufficient margin needs to be ensured at regular intervals
5. If the securities taken are in the nature of shares, debentures, etc., the ownership of the same should be transferred in the name of the bank and the effective control of such securities be retained as a part of documentation.
6. All securities requiring registration should be registered in the name of the bank or otherwise accompanied by documents sufficient to give title to the bank.
7. In the case of goods in the possession of the bank, contents of the packages should be test checked at the time of receipt. The godowns should be frequently inspected by responsible officers of the branch concerned, in addition to the inspectors of the bank.
8. Drawing Power Register should be updated every month to record the value of securities hypothecated. These entries should be checked by an officer.
9. The accounts should be kept within both the drawing power and the sanctioned limit.
10. All the accounts which exceed the sanctioned limit or drawing power or are otherwise irregular should be brought to the notice of the controlling authority regularly.
11. The operation of each advance account should be reviewed at least once a year, and at more frequent intervals in the case of large advances.

(4 Marks)

(B) Matters which should be specially considered in the audit of accounts of a partnership:

- (i) Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.
- (ii) Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans; purchase of assets, extraordinary contracts entered into and other such matters as are not of a routine nature.
- (iii) Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.
- (iv) Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.
- (v) Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreements.
- (vi) Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners.
- (vii) Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

**(4 Marks)**

**Or**

- (B)** Section 73 of the Multi-State Co-operative Societies Act, 2002 discusses the powers and duties of auditors. According to this, every auditor of a Multi-State co-operative society shall have a right of access at all times to the books accounts and vouchers of the Multi-State co-operative society, whether kept at the head office of the Multi- State co-operative society or elsewhere, and shall be entitled to require from the officers or other employees of the Multi-State co-operative society such information and explanation as the auditor may think necessary for the performance of his duties as an auditor.

As per section 73(2), the auditor shall make following inquiries:

- (a) Whether loans and advances made by the Multi-State co-operative society on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the Multi-State co-operative society or its members,
  - (b) Whether transactions of the Multi-State co-operative society which are represented merely by book entries are not prejudicial to the interests of the Multi-State co-operative society,
  - (c) Whether personal expenses have been charged to revenue account, and
  - (d) Where it is Stated in the books and papers of the Multi-State co-operative society that any shares have been allotted for cash, whether cash has actually, been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet as correct regular and not misleading.
- (C)** 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.

**(3 Marks)**

**(D) Block Sampling:** This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. Although in some circumstances it may be an appropriate audit procedure to examine a block of items, it would rarely be an appropriate sample selection technique when the auditor intends to draw valid inferences about the entire population based on the sample.

**Example**

Take the first 200 sales invoices from the sales day book in the month of September; alternatively take any four blocks of 50 sales invoices. Therefore, once the first item in the block is selected, the rest of the block follows items to the completion.

**(3 Marks)**