



CA Inter Nov 2018

Auditing and Assurance

Mumbai (Code- INA 3004)

21st June 2018 (50 Marks)

Topics- Audit Report, Standards on Auditing, Audit of Banks, Different Entities, Items of Financial Statements, Automated Environment.

Question 1

**State with reasons (in short) whether the following statements are correct or incorrect:
(5 * 2 = 10 Marks)**

1. All automated environments are complex.
Incorrect: The complexity of an automated environment depends on various factors including the nature of business, level of automation, volume of transactions, use of ERP and so on. There could be environments where dependence on IT and automation is relatively less or minimal and hence, considered less complex or even non-complex.
2. In the computerised environment, the auditor need not be familiar with latest applicable RBI guidelines that have bearing on the classification/ provisions and income recognition.
Incorrect. In the Computerised environment, it is imperative that the auditor is familiar with, and is satisfied that, all the norms/parameters as per the latest applicable RBI guidelines are incorporated and built into the system that generates information/data having a bearing on the classification/ provisions and income recognition.
3. Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the Finance Minister may on the advice of the C&AG prescribe.
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.
4. The auditor shall express a Qualified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
Incorrect: The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
5. Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements.
Incorrect. Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not a substitute for disclosures in the financial

statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation.

Question 2

A. How will you vouch and/or verify the following?

- 1) Goods sent out on Sale or Return Basis
- 2) Borrowing from Banks.

(5 Marks)

Answer

1) Goods sent out on Sale or Return Basis

- (a) Check whether a separate memoranda record of goods sent out on sale or return basis is maintained. The party accounts are debited only after the goods have been sold and the sales account is credited.
- (b) See that price of such goods is unloaded from the sales account and the trade receivable's record. Refer to the memoranda record to confirm that on the receipt of acceptance from each party, his account has been debited and the sales account correspondingly credited.
- (c) Ensure that the goods in respect of which the period of approval has expired at the close of the year either have been received back subsequently or customers' account have been debited.
- (d) Confirm that the inventory of goods sent out on approval, the period of approval in respect of which had not expired till the close of the year lying with the party, has been included in the closing inventory.

2) Borrowing from Banks.

- (a) Reconcile the balances in the overdraft or loan account with that shown in the pass book(s) and confirm that last mentioned balance by obtaining a certificate from the bank showing the balance in the accounts as at the end of the year.
- (b) Obtain a certificate from the bank showing particulars of securities deposited with the bank as security for the loans or of the charge created on an asset or assets of the concern and confirm that the same has been correctly disclosed and duly registered with Registrar of Companies and recorded in the Register of charges.
- (c) Verify the authority under which the loan or draft has been raised in the case of a company, only the Board of Directors is authorized to raise a loan or borrow from a bank.
- (d) Confirm, in the case of a company, that the restraint contained in Section 180 of the Companies Act, 2013 as regards the maximum amount of the loan that the company can raise has not been contravened.
- (e) Ascertain the purpose for which loan has been raised and the manner in which it has been utilized and that this has not prejudicially affected the entity.

B. Briefly mention three reasons why IT should be considered relevant to an audit of financial statements.

(5 Marks)

When a business operates in a more automated environment it is likely that we will see several business functions and activities happening within the systems. Consider the following aspects instead of:

- Computation and Calculations are automatically carried out (for example, bank interest computation and inventory valuation).
- Accounting entries are posted automatically (for example, sub-ledger to GL postings are automatic).
- Business policies and procedures, including internal controls, are applied automatically (for example, delegation of authority for journal approvals, customer credit limit checks are performed automatically).
- Reports used in business are produced from systems. Management and other stakeholders rely on these reports and information produced (for example, debtors ageing report).
- User access and security are controlled by assigning system roles to users (**for example**, segregation of duties can be enforced effectively).

Companies derive benefit from the use of IT systems as an enabler to support various business operations and activities. Auditors need to understand the relevance of these IT systems to an audit of financial statements.

While it is true that the use of IT systems and automation benefit the business by making operations more accurate, reliable, effective and efficient, such systems also introduce certain new risks, including IT specific risks, which need to be considered, assessed and addressed by management.

To the extent that it is relevant to an audit of financial statements, even auditors are required to understand, assess and respond to such risks that arise from the use of IT systems.

Question 3

"The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements. Discuss. **(10 Marks)**

The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference. The discussion provides:

- An opportunity for more experienced engagement team members, including the audit engagement partner, to share their insights based on their knowledge of the bank and its environment.

- An opportunity for engagement team members to exchange information about the bank's business risks.
- An understanding amongst the engagement team members about effect of the results of the risk assessment procedures on other aspects of the audit, including decisions about the nature, timing, and extent of further audit procedures.

The discussion between the members of the engagement team and the audit engagement partner should be done on the susceptibility of the bank's financial statements to material misstatements. These discussions are ordinarily done at the planning stage of an audit.

The engagement team discussion ordinarily includes a discussion of the following matters:

- Errors that may be more likely to occur;
- Errors which have been identified in prior years;
- Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
- Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
- Need to maintain professional skepticism throughout the audit engagement;
- Need to alert for information or other conditions that indicates that a material misstatement may have occurred (e.g., the bank's application of accounting policies in the given facts and circumstances).

Question 4

- A. Mention the special points to be examined by the auditor in the audit of a charitable institution running hostel for students pursuing the Chartered Accountancy Course and which charges only `500 per month from a student for his lodging/boarding. **(6 Marks)**
1. Check the day-to-day administration expenses incurred along with the necessary vouchers, supporting for the same like salary registers, repairs register, etc.
 2. Verify whether the expenses incurred are in conformity with the budgets prepared internally or filed with the relevant authorities.
 3. Check the amount spent on provisions of hostel facilities with reference to bills, etc. See that whenever heavy expenditure has been incurred on renovation of the hostel, computer centre, etc. the same is accounted for properly (if such facilities are being provided by the hostel).
 4. Verify investments made from surplus funds as well as existing investments by physically verifying the same and that they are in the name of the institution and that there is no charge/pledge against the same.
 5. Verify all capital expenditure and expenditure on repairs, etc., incurred with the vouchers and also whether proper tenders, etc., were invited for the same. See that all furniture, glass,

- cutlery, kitchen utensils, liner, etc. are adequately depreciated.
6. Library Facilities: See that proper library register are maintained. The system regarding issue and receipt of books is in order. Late fee fines and money received on account of lost book is accounted for properly. Obsolete books are written off only after proper authorisation. Expenses incurred on newspapers and weekly magazines as compared to Journals and periodical shave been accounted for properly.
 7. Check the provision of other additional facilities like computer facilities, etc. Ensure that proper registers are maintained for charging fees, based on monthly or hourly basis. In case such facility is extended to each room, whether the charges are payable on lump-sum basis or on actual usage basis. Also ensure that amounts spent have been allocated properly.
 8. Verify whether the institution is eligible for income tax exemption and if not, whether provision for taxation has been made.

B. Discuss the objective of the auditor as per Standard on Auditing (SA) 705 “Modifications to The Opinion in The Independent Auditor’s Report”. **(4 Marks)**

As per Standard on Auditing (SA) 705 “Modifications To The Opinion In The Independent Auditor’s Report”, the objective of the auditor is **to express clearly an appropriately modified opinion** on the financial statements that is necessary when:

- (a) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

Question 5

A. Expenditure Audit.

(5 Marks)

The audit of government expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are to ensure that there is provision funds authorised by competent authority fixing the limits within which expenditure can be incurred. These standards are—

- (i) that the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the Financial Rules and Regulations framed by the competent authority. Such an audit is called as the audit against ‘rules and orders’.
- (ii) that there is sanction, either special or general, accorded by competent authority authorising the expenditure. Such an audit is called as the audit of sanctions.
- (iii) that there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority. Such an audit is called as audit against provision of funds.
- (iv) that the expenditure is incurred with due regard to broad and general principles of financial propriety. Such an audit is also called as propriety audit.

(v) that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them. Such an audit is termed as the performance audit.

B. Communicating Key Audit Matters- not a substitute for disclosure in the Financial Statements. Discuss **(5 Marks)**

Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not:

- (a) A substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation;
- (b) A substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705(Revised);
- (c) A substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern; or
- (d) A separate opinion on individual matters.