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CA INTERMEDIATE NOV 19

SUBJECT- AUDIT

**Test Code – CIM 8454**

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

Head Office : Shraddha, 3<sup>rd</sup> Floor, Near Chinai College, Andheri (E), Mumbai – 69.

Tel : (022) 26836666

**ANSWER 1****(1\* 20 = 20 MARKS)**

Q.NO	ANS	Q.NO	ANS
1.1	B	1.11	A
1.2	D	1.12	A
1.3	A	1.13	B
1.4	B	1.14	D
1.5	B	1.15	A
1.6	B	1.16	C
1.7	D	1.17	B
1.8	A	1.18	B
1.9	B	1.19	C
1.10.	A	1.20.	A

**ANSWER 2****(1\* 5 = 10 MARKS)**

Q.NO	ANS
2.1	C
2.2	D
2.3	B
2.4	A
2.5	A

**ANSWER 3 (ANY 7 )**

- (A) Incorrect:** An audit is not an official investigation into alleged wrong doing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.
- (B) Incorrect:** Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone ordinarily does not provide sufficient audit evidence of the absence of a material misstatement at the assertion level, nor of the operating effectiveness of controls.
- (C) Incorrect-** As per section 139(5), in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the Comptroller and Auditor-General of India shall, in respect of a financial year, appoint an auditor duly qualified to be appointed as an auditor of companies under this Act, within a period of 180 days from the commencement of the financial year, who shall hold office till the conclusion of the annual general meeting.
- (D) Incorrect:** According to Section 53 of the Companies Act, 2013, a company shall not issue shares at a discount, except in the case of an issue of sweat equity shares given under Section 54 of the Companies Act, 2013.
- (E) Incorrect:** SQC 1 "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files. An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report.

**(F) Incorrect-** Rule 24 of LLP Rules 2009 provides that any LLP, whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty five lakh rupees, is not required to get its accounts audited. However if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rules.

**(G) Incorrect:** The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the “risks of material misstatement”. However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

**(H) Incorrect-** Rule 3 of the Companies (Cost Records and Audit) Rules, 2014 provides the classes of companies, engaged in the production of goods or providing services, having an overall turnover from all its products and services of Rs. 35 crore or more during the immediately preceding financial year, required to include cost records in their books of account.

**(2\* 7 = 14 MARKS)**

**ANSWER 4(A)**

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 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.

**(4 MARKS)**

**ANSWER 4(B)**

For the purpose of programme construction, the following points should be kept in mind:

- i. Stay within the scope and limitation of the assignment.
- ii. Determine the evidence reasonably available and identify the best evidence for deriving the necessary satisfaction.
- iii. Apply only those steps and procedures which are useful in accomplishing the verification purpose in the specific situation.
- iv. Consider all possibilities of error.
- v. Co-ordinate the procedures to be applied to related items.

**(3 MARKS)**

#### **ANSWER 4(C)**

SQC 1 requires the firm to obtain information before accepting an engagement. Information such as the following assists the engagement partner in determining whether the decisions regarding the acceptance and continuance of audit engagements are appropriate:

- (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.

**(3 MARKS)**

#### **ANSWER 4(D)**

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)**

#### **ANSWER 5(A)**

The SAs do not ordinarily refer to inherent risk and control risk separately, but rather to a combined assessment of the "risks of material misstatement". However, the auditor may make separate or combined assessments of inherent and control risk depending on preferred audit techniques or methodologies and practical considerations. The assessment of the risks of material misstatement may be expressed in quantitative terms, such as in percentages, or in non-quantitative terms. In any case, the need for the auditor to make appropriate risk assessments is more important than the different approaches by which they may be made.

It can be concluded from the above that-

**Risk of Material Misstatement= Inherent Risk x Control Risk**

**(4 MARKS)**

### ANSWER 5(B)

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).

(4 MARKS)

### ANSWER 5(C)

**Self-review threats**, which occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement (Non audit services include any professional services provided to an entity by an auditor, other than audit or review of the financial statements. These include management services, internal audit, investment advisory service, design and implementation of information technology systems etc.), or when a member of the audit team was previously a director or senior employee of the client. Instances where such threats come into play are (i) when an auditor having recently been a director or senior officer of the company, and (ii) when auditors perform services that are themselves subject matters of audit.

(3 MARKS)

### ANSWER 5(D)

Completion Memorandum or Audit Documentation Summary.

The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes-

- (i) the significant matters identified during the audit.
- (ii) how they were addressed.

Such a summary may facilitate effective and efficient review and inspection of the audit documentation, particularly for large and complex audits. Further, the preparation of such a summary may assist auditor's consideration of the significant matters. It may also help the auditor to consider whether there is any individual relevant SA objective that the auditor cannot achieve that would prevent the auditor from achieving the overall objectives of the auditor.

(3 MARKS)

**ANSWER 6(A)**

No Intangible asset arising from research (or from the research phase of an internal project) shall be recognised. Expenditure on research shall be recognised as an expense when it is incurred since in the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits. Thus, board of directors of PQR Ltd cannot recognize the expense as internally generated intangible asset.

An intangible asset shall be recognised if, and only if:

- (i) the said asset is identifiable;
- (ii) the entity controls the asset i.e. the entity has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits;
- (iii) it is probable that future economic benefits associated with the asset will flow to the entity;
- (iv) the cost of the item can be measured reliably.

**(4 MARKS)**

**ANSWER 6(B)**

Analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price may include:

- (i) Consumption Analysis: Auditor should scrutinize raw material consumed as per manufacturing account and compare the same with previous years with closing stock and ask for the reasons from Management if any significant variations found.
- (ii) Stock Composition Analysis: Auditor to collect the reports from management for composition of stock i.e. raw materials as a percentage of total stock and compare the same with previous year and ask for reasons from management in case of significant variations.
- (iii) Ratios: Auditor should compare the creditors turnover ratios and stock turnover ratios of the current year with previous years.
- (iv) Auditor should review quantitative reconciliation of closing stocks with opening stock, purchases and Consumption.

**(4 MARKS)**

**ANSWER 6(C)**

While reviewing Employee Benefits expenses auditor needs to obtain a clear understanding about the organisation and its hiring, appraisal and retirement process in the following manner:

- (i) The auditor first tests the controls the company has set around the employee benefit payment process to determine how strong and reliable they are. If they are strong, the auditor can minimize the amount of transaction testing he must do. Common internal controls over the employee benefit payment cycle includes maintaining of attendance records, authorisation and approval of monthly payroll processing and disbursement.
- (ii) The auditor selects a random sample of transactions and examines the related appointment letters, appraisal letters, attendance records, HR policies, employee master etc.

- (iii) The auditor performs Substantive analytical procedure consisting of monthly expense reasonability, comparison with previous accounting period, any analysis auditor may find relevant and most important of all setting an expectation in relation to the expense incurred during the period under audit and compare that with the client's business operations and overall trend in the industry.

(3 MARKS)

#### ANSWER 6(D)

**Liabilities in addition to borrowings, include** trade payables and other current liabilities, deferred payment credits and provisions. Verification of liabilities is as important as that of assets, considering if any liability is omitted (or understated) or overstated, the Balance Sheet would not show a true and fair view of the state of affairs of the entity.

Further, a liability is classified as current if it satisfies any of the following criteria:

- It is expected to be settled in the entity's normal operating cycle
- It is held primarily for the purpose of being traded
- It is due to be settled within twelve months after the reporting period
- The entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting period. Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments does not affect its classification.

(3 MARKS)

#### ANSWER 7(A)

**Right to report to the members of the company on the accounts examined by him** – The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under this section and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

(4 MARKS)

#### ANSWER 7(B)

**Basis for Opinion:** The auditor's report shall include a section, directly following the Opinion section, with the heading "**Basis for Opinion**", that:

- (a) States that the audit was conducted in accordance with Standards on Auditing;
- (b) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- (c) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- (d) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

(4 MARKS)

### ANSWER 7(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.

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.
- (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.
- (viii) Lower staff development costs.
- (ix) Lower costs to carry out the work.
- (x) A sense of healthy competition towards a better performance

(6 MARKS)

### ANSWER 8(A)

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

- (i) Errors that may be more likely to occur;
- (ii) Errors which have been identified in prior years;
- (iii) Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
- (iv) Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
- (v) Need to maintain professional skepticism throughout the audit engagement;
- (vi) 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).

(4 MARKS)



### ANSWER 8(B)

AS-19/ Ind-AS 17 defines that lease arrangements could be of 2 types i.e.

- (i) Finance Lease and
- (ii) Operating Lease.

Finance Lease: An arrangement with the following attributes qualifies as a Finance Lease:

The lease arrangement transfers ownership of the asset to the lessee at the end of the lease term;

- The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
- The lease term is for the major part of the economic life of the asset even if title is not transferred;
- At the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset; and
- the leased assets are of such a specialized nature that only the lessee can use them without major modifications Operating Lease.

An arrangement that does not transfer substantially all the risks and rewards incidental to ownership qualifies as an Operating Lease. In other words, an operating lease is a lease arrangement "Other than finance lease".

(4 MARKS)

OR

### ANSWER 8(B)

An effective risk management system in a bank generally requires the following:

- (i) **Oversight and involvement in the control process by those charged with governance:** Those charged with governance (BOD/Chief Executive Officer) should approve written risk management policies. The policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable.
- (ii) **Identification, measurement and monitoring of risks:** Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria.
- (iii) **Control activities:** A bank should have appropriate controls to manage its risks, including effective segregation of duties (particularly, between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting of limits, reporting and approval of exceptions, physical security and contingency planning.
- (iv) **Monitoring activities:** Risk management models, methodologies and assumptions used to measure and manage risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit.
- (v) **Reliable information systems:** Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

(4 MARKS)

### ANSWER 8(C)

**Government Expenditure Audit:** Audit of government expenditure is one of the major components of government audit conducted by the office of C&AG. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorised by competent authority fixing the limits within which expenditure can be incurred. **Briefly, these standards are explained below:**

- (i) **Audit against Rules & Orders:** The auditor has to see that the expenditure incurred conforms to the relevant provisions of the statutory enactment and is in accordance with the financial rules and regulations framed by the competent authority.
- (ii) **Audit of Sanctions:** The auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, accorded by the competent authority, authorising such expenditure.
- (iii) **Audit against Provision of Funds:** It contemplates that there is a provision of funds out of which expenditure can be incurred and the amount of such expenditure does not exceed the appropriations made.
- (iv) **Propriety Audit:** It is required to be seen that the expenditure is incurred with due regard to broad and general principles of financial propriety. The auditor aims to bring out cases of improper, avoidable, or in fructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. Audit aims to secure a reasonably high standard of public financial morality by looking into the wisdom, faithfulness and economy of transactions.
- (v) **Performance Audit:** This involves 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. Efficiency-cum- performance audit, wherever used, is an objective examination of the financial and operational performance of an organisation, programme, authority or function and is oriented towards identifying opportunities for greater economy, and effectiveness.

**(6 MARKS)**