



**J.K. SHAH**<sup>®</sup>  
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**SUGGESTED SOLUTION**  
**INTERMEDIATE N'19 EXAM**  
**SUBJECT- AUDIT**  
**Test Code - PIN 5059**  
**BRANCH - () (Date :)**

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## ANSWER-1

1. D
2. D
3. C
4. A
5. C
6. C
7. D
8. D
9. D
10. D
11. B
12. D
13. A
14. C
15. A
16. D
17. C
18. A
19. D
20. B
21. D
22. A
23. D
24. B
25. C

## ANSWER- 2

(7\*2 = 14 MARKS)

1. **Incorrect** : The difference between the two is that provisions are amounts set aside to meet specific/ identified liabilities or diminution in recoverable value of assets. These must be provided for regardless of the fact whether the Company has earned profit or not.

Reserves on the other hand, represent amounts appropriated out of profits, held for equalising the dividends of the company from one period to another or for financing the expansion of the company or for generally strengthening the company financially.

2. **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:
  - a. To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
  - b. 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.
3. **Incorrect:** Even though specialized audit tools are very useful, such tools are not always required or necessary to carry out data analytics. More commonly available spreadsheet

applications like MS-Excel can also be effectively used for carrying out data analytics.

4. **Correct:** As per SA 240 “The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements”, it is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behavior which can be reinforced by an active oversight by those charged with governance.
  
5. **Incorrect:** According to section 139 of the Companies Act, 2013, the provisions related to rotation of auditor are applicable to all private limited companies having paid up share capital of Rs. 20 crore or more; and all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of Rs. 50 crore or more.  
  
Although company A is a private limited company yet it is having public borrowings from nationalized bank of Rs. 50 crores, therefore it would be governed by provisions of rotation of auditor.
  
6. **Incorrect:** According to SA 530 “Audit sampling”, ‘audit sampling’ refers to the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.
  
7. **Incorrect:** Emphasis of Matter paragraph is a paragraph included in the auditor’s report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor’s judgment, is of such importance that it is fundamental to users’ understanding of the financial statements.

### ANSWER-3

### ANSWER-A

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-

1. the significant matters identified during the audit and
2. 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.

(4 MARKS)

### ANSWER-B

**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-C

#### Purpose of communicating key audit matters

As per **SA 701, "Communicating Key Audit Matters in the Auditor's Report"**, the purpose of communicating key audit matters is to **enhance the communicative value** of the auditor's report by providing **greater transparency** about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements to **assist them in understanding those matters** that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and areas of significant management judgment in the audited financial statements.

(4 MARKS)

### ANSWER-4

#### ANSWER-A

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

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.

(5 MARKS)

### ANSWER-B

**Audit Sampling:** As per SA 530 on "Audit Sampling", the meaning of the term Audit Sampling is – the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The requirements relating to sample design, sample size and selection of items for testing are explained below-

**Sample design** - When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.

**Sample Size-** The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.

**Selection of Items for Testing-** The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

(4 MARKS)

### ANSWER-C

**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.
- **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.
  - **For example,** Financial ratios may include:
    - Trade receivables or inventory turnover
    - Freight expense as a percentage of sales revenue
- **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.

- **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).

(5 MARKS)

#### ANSWER-5

#### ANSWER-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”.**

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.

(4 MARKS)

#### ANSWER-B

**Liabilities in addition to borrowings (discussed above), 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.

(4 MARKS)

#### ANSWER-C

**(a) The auditor is not expected to, and cannot, reduce audit risk to zero** and cannot therefore obtain absolute assurance that the financial statements are free from material

misstatement due to fraud or error. This is because there are inherent limitations of an audit. The inherent limitations of an audit arise from:

- (i) **The Nature of Financial Reporting:** The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.
- (ii) **The Nature of Audit Procedures:** There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:
1. There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.
  2. Fraud may involve sophisticated and carefully organized schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
  3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation. **(3 MARKS)**

- (iii) **Timeliness of Financial Reporting and the Balance between Benefit and Cost:** The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.

Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost. **(1.5 MARKS)**

- (iv) **Other Matters that Affect the Limitations of an Audit:** In the case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.

**(1.5 MARKS)**

## **ANSWER-6**

## **ANSWER-A**

### **Matters to be included in the Auditor's Report under CARO, 2016:**

The auditor's report on the accounts of a company to which CARO applies shall include a statement on the following matters, namely-

- (i) **in case the company has accepted deposits,** whether the directives issued by the

Reserve Bank of India and the provisions of sections 73 to 76 or any other relevant provisions of the Companies Act, 2013 and the rules framed there under, where applicable, have been complied with? If not, the nature of such contraventions be stated; If an order has been passed by Company Law Board or National Company Law Tribunal or Reserve Bank of India or any court or any other tribunal, whether the same has been complied with or no. **(2 MARKS)**

- (ii) Whether the **Nidhi Company** has complied with the Net Owned Funds to Deposits in the ratio of 1:20 to meet out the liability and whether the Nidhi Company is maintaining ten per cent unencumbered term deposits as specified in the Nidhi Rules ,2014 to meet out the liability; **(2 MARKS)**

### ANSWER-B

**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:

- ◆ 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.
- ◆ All the necessary documents (e.g., agreements, demand promissory notes, letters of hypothecation, etc.) should be **executed** by the parties before advances are made.
- ◆ The **compliance** with the terms of sanction and end use of funds should be **ensured**.
- ◆ **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**.
- ◆ 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.
- ◆ 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.
- ◆ 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.
- ◆ Drawing Power Register should be **updated** every month to record the value of securities hypothecated. These entries should be checked by an officer.
- ◆ The accounts should be kept within both the **drawing power** and the **sanctioned limit**.
- ◆ 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.
- ◆ 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.

**(6 MARKS)**

### ANSWER-C

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 test of controls that have been performed provide an appropriate basis for reliance on the controls;
- (b) Additional test of controls are necessary; or
- (c) The potential risks of misstatement need to be addressed using substantive procedures.

(4 MARKS)

### ANSWER-7

### ANSWER-A

Under **sub-section (3) of section 141 along with the Companies (Audit and Auditors) Rule, 2014**, a person who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company, shall not be eligible for appointment as an auditor of a company.

It may be noted that the relative may hold security or interest in the company of face value not exceeding rupees one lakh.

Where a person appointed as an auditor of a company incurs any of the disqualifications mentioned in sub-section (3) after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be a casual vacancy in the office of the auditor.

Applying the above provisions to the given problem, it may be concluded that Firm of RGS, Chartered Accountants is not eligible to continue as auditors. Firm shall vacate its office as auditor and such vacation shall be treated as casual vacancy.

(4 MARKS)

### ANSWER-B

The **reliability of data** is influenced by its **source and nature and is dependent** on the circumstances under which it is obtained. Accordingly, the following are relevant when determining whether data is reliable for purposes of designing substantive analytical procedures:

- (i) **Source of the information available**. For example, information may be more reliable when it is obtained from independent sources outside the entity;
- (ii) **Comparability of the information** available. For example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialized products;
- (iii) **Nature and relevance of the information** available. For example, whether budgets have been established as results to be expected rather than as goals to be achieved; and
- (iv) **Controls over the preparation of the information** that are designed to ensure its completeness, accuracy and validity. For example, controls over the preparation, review and maintenance of budgets.

The auditor may consider testing the **operating effectiveness of controls**, if any, over the entity's preparation of information used by the auditor in performing substantive analytical procedures in response to assessed risks. When such controls are **effective**, the auditor generally has **greater confidence in the reliability of the information** and, therefore, in the results of analytical procedures. The operating **effectiveness of controls** over non-financial information may often be tested in conjunction with other tests of controls. For example, in establishing controls over the processing of sales invoices, an entity may include controls over

the recording of unit sales. In these circumstances, the auditor may test the **operating effectiveness of controls** over the recording of unit sales in conjunction with tests of the operating effectiveness of controls over the processing of sales invoices. Alternatively, the auditor may consider whether the information was subjected to audit testing. SA 500 (Revised) establishes requirements and provides guidance in determining the audit procedures to be performed on the information to be used for substantive analytical procedures.

(5 MARKS)

### **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.

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.

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 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.

(5 MARKS)