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SUGGESTED SOLUTION

CA INTERMEDIATE

SUBJECT- AUDIT

Test Code - CIM 8406

BRANCH - () (Date :)

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PART A- Multiple Choice Questions

Questions (1-20) carry 1 Mark each

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

Questions (21-25) carry 2 Marks each

21. A
22. C
23. A
24. B
25. D

ANSWER 1 (any 7)

- (i). **Correct:** 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.
- (ii). **Incorrect:** The auditor shall express a qualified opinion when:
- (a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
 - (b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive

(iii). Incorrect: It is important, both for the auditor and client, that each party should be clear about the nature of the engagement. It must be reduced to writing and should exactly specify the scope of the work.

(iv). Correct: The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, such as forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion

(v). Incorrect: 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.

(vi) Correct: According to SA-300, "Planning an Audit of Financial Statements", 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.

(vii). 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.

(viii). Incorrect: Objective examination connotes critical examination and scrutiny of the accounting statements of the undertaking with a view to assessing how far the statements present the actual state of affairs in the correct context and whether they give a true and fair view about the financial results and state of affairs.

(2*7= 14 marks)

ANSWER 2(A)

As per sub-section (3) & (4) of section 73 of Multi- state Co-operative Societies Act, 2002, the auditor shall make a report to the members of the Multi-State co-operative society on the accounts examined by him and on every balance-sheet and profit and loss account and on every other document required to be part of or annexed to the balance-sheet or profit and loss account, which are laid before the Multi-State co- operative society in general meeting during his tenure of office, and the report shall state whether, in his opinion and to the best of his information and according to the explanation given to him, the said account give the information required by this act in the manner so required, and give a true and fair view:

- (a) In the case of the balance-sheet, of the state of the Multi-State co-operative society's affairs as at the end of its financial year; and
- (b) In the case of the profit and loss account, of the profit or loss for its financial year. The auditor's report shall also state:
 - (i) Whether he has obtained all the information and explanation which to the best of his knowledge and belief were necessary for the purpose of his audit.
 - (ii) Whether, in his opinion, proper books of account have been kept by the Multi- State co-operative society so far as appears from his examination of these books and proper returns

adequate for the purpose of his audit have been received from branches or offices of the Multi-State co-operative society not visited by him.

- (iii) Whether the report on the accounts of any branch office audited by a person other than the Multi-State co-operative society's auditor has been forwarded to him and how he has dealt with the same in preparing the auditor's report.
- (iv) Whether the Multi-State co-operative society's balance sheet and profit and loss account dealt with by the report are in agreement with the books of account and return.

Where any of the matters referred to in sub-section (3) or (4) is answered in the negative or with a qualification, the auditor's report shall state the reason for the answer.

(4 MARKS)

ANSWER 2(B)

(i) Assertions about transactions and events for the period relating to fixed assets :

Occurrence—transactions and events relating to fixed assets have been recorded, have occurred and pertain to the entity.

- (1) Completeness—all transactions and events relating to fixed assets that should have been recorded have been recorded.
- (2) Accuracy—amounts and other data relating to recorded transactions and events have been recorded appropriately.
- (3) Cut-off—transactions and events have been recorded in the correct accounting period.
- (4) Classification—transactions and events have been recorded in the proper accounts.

(ii) The specific assertions are as follows:

- (1) the firm owns the plant and machinery;
- (2) the historical cost of plant and machinery is Rs. 4 lacs;
- (3) the plant and machinery physically exists;
- (4) the asset is being utilized in the business of the company productively;
- (5) total charge of depreciation on this asset is Rs. 1,66,000 to date on which Rs. 26,000 relates to the year in respect of which the accounts are drawn up; and
- (6) the amount of depreciation has been calculated on recognized basis and the calculation is correct

(6 MARKS)

ANSWER 2(C)

Sub-section (8) of section 143 of the Companies Act, 2013, prescribes the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor. Where a company has a branch office, the accounts of that office shall be audited either by the auditor appointed for the company (herein referred to as the company's auditor) under this Act or by any other person qualified for appointment as an auditor of the company under this Act and appointed as such under section 139, or where the branch office is situated in a country outside India, the accounts of the branch office shall be audited either by the company's auditor or by an accountant or by any other person duly qualified to act as an auditor of the accounts of the branch office in accordance with the laws of that country and the duties and powers of the company's auditor with reference to the audit of the branch and the branch auditor, if any, shall be such as may be prescribed:

It may be noted that the branch auditor shall prepare a report on the accounts of the branch examined by him and send it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

Further as per rule 12 of the Companies (Audit and Auditors) Rules, 2014, the branch auditor shall submit his report to the company's auditor and reporting of fraud by the auditor shall also extend to such branch auditor to the extent it relates to the concerned branch.

(4 MARKS)

ANSWER 3(A) (Any 5 points)

Audit of Hospital: The special steps involved in such an audit are stated below-

- (1) **Register of Patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
- (2) **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
- (3) **Income from Investments, Rent etc:** See by reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected.
- (4) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
- (5) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
- (6) **Authorization and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorized.
- (7) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.
- (8) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
- (9) **Internal Check:** Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to insure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorization.
- (10) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
- (11) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
- (12) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.
- (13) **Management Representation and Certificate:** Get proper Management

Representation and Certificate with respect to various aspects covered during the course of audit.

(5 MARKS)

ANSWER 3(B)

In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity. For all additions to land, building in particular, the auditor should obtain copies of conveyance deed/ sale deed to establish whether the entity is mentioned to be the legal and valid owner.

The auditor should insist and verify the original title deeds for all immoveable properties held as at the balance sheet date. In case the entity has given such immoveable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security. In addition, the auditor should also verify the register of charges, available with the entity to assess the PPE that has been given as security to any third parties

(5 MARKS)

ANSWER 3(C)

No conscious effort in human society is divested of economic considerations and auditing is no exception. There is a growing realization 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 organizations, 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(A)

Control Environment – Component of Internal Control: The auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether:

- (i) Management has created and maintained a culture of honesty and ethical behavior; and
- (ii) The strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control.

What is included in Control Environment?

The control environment includes:

- (i) the governance and management functions and
- (ii) the attitudes, awareness, and actions of those charged with governance and management.
- (iii) The control environment sets the tone of an organization, influencing the control consciousness of its people.

Elements of the Control Environment: Elements of the control environment that may be relevant when obtaining an understanding of the control environment include the following:

- (a) **Communication and enforcement of integrity and ethical values** – These are essential elements that influence the effectiveness of the design, administration and monitoring of controls.
- (b) **Commitment to competence** – Matters such as management’s consideration of the competence levels for particular jobs and how those levels translate into requisite skills and knowledge.
- (c) **Participation by those charged with governance** – Attributes of those charged with governance such as:
 - ◆ Their independence from management.
 - ◆ Their experience and stature.
 - ◆ The extent of their involvement and the information they receive, and the scrutiny of activities.
 - ◆ The appropriateness of their actions, including the degree to which difficult questions are raised and pursued with management, and their interaction with internal and external auditors.
- (d) **Management’s philosophy and operating style** – Characteristics such as management’s:
 - ◆ Approach to taking and managing business risks.
 - ◆ Attitudes and actions toward financial reporting.
 - ◆ Attitudes toward information processing and accounting functions and personnel.
- (e) **Organizational structure** – The framework within which an entity’s activities for achieving its objectives are planned, executed, controlled, and reviewed.
- (f) **Assignment of authority and responsibility** - Matters such as how authority and responsibility for operating activities are assigned and how reporting relationships and authorization hierarchies are established.
- (g) **Human resource policies and practices** – Policies and practices that relate to, for example, recruitment, orientation, training, evaluation, counselling, promotion, compensation, and remedial actions.

(6 MARKS)

ANSWER 4(B)

Audit of Advances: Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:

- (a) Amounts included in balance sheet in respect of advances are outstanding at the date of the balance sheet.
- (b) Advances represent amount due to the bank.
- (c) Amounts due to the bank are appropriately supported by Loan documents and other documents as applicable to the nature of advances.
- (d) There are no unrecorded advances.

- (e) The stated basis of valuation of advances is appropriate and properly applied, and that the recoverability of advances is recognized in their valuation.
- (f) The advances are disclosed, classified and described in accordance with recognized accounting policies and practices and relevant statutory and regulatory requirements.
- (g) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

(5 MARKS)

ANSWER 4(C)

Ceiling on number of Audits:

1. Section 141(3)(g) of the Companies Act, 2013 prescribes that a person shall not be eligible for appointment as an auditor of a company namely – a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies other than one person companies, dormant companies, small companies and private companies having paid-up share capital less than Rs. 100 crore.
2. In the case of a firm of auditors, it has been further provided that ‘specified number of companies’ shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere. This limit of 20 company audits is per person. In the case of an audit firm having 3 partners, the overall ceiling will be $3 \times 20 = 60$ company audits.
3. Sometimes, a chartered accountant is a partner in a number of auditing firms. In such a case, all the firms in which he is partner or proprietor will be together entitled to 20 company audits on his account. Subject to the overall ceiling of company audits, how they allocate the 20 audits between themselves is their affairs.

(3 MARKS)

ANSWER 5(A)

An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.

A request from the client for the auditor to change the engagement may result from -

1. a **change in circumstances** affecting the need for the service,
2. a **misunderstanding** as to the nature of an audit or related service originally requested.
3. **A restriction on the scope of the engagement**, whether imposed by management or caused by circumstances.

(3 MARKS)

ANSWER 5(B)

Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the following:

- ◆ Check completeness of data and population that is used in either test of controls or substantive audit tests.
- ◆ Selection of audit samples – random sampling, systematic sampling.
- ◆ Re-computation of balances – reconstruction of trial balance from transaction data.

- ◆ Re performance of mathematical calculations – depreciation, bank interest calculation.
- ◆ Analysis of journal entries as required by SA 240.
- ◆ Fraud investigation.
- ◆ Evaluating impact of control deficiencies.

(3 MARKS)

ANSWER 5(C)

Manipulation of Accounts: Detection of manipulation of accounts with a view to presenting a false state of affairs is a task requiring great tact and intelligence because generally management personnel in higher management cadre are associated with this type of fraud and this is perpetrated in methodical way. This type of fraud is generally committed:

- (a) to avoid incidence of income-tax or other taxes;
- (b) for declaring a dividend when there are insufficient profits;
- (c) to withhold declaration of dividend even when there is adequate profit (this is often done to manipulate the value of shares in stock market to make it possible for selected persons to acquire shares at a lower cost); and
- (d) for receiving higher remuneration where managerial remuneration is payable by reference to profits.

(4 MARKS)

ANSWER 5(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 6(A)

Responsibilities of the Auditor

There are specific accounting and disclosure requirements for related party relationships, transactions and balances to enable users of the financial statements to understand their nature and effects on the financial statements.

The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances.

The auditor needs to obtain an understanding of the entity's related party relationships and transactions sufficient to be able to conclude whether the financial statements, insofar as they are affected by those relationships and transactions.

- (a) Achieve a true and fair presentation, or
- (b) Are not misleading (for compliance frameworks).

In addition, an understanding of the entity's related party relationships and transactions is relevant to the auditor's evaluation of whether fraud risk factors are present as required by SA 240. This is because fraud may be more easily committed through related parties.

Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs. In the context of related parties, the potential effects of inherent limitations on the auditor's ability to detect material misstatements are greater for such reasons as the following :

- Management may be unaware of the existence of all related party relationships.
- Related party relationships may present a greater opportunity for collusion, concealment or manipulation by management.
- Planning and performing the audit with professional skepticism as required by SA 200 is therefore particularly important in this context, given the potential for undisclosed related party relationships and transactions. The requirements in this SA are designed to assist the auditor in identifying and assessing the risks of material misstatement associated with related party relationships and transactions, and in designing audit procedures to respond to the assessed risks.

(8 MARKS)

ANSWER 6(B)

Overall audit strategy sets the scope, timing and direction of the audit, and guides the development of the more detailed audit plan.

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.

(6 MARKS)

OR

ANSWER 6(B)

Emphasis of Matter paragraph – 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.

Emphasis of Matter Paragraphs in the Auditor’s Report

If the auditor considers it necessary to draw users’ attention to a matter 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, the auditor shall include an Emphasis of Matter paragraph in the auditor’s report provided:

- (a) The auditor would not be required to modify the opinion in accordance with SA 705 (Revised) as a result of the matter; and
- (b) When SA 701 applies, the matter has not been determined to be a key audit matter to be communicated in the auditor’s report.

Separate section for Emphasis of Matter paragraph

When the auditor includes an Emphasis of Matter paragraph in the auditor’s report, the auditor shall:

- (a) Include the paragraph within a separate section of the auditor’s report with an appropriate heading that includes the term “Emphasis of Matter”;
- (b) Include in the paragraph a clear reference to the matter being emphasized and to where relevant disclosures that fully describe the matter can be found in the financial statements. The paragraph shall refer only to information presented or disclosed in the financial statements; and
- (c) Indicate that the auditor’s opinion is not modified in respect of the matter emphasized.

(6 MARKS)