

TEST SERIES – Audit Paper 4 (60 Marks – 2 hrs)

**Chapter 9 – SPECIAL FEATURES OF AUDIT OF DIFFERENT
TYPES OF ENTITIES**

Chapter 10 – AUDIT OF BANKS &

Chapter 11 – ETHICS AND TERMS OF AUDIT ENGAGEMENTS

Total there are 25 MCQ including Case Study, all of 1 Mark each

MCQ Based Questions

1. _____ aims at ascertaining that the expenditure incurred has been on the purpose for which the grant and appropriation had been provided and that the amount of such expenditure does not exceed the appropriation made.

- (a) Audit against provision of funds
- (b) Propriety audit
- (c) Audit of sanctions
- (d) Audit against rules and orders

2. The C & AG, some years ago, gave adverse comments on expenditure incurred on buying coffins for soldiers killed in a war. In his opinion, the coffins cases imported could have been replace with less expensive, domestically produced ones.

This is an aspect of –

- (a) Audit of sanctions
- (b) Audit of stores and stocks
- (c) Propriety audit
- (d) All of the above

3. While auditing a cinema hall, the auditor needs to verify that

- (a) Entrance to the cinema hall during show is only through printed tickets
- (b) Tickets are serially numbered and bound into books
- (c) That for advance booking a separate series of tickets is issued
- (d) All of above

4. Any amount due to the bank under any credit facility is 'overdue' if: -

- (a) it is not paid on the due date fixed by the bank
- (b) it is not paid within 30 days of due date fixed by the bank
- (c) it is not paid within 60 days of due date fixed by the bank
- (d) it is not paid within 90 days of due date fixed by the bank

5. Identify the correct statement: -

- (a) Income from non-performing assets is recognized on accrual basis
- (b) Income from non-performing assets is never recognized.
- (c) Income from non-performing assets is recognized on basis of actual recovery
- (d) Income from non-performing assets is recognized only when such assets are upgraded to standard assets

6. The LFAR is to be submitted before _____ every year

- (a) 30th April
- (b) 31st May
- (c) 30th June
- (d) 30th September

7. The term “Drawing Power” is associated with which of the following facilities as sanctioned by any Bank:

- (a) Letter of Credit
- (b) Term Loan
- (c) Staff Advances
- (d) Cash Credit Limit

8. Professional skepticism includes-

- (a) Overlooking unusual circumstances.
- (b) Using inappropriate assumptions in determining extent of audit procedures.
- (c) Over generalising when drawing conclusions from audit observations.
- (d) Being vigilant to conditions that might indicate possibilities of fraud.

9. Which of the following is not a fundamental principle governing professional ethics?

- (a) Professional competence and due care
- (b) Integrity
- (c) Objectivity
- (d) Safeguards to independence

10. Identify the most appropriate statement in context of SQC 1.

- (a) Assembly of engagement files should be completed in not more than 60 days after date of auditor’s report in case of audit engagements.
- (b) Engagement files should be completed before date of auditor’s report in case of audit engagements.
- (c) Engagement files should be completed in not more than 60 days after completion of an engagement.
- (d) Engagement files should be completed on date on which audit report is signed in case of audit engagements.

11. The auditor's _____ safeguards the auditor's ability to form an audit opinion without being affected by any influences.

- (a) Objectivity
- (b) Independence
- (c) Confidentiality
- (d) Integrity

12. Which of the following SAs deals with responsibilities of auditor regarding quality control procedures for an audit of financial statements

- (a) SA 200
- (b) SA 210
- (c) SA 220
- (d) SA 260

13. In addition to the audit certificate in the prescribed form and various schedules, the auditor of a Co-operative society in the applicable State has to answer two sets of questionnaires called as

- (a) Internal Control Questionnaires
- (b) Audit Supplements
- (c) Audit Memos
- (d) Memorandum reports

14. The CAG shall be paid salary equivalent to

- (a) Judge of High Court
- (b) Judge of Supreme Court
- (c) Prime Minister
- (d) President of India

15. _____ is competent to make laws to determine salary and other conditions of service

- (a) The Parliament
- (b) President of India
- (c) Prime Minister of India
- (d) CBI

Case Study 1

(A) Audit of “Implementation of Nagpur Metro Rail Project” was conducted by the Comptroller and Auditor General of India.

Following is extract of few audit findings placed on website cag.gov.in.

“The location of New Airport station was not ideal from the viewpoint of ridership due to sparse population in and around the station and also from the accessibility point of view. Cotton Market station, the second additional station was projected to have high peak hour peak direction trips but the work was kept on hold midway citing fund crunch due to non-release of pending contribution from stakeholders. However, the situation could have been managed through prioritization of works.”

(B) Another set of audit findings in respect of audit of Haryana Power Generation Corporation Limited, a wholly owned government company responsible for operation of power generation plants in state of Haryana is as under:

“The main reason for low generation was higher variable cost of thermal power stations which resulted in backing down of plants.”

(C) A report was tabled in Parliament highlighting main features of direct taxes administration of country as mandated in Constitution of India. This report primarily discussed compliance to the provisions of the Income Tax Act, 1961 and the associated rules and procedures etc. as applied to administration of direct taxes including irregularities noticed in finalizing assessments etc.

(D) Radial finance corporation Limited is a government company. The audit of the company is conducted by statutory auditors appointed by Comptroller and Auditor General of India.

(E) Bharat Insurance Company Limited is a general insurance government owned company. The statutory auditor is appointed by Comptroller and Auditor General of India.

The annual report for a particular year also contains comments of statutory auditors on matters such as whether company has carried out reconciliations in respect of its inter-company balances with other government owned insurance companies.

Based on above, answer the following questions:

1. Based upon plain reading of audit findings stated at Para (A), identify type of audit carried out by office of the Comptroller and Auditor General of India.

- (a) Audit against provision of funds
- (b) Propriety audit
- (c) Performance audit
- (d) Compliance audit

2. Keeping in view audit findings in respect of Haryana Power Generation Corporation Limited, identify type of audit carried out.

- (a) Audit of Government Company
- (b) Audit against rules and orders

- (c) Compliance audit
- (d) Performance audit

3. Which of the following is the most appropriate statement in context of report tabled in Parliament regarding administration of direct taxes?

- (a) It is likely to be a report prepared for submission to the President under Article 151 of the Constitution of India by Comptroller and Auditor General of India.
- (b) It is likely to be a report prepared for submission to the Prime Minister under Article 151 of the Constitution of India by an independent task force of experts.
- (c) It is likely to be a report prepared for submission to the President under Article 151 of the Constitution of India by Central Board of Direct Taxes.
- (d) It is likely to be a report prepared for submission to the Prime Minister under Article 151 of the Constitution of India by Central Board of Direct Taxes.

4. Who is empowered to conduct “supplementary audit” in case of Radial finance Corporation Limited, a government company?

- (a) Central Government
- (b) Another independent auditor appointed by CAG
- (c) CAG
- (d) Another independent auditor appointed by Ministry of Corporate Affairs

5. As regards comments of auditors specified in respect of audit report of above insurance company, which of the following is likely to be most appropriate statement?

- (a) Such are likely to be comments of test audit carried out by CAG.
- (b) Such are likely to be comments in respect of directions to statutory auditor by CAG for reporting on specific aspect of their audit work.
- (c) Such are likely to be comments of supplementary audit carried out by CAG
- (d) Such are likely to be comments of statutory auditors in accordance with requirements of Standards on Auditing

CASE STUDY 2

M/s RGL has been appointed as auditors of New Indian Bank (a nationalised bank) for the Financial year 2018-19 by its Board of Directors. Appointment of M/s RGL has been challenged by a shareholder in the Bank’s Annual General Meeting stating that the appointment should have been made by the shareholders in the bank’s AGM. Their appointment as auditors of the bank throws some questions for the bank’s management. New Indian bank has exposure to crop loans as many branches are located in the rural area. While conducting the audit, the auditors are faced with the question of classification of non performing advances. Also, New Indian bank has lot of Credit cards issued to its clients, some of which are overdue for long. While conducting the audit, the auditors came across various peculiarities relating to Bank Audits like classification of NPA’s, reporting etc. to name a few. On the basis of above facts, please suggest appropriate treatments in respective cases.

Based on above, answer the following questions:

1. As per the provisions of relevant enactments, please advise who can appoint auditors of a Nationalised bank.

- (a) Board of Directors of the Bank
- (b) Reserve Bank of India
- (c) Comptroller and Auditor General of India
- (d) Central Government

2. The matters which the banks require their auditors to deal with in the Long Form Audit Report is to be specified by

- (a) Banking Regulation Act, 1949
- (b) Central Government
- (c) Comptroller and Auditor General of India
- (d) Reserve Bank of India

3. The auditors should classify Credit card accounts as NPA, if _____ amount due, as mentioned in the credit card statement is not paid fully within _____ days from next statement date.

- (a) Total, 90
- (b) Minimum, 90
- (c) Minimum, 30
- (d) Minimum, 60

4. An agricultural advance is classified as NPA, if interest or principal is overdue for _____ in case of short duration crops or if interest or principal is overdue for _____ in case of long duration crops.

- (a) One crop season, two crop season
- (b) Two crop season, one crop season
- (c) 90 days, 120 days
- (d) 120 days, 90 days

5. The bank is a consortium member of Cash Credit Facilities of Rs 100 crores to Bottle Limited. Bank's own share is Rs 20 crores only. During the last two quarters against a debit of Rs 1.75 crores towards interest the credits in Bottle Ltd's account are to the tune of Rs 1.25 crores only.

The auditors have classified the account of Bottle Ltd as performing

- (a) Incorrect, Bottle Ltd is Non Performing Asset (NPA)
- (b) Correct, Bottle Ltd is performing asset
- (c) Bottle Ltd's classification is subjective
- (d) None of the above.

State with reasons (in short) whether the following statements are correct or incorrect: 2 Marks Each (Attempt any 5 out of 6)

(1) 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.

(2) According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.

(3) The external control of municipal expenditure is exercised by the Central Government through the appointment of auditors to examine municipal accounts.

(4) RBI has been entrusted with the responsibility of regulating the activities of commercial banks only.

(5) In the computerised environment, the auditor need not be familiar with latest applicable RBI guidelines.

(6) Any amount due to the bank under any credit facility is 'overdue' if it is not paid within 90 days of becoming due.

Descriptive Questions: (Attempt any 5 out of 6) . All of 5 Marks Each

Q1 Write a short note on Performance Audit ?

Q2 What are Questions to be kept in mind While Undertaking / performing Control Activities in Bank ?

Q.3 What are Points to be kept in Mind in Audit of Hospitals?

Q.4 Write a Short Note on Internal Controls in case of Hotels

Q.5 What are Points Auditor has to consider in case of Audit of Trusts

Q.6 What are 5 Threats to Independence?

ANSWERS to MCQs

1	(a)
2	(c)
3	(d)
4	(a)
5	(c)
6	(c)
7	(d)
8	(d)
9	(d)
10	(a)
11	(b)
12	(c)
13	(a)
14	(a)
15	(c)

ANSWER TO CASE STUDY 1

1	(c)
2	(d)
3	(a)
4	(c)
5	(b)

ANSWER TO CASE STUDY 2

1	(a)
2	(d)
3	(b)
4	(b)
5	(a)

Answers to TRUE & FALSE:

1. 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.

2. Correct: According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations i.e. the expenditure is incurred with due regard to broad and general principles of financial propriety.

3. Incorrect: The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. However, the municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit.

4. Incorrect: RBI has been entrusted with the responsibility of regulating the activities of commercial and other banks. All the Banks and even NBFC's fall under the regulatory function of RBI.

5. 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.

6. Incorrect: Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank and 90 days of becoming overdue.

Answers to Descriptive Question:

(1.Ans)

Performance audit - The scope of audit has been extended to cover efficiency, economy and effectiveness audit or performance audit, or full scope audit:

Efficiency audit looks into whether the various schemes/projects are executed and their operations conducted economically and whether they are yielding the results expected of them.

Economy audit looks into whether government have acquired the financial, human and physical resources in an economical manner, and whether the sanctioning and spending authorities have observed economy.

Effectiveness audit is an appraisal of the performance of programmes, schemes, projects with reference to the overall targeted objectives as well as efficiency of the means adopted for the attainment of the objectives.

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.

The procedure for conducting performance audit covers

- Identification of topic,
- Preliminary study,
- planning,
- Execution of audit, and
- reporting.

(2.Ans)

Who	<ul style="list-style-type: none">• Who performs the control?• Does the above person have requisite knowledge and authority to perform the control?
What	<ul style="list-style-type: none">• What evidence is available to demonstrate /prove that the control is performed?
When	<ul style="list-style-type: none">• When and with what frequency is the control performed?• Is the frequency enough to prevent, detect and correct risk of material misstatements?
Where	<ul style="list-style-type: none">• Where is the evidence of performance of the control retained?• For how long is the evidence retained?• Is the evidence accessible/ available for audit?
Why	<ul style="list-style-type: none">• Why is the control being performed?• What type of errors prevented or detected through the performance of the control?
How	<ul style="list-style-type: none">• How is the control performed?• What are the control activities?• Can these activities be bypassed?• Can the bypass, if any, be detected?• How are expectations / deviations resolved on identification?• What is the time frame for resolving the exceptions/deviations?

(3.Ans)

- 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 with 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. Authorisation 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 authorised.
- 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 authorisation.
- 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.

(4.Ans)

Internal Controls:

(a) It is the responsibility of management to introduce controls which will minimise the leakage/pilferage as far as possible.

(b) Preparation of regular perhaps weekly, trading accounts for each sales point and a detailed scrutiny of the resulting profit percentages, with any deviation from the anticipated form being investigated. The auditor should examine them and obtain explanations for any apparent deviations.

(c) The auditor should verify a few restaurant bills by reference to K.O.T.s (Kitchen Order Tickets) or basic record. This would enable the auditor to ensure that controls regarding revenue cycle are in order.

(d) The auditor should satisfy himself that all taxes collected from occupants on food and occupation have been paid over to the proper authorities.

(e) If the internal control in a hotel is weak or perhaps breaks down, then a very serious problem exists for the auditor. As a result, the scope of his audit tests will necessarily be increased and, in the event of a material discrepancy being unexplained, he will have to consider qualifying his audit report.

(5.Ans)

The auditor has to ascertain:

(a) whether accounts are maintained regularly and in accordance with the provisions of the applicable Act and the rules;

(b) whether receipts and disbursements are properly and correctly shown in the accounts and money received in the form of donations is being applied as per the objects of the trust and as per the specific direction by the donor, if any.

(c) whether the cash balance and vouchers in the custody of the manager or trustee on the date of audit were in agreement with the accounts;

(d) whether all books, deeds, accounts, vouchers or other documents or records required by the auditor were produced before him;

(e) whether a register of movable and immovable properties is maintained.

(f) whether the manager or trustee or any other person required by the auditor to appear before him did so and furnished the necessary information required by him;

- (g) whether any property or funds of the Trust were applied for any object or purpose other than the object or purpose of the Trust;
- (h) the amounts of outstanding for more than one year and the amounts written off, if any;
- (i) whether any money of the public trust has been invested contrary to the provisions of applicable Act which have come to the notice of the Auditor
- (j) all cases of irregular, illegal or improper expenditure, or failure or omission to recover monies or of loss or waste of money or other property thereof,
- (k) whether the maximum and minimum number of the trustees is maintained;
- (l) whether the meeting are held regularly as provided in such instrument
- (m) whether the minute books of the proceedings of the meeting is maintained
- (n) whether any of the trustees has any interest in the investment of the trust
- (o) whether any of the trustees is a debtor or creditor of the trust.
- (p) whether anonymous donations received are properly accounted for and donations in cash are not received by the Trust over and above the prescribed limit of accepting cash donations.
- (q) whether the irregularities pointed out by the auditors in the accounts of the previous year have been duly complied with by the trustees during the period of audit
- (r) any special matter which the auditor may think fit or necessary to bring to the notice of the Deputy or Assistant Charity Commissioner

(6.Ans)

Five types of threats to independence of auditors are discussed below:

1. Self-interest threats

Self-interest threats occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include

- (i) direct financial interest or materially significant indirect financial interest in a client
- (ii) loan or guarantee to or from the concerned client
- (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement
- (iv) close business relationship with an audit client
- (v) potential employment with the client and
- (vi) contingent fees for the audit engagement

2. Self-review threats

Self-review threats occur when during a review of any judgement or conclusion reached in a previous audit or non-audit engagement, or when a member of the audit team was previously a director or senior employee of the client. 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 etc. Instances where such threats come into play are: -

- (i) when an auditor having recently been a director or senior officer of the company.
- (ii) when auditors perform services that are themselves subject matters of audit.

3. Advocacy threats

Advocacy threats occur when the auditor promotes, or is perceived to promote, a client's opinion to a point where people may believe that objectivity is getting compromised, e.g., when an auditor deals with shares or securities of the audited company, or becomes the client's advocate in litigation and third party disputes. In such situations, auditor can be perceived as backing and championing causes of auditee client and it may lead to belief that auditor is not acting and working objectively.

4. Familiarity threats

Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. This can occur in many ways including:

- (i) close relative of the audit team working in a senior position in the client company
- (ii) former partner of the audit firm being a director or senior employee of the client
- (iii) long association between specific auditors and their specific client counterparts and
- (iv) acceptance of significant gifts or hospitality from the client company, its directors or employees.

Provisions in Companies Act, 2013 regarding rotation of auditors mainly address these very familiarity threats.

5. Intimidation threats

Intimidation threats occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism. Basically, these could happen because of threat of replacement over disagreements with the application of accounting principles, or pressure to disproportionately reduce work in response to reduced audit fees or being threatened with litigation.