

J.K. SHAH[®]

**TEST
SERIES**



SUGGESTED SOLUTION

CA INTERMEDIATE

SUBJECT- AUDIT

Test Code – IMP 2405

BRANCH - () (Date :)

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MULTIPLE CHOICE QUESTIONS :

NO.	ANSWER		
1	C	Engagement standards ensure uniformity by practitioners in course of performance of their duties.	1 M
2	C	Use quality control for audit of Financial Statements	1 M
3	C	Professional Judgement	1 M
4	D	All of the above	1 M
5	A	Significant Risk	1 M
6	A	Entity Level Controls	1 M
7	A	Reconciliation of bank accounts	1 M
8	B	The auditor should obtain written representation acknowledging management belief that effect of uncorrected misstatements is material.	1 M
9	B	Heterogeneous	1 M
10	D	All of the above	1 M
11	D	Both (a) and (b)	1 M
12	B	Nature of the Virtual Currency	1 M
13	B	Existence	1 M
14	D	In case of verifying compliance with specific legal requirements, it is suitable.	1 M
15	B	Board of society	1 M
16	B	Adverse Opinion	1 M
17	B	Source and nature	1 M
18	D	Not potential competitors	1 M
19	D	Safeguards to independence	1 M
20	A	Assembly of engagement files should be completed in not more than 60days after date of auditor's report in case of audit engagements.	1 M
21	1 (C)	It is necessary that audit programme be suitably updated or notes are given in working papers to this effect so that planned duties are in accordance with actual work performance.	2 M
	2(C)	Materiality arrived on basis of professional judgment along with factors considered in the determination has to be documented.	2 M
	3(D)	Precise calculation of risk of material misstatements has to be documented.	2 M
	4(D)	Reports showing that stocks conform to quality control standards in accordance with law are essential part of audit documentation.	2 M
	5(D)	Documentation to show that such transactions are at close length basis.	2 M

DIVISION B – DESCRIPTIVE ANSWERS**ANSWER : 1 (ANY 7)**

- (a) **Correct** : The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.
- (b) **Correct** : Audit of expenditure against regularity involves interpretation of the constitution, statutes, rules, regulation and orders but not to prescribe what such rules, regulation and orders shall be. It is function of audit to carry out examination of rules, regulation and orders issued by the executive of Government.

- (c) **Correct:** As per the Standard on Auditing (SA) 520 “Analytical Procedures” the term “analytical procedures” means evaluations of financial information through analysis of plausible relationship among both financial and non financial data.
- (d) **Incorrect:** If 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.
- (e) **Incorrect:** The method of evaluation of internal control referred above is known as Narrative Record because in Narrative Record method, a whole description of internal control operating in an entity is recorded
- (f) **Incorrect:** Audit Documentation helps in planning the audit of a company in a proper manner and also helps in conducting the audit of that company in a more effective way.
- (g) **Incorrect:** Statistical sampling uses scientific method choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non-statistical sampling, auditor’s judgment and past experience is used to choose samples without and scientific method. Hence, personal bias is involved in non-statistical sampling and not Statistical.
- (h) **Incorrect:** The auditor shall obtain an understanding of internal control relevant to the audit and it is a matter of the auditor’s professional judgment whether a control, individually or in combination with others, is relevant to the audit.

Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit.

(7 * 2 MARKS= 14 MARKS)

ANSWER : 2(A)

The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

The following are the guiding principles in this regard: -

1. For the public to have confidence in the quality of audit, it is essential that auditors should always be and appears to be independent of the entities that they are auditing.
2. In the case of audit, the key fundamental principles are integrity, objectivity and professional skepticism, which necessarily require the auditor to be independent.
3. Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.
4. When such threats exist, the auditor should either desist from the task or put in place safeguards that eliminate them.
5. If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

Remembering the above guiding principles, both Mr. R and Mr. V should not d Best Ltd. as it would act as a threat (familiarity threat) and affect impence of auditors.

(4 MARKS)

ANSWER : 2(B)

(a) SA 701 deals with the auditor's responsibility to communicate key audit matters in the auditor's report. It is intended to address both the auditor's judgement as to what to communicate in the auditor's report and the form and content of such communication.

(b) Determining Key Audit Matters

The auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- (i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.
- (ii) Significant auditor judgements relating to areas in the financial statements that involved significant management judgement, including accounting estimates that have been identified as having high estimation uncertainty.
- (iii) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the matters determined, as stated above, were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

(4 MARKS)

ANSWER : 2(C)

Substantive analytical procedures in respect of sales will consist of sales trend analysis, comparison with previous accounting period, category – wise sales analysis, any analysis the auditor may find relevant and most important of all, building a sales expectation and comparing that with the client's sales records. The auditor will need to know the sales prices of the products or services over the year, monthly average sales price per product or service, discount policy.

(3 MARKS)

ANSWER : 2(D)

Regarding disclosure of “Cash and cash equivalents” in the Financial Statements, ensure whether the following disclosures as required under Schedule III (Part 1) to Companies Act, 2013 have been made:

- (i) Cash and cash equivalents shall be classified as:
 - (a) Balances with banks;
 - (b) Cheques, drafts on hand;
 - (c) Cash on hand;
 - (d) Others (specify nature)
- (ii) Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.
- (iii) Balances with banks to the extent held as margin money or security against the borrowings, guarantees, other commitments shall be disclosed separately.
- (iv) Repatriation restrictions, if any, in respect of cash and bank balances shall be separately stated.
- (v) Bank deposits with more than 12 months' maturity shall be disclosed separately.

(3 MARKS)

ANSWER : 3(A)

If IT related risks are not mitigated, that could have an impact on controls. Let the auditor understand how:

Impact on controls

1. He cannot rely on automated controls, system calculations and accounting procedures built into applications.
2. He cannot rely on IT dependent manual controls.
3. The system data and reports should be tested substantively for completeness and accuracy.
4. More substantive audit work is needed.

(4 MARKS)

ANSWER : 3(B)

In larger organizations, with huge transactions, statistical sampling is always recommended as it is unbiased, and the sample selected are not prejudged.

Characteristics/ features of Statistical Sampling:

- Audit testing done through this approach is **more scientific** than testing based entirely on the auditor's own judgment because it involves use of **mathematical laws of probability** in determining the appropriate sample size in varying circumstances.
- Statistical sampling has reasonably wide application where a population to be tested consists of a **large number of similar items** and more in the case of transactions involving compliance testing, trade receivables' confirmation, payroll checking, vouching of invoices and petty cash vouchers.
- There is **no personal bias** of the auditor in case of statistical sampling. Since it is scientific, the results of sample can be evaluated and projected on the whole population in a more reliable manner.

For Example: An auditor while verifying the Purchases during the year realized that the purchase transactions in that year are more than 45000 in number, then in such case, statistical sampling will be highly recommended in the audit program. Random Sampling (discussed ahead in this topic) is the method you decide to choose sample in such a situation.

(4 MARKS)

ANSWER : 3(C)

There are two interlinked perspectives of independence of auditors, one, independence of mind; and two, independence in appearance. The Code of Ethics for Professional Accountants issued by International Federation of Accountants (IFAC) defines the term 'Independence' as follows:

"Independence is:

- (a) **Independence of mind** – the state of mind that permits the provision of an opinion without being affected by influences allowing an individual to act with integrity, and exercise objectivity and professional skepticism; and
- (b) **Independence in appearance** – the avoidance of facts and circumstances that are so significant that a third party would reasonably conclude an auditor's integrity, objectivity or professional skepticism had been compromised."

(3 MARKS)

ANSWER : 3(D)

Audit procedures which need to be performed to confirm Work-in-progress of inventories have been valued appropriately and as per generally accepted accounting policies and practices are as under:

- Ascertain how the various stages of production/ value additions are measured and in case estimates are made, understand the basis for such estimates.
- Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity.
- Ensure that material costs exclude any abnormal wastage factors.

(3 MARKS)

ANSWER : 4(A)

The auditor shall document:

- (a) The discussion among the engagement team and the significant decisions reached;
- (b) Key elements of the understanding obtained regarding each of the aspects of the entity and its environment and of each of the internal control components, the sources of information from which the understanding was obtained; and the risk assessment procedures performed;
- (c) The identified and assessed risks of material misstatement at the financial statement level and at the assertion level; and
- (d) The risks identified, and related controls about which the auditor has obtained an understanding.

(4 MARKS)

ANSWER : 4(B)

Purported disadvantages of audit programme may be eliminated by imaginative supervision of the work carried on by the assistants; the auditor must have a receptive attitude as regards the assistants ; the assistants should be encouraged to observe matters objectively and bring significant matters to the notice of supervisor / principal.

(4 MARKS)

ANSWER : 4(C)

Objectives of Internal Control

Internal control over safeguarding of assets against unauthorized acquisition, use, or disposition may include controls relating to both financial reporting and operations objectives. The auditor's consideration of such control is generally limited to those relevant to the reliability of financial reporting. For example, use of access controls, such as passwords, that limit access to the data and programs that process cash disbursements may be relevant to a financial statement audit. Conversely, safeguarding controls relating to operations objectives, such as controls so prevent the excessive use of materials in production, generally are not relevant to a financial statement audit.

Objectives of Internal Control are :

- (i) transactions are executed in accordance with management general or specific authorization;
- (ii) All transactions are promptly recorded in the correct amount in the appropriate accounts and in the accounting period in which executed so as to permit preparation of financial information within a framework of recognized accounting policies and practices and relevant statutory requirements, if any, and to maintain accountability for assets;
- (iii) assets are safeguarded from unauthorized access, use or disposition; and
- (iv) the recorded assets are compared with the existing assets at reasonable intervals and

appropriate action is taken with regard to any differences.

(3 MARKS)

ANSWER : 4(D)

It reflects the date that the auditor's report and audited financial statements are made available to third parties. The date the financial statements are issued generally depends on the regulatory environment of the entity. In some circumstances, the date the financial statements are issued may be the date that they are filed with a regulatory authority. Since audited financial statements cannot be issued without an auditor's report, the date that the audited financial statements are issued must not only be at or later than the date of the auditor's report, but must also be at or later than the date the auditor's report is provided to the entity.

(3 MARKS)

ANSWER : 5(A)

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 immovable 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 immovable property as security. In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

(4 MARKS)

ANSWER : 5(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 specialised 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.

(4 MARKS)

ANSWER : 5(C)

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.

(3 MARKS)

ANSWER : 5(D)

The instances highlighted in above situation are examples of misstatements identified during the audit. Over valuation of inventory of finished goods by Rs. 2 crore and wrongly charging freight of Rs.10 lacs paid on machinery to statement of profit and loss instead of capitalizing are examples of misstatements.

The auditor should communicate above identified misstatements to those charged with governance and request for correction of these misstatements. In case, these are not corrected, understand the reasons for not making the corrections and reassess materiality. It should also be considered whether uncorrected statements are material individually or in aggregate. Effect of corrections and reassess materiality. It should also be considered whether uncorrected statements are material individually or in aggregate. Effect of uncorrected misstatements on the opinion in auditor's report should be communicated to those charged with governance.

(3 MARKS)

ANSWER : 6(A)

Power of Central Government to direct special audit in certain cases - Under section 77 of the Multi-State Co-operative Societies Act, 2002, where the Central Government is of the opinion:

- (a) that the affairs of any Multi-State co-operative society are not being managed in accordance with self-help and mutual deed and co-operative principles or prudent commercial practices or with sound business principles; or
- (b) that any Multi-State co-operative society is being managed in a manner likely to cause serious injury or damage to the interests of the trade industry or business to which it pertains; or
- (c) that the financial position of any Multi-State co-operative society is such as to endanger its solvency.

Action by the Central Government:

On receipts of the report of the special auditor the Central Government may take such action on the report as it considers necessary in accordance with the provision of the Act or any law for the time being in force.

However, if the Central Government does not take any action on the report within four months from the date of its receipt, that Government shall send to the Multi- State Co- operative society either a copy of, or relevant extract from, the report with its comments thereon and require the Multi-State Co-operative society either to circulate that copy or those extracts to the members or to have such copy or extracts read before the Multi-State Co-operative society at its next general meeting.

(4 MARKS)

OR

ANSWER : 6(A)

Consortium advances mean advancing loans to a borrower by two or more Banks jointly by forming a **Consortium**. Joint appraisal, control and monitoring will facilitate for exchange of valuable information among the Banks. Usually, a Bank with a higher share will **lead the consortium**.

Consortium advances should be based on the record of recovery of the respective individual member banks and other aspects having a bearing on the recoverability of the advances.

Where the remittances by the borrower under consortium lending arrangements are pooled with one bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, an NPA.

The banks participating in the consortium, therefore, need to arrange to get their share of recovery transferred from the lead bank or to get an express consent from the lead bank for the transfer of their share of recovery, to ensure proper asset classification in their respective books.

(4 MARKS)

ANSWER : 6(B)

Management develops controls and uses performance indicators to aid in managing key business and financial risks. An effective risk management system in a bank generally requires the following:

- (a) Oversight and involvement in the control process by those charged with governance:** Those charged with governance (Board of Directors/Managing Director) 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.
- (b) 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.
- (c) Control activities:** A bank should have appropriate controls to mitigate 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 up limits, reporting and approval of exceptions, physical security and contingency planning.
- (d) Monitoring activities:** Risk management models, methodologies and assumptions used to

measure and mitigate risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit.

- (e) **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 : 6(C)

- (a) **Hypothecation of goods:** Deed of hypothecation or other document creating the charge, together with a statement of inventories held at the Balance Sheet Date.
- (b) **Life Insurance Policy:** Assignment of policy in favour of the lender, duly registered with the insurer.
- (c) **Shares and Debentures:** The scrip and the endorsement thereon of the name of the transferee, in the case of transfer.

(3 MARKS)

ANSWER : 6(D)

The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

That conclusion shall take into account :

- (a) Whether sufficient appropriate audit evidence has been obtained;
- (b) Whether uncorrected misstatements are material, individually or in aggregate;
- (c) The evaluations.

(3 MARKS)