



USE CODE : JUN20

**Single Subject
@ 3,540**

**Single Group
@ 7,670**

**Both Groups
@ 15,340**



USE CODE : NOV20

**Single Subject
@ 5,900**

**Single Group
@ 11,800**

**Both Groups
@ 21,240**

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Test Paper 4 - Solution
National Test Series
Subject: Auditing and Assurance

Marks: 100 Marks

Duration: 3 Hrs.

Part - I

Multiple Choice Questions:

(30×1 Mark each = 30 Marks)

Case Study based MCQs

Case Study 1

M/s NSG & Associates have been appointed as auditors of Viaan Ltd. for the financial year 2019-20. The processes, operations, accounting and decisions are carried out by using computers in Viaan Ltd. The auditors understand that there are several aspects that they should consider to determine the level of automation and complexity in the business environment of Viaan Ltd. While planning the audit work, the engagement partners discussed with the audit staff about the various types of controls in the automated environment.

The different types of audit tests that can be used in audit of an automated business environment were also discussed within the engagement team. The responsibility regarding the Internal Financial Controls was also discussed in detail. Further the tools and techniques that can be used to deal with the enormous data and information of Viaan Ltd. were briefed to the audit staff by the engagement partners.

Based on the above facts, answer the following: -

1. _____ are the manual controls that make use of some form of data or information or report produced from the IT systems and applications.
(a) Application Controls
(b) IT dependent Controls
(c) Automated Controls
(d) General IT Controls
Solution: (b)

2. Statement 1: Application controls include both manual and automated controls that operate at a business process level.
Statement 2: General IT Controls apply to mainframe, miniframe as well as end user environment.
(a) Only Statement 1 is correct
(b) Only Statement 2 is correct
(c) Both Statements 1 & 2 are correct
(d) Both Statements 1 & 2 are incorrect
Solution: (c)

3. _____ are also known as pervasive or indirect controls :-

- (a) General IT Controls
- (b) Application Controls
- (c) IT dependent Controls
- (d) None of the above

Solution: (a)

4. Which of the following are not the types of audit tests that can be used in the audit in an automated environment?

- (a) Observation
- (b) Inspection
- (c) Re performance
- (d) None of the above

Solution: (d)

5. _____ is the combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information: -

- (a) Computer Assisted Audit Techniques
- (b) Automated Controls
- (c) Data Analytics
- (d) None of the above

Solution: (c)

Case Study 2

M/s JK & Associates have been appointed as auditors of Venus Ltd. for the financial year 2019-20. The team consist of Mr. J & Mr. K both Chartered Accountants as also the engagement partners and the audit staff consisting of 2 article assistants. While starting the audit work of Venus Ltd, the engagement partners briefed the audit staff about the audit work, areas to be covered and the various auditing concepts and their application in the audit of Venus Ltd along with applicable Standard on Auditing.

Various topics like audit planning, overall audit strategy, audit programme were discussed in detail. The team was told about the purpose and implication of various statements and guidance notes issued by the Institute of Chartered Accountants of India (ICAI) from time to time. Mr. K also briefed the team about the concept of materiality to be applied while planning and performing audit. The team was also explained in detail about the area where benchmark materiality can be applied in case of Venus Ltd.

Based on the above facts, answer the following:-

6. sets the scope, timing & direction of the audit and guides the development of the more detailed plan.

- (a) Audit Programme
- (b) Overall Audit Strategy
- (c) Completion Memorandum
- (d) Audit Plan

Solution: (b)

7. Statement 1: The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential process but are closely inter-related.
Statement 2: The auditor shall establish an overall audit strategy that guides the development of audit plan.
(a) Only Statement 1 is correct
(b) Only Statement 2 is correct
(c) Both Statements 1 & 2 are correct
(d) Both Statements 1 & 2 are incorrect
Solution: (c)
8. _____ means the amount set by the auditor at less than materiality for the financial statements as a whole to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatement exceeds materiality for the financial statements as a whole :-
(a) Benchmark Materiality
(b) Materiality in Planning
(c) Performance Materiality
(d) Materiality.
Solution: (c)
9. Which of the following is not an example of benchmark that can be used in determining the materiality in the case of financial statements:-
(a) Total Revenue
(b) Profit before tax
(c) Net Asset Value
(d) None of the above
Solution: (c)
10. (i) Guidance notes issued by ICAI provide guidance to members on matters which may arise in the course of their professional work.
(ii) Statements are issued by ICAI with a view to secure compliance by members on some matters.
(iii) Guidance notes are recommendatory in nature.
(iv) Statements are mandatory in nature.
(a) All the above statements are correct.
(b) Statements 1 & 2 are correct
(c) Statements 1, 2 & 3 are correct
(d) Statements 1,2 & 4 are correct
Solution: (c)

MCQs not based on Case Study

11. State the retention period of working papers as per SA 230
(a) Six years
(b) Eight years
(c) Seven years
(d) Five years
Solution: (c)

12. There are different board approaches to the Auditor's reporting responsibilities in respect of comparative information.

- (a) Five
- (b) Two
- (c) Four
- (d) Three

Solution: (b)

13. The overall audit strategy and the audit plan remains the ____ responsibility.

- (a) Auditor's
- (b) Management's
- (c) Those changed with governance
- (d) All of the above

Solution: (a)

14. An auditor of a co-operative society is appointed by

- (a) Particular state government
- (b) Registrar of Co-operative
- (c) Member of Co-operative society
- (d) Any of the above can appoint

Solution: (b)

15. Who shall fix the remuneration of first auditor in cash of non-government company

- (a) Board
- (b) Members
- (c) Both a and b
- (d) CAG

Solution: (c)

16. Internal check is meant for

- (a) Prevention of frauds
- (b) Detection of frauds
- (c) Helping audit in depth
- (d) Detection of error

Solution: (a)

17. Surprise checks are part of

- (a) an auditor's working papers
- (b) an audit programme
- (c) an auditor's report
- (d) an accounting standards

Solution: (b)

18. Which of the following CAATs allow fictitious transactions planted by the auditor to be processed along with real ones on client's system?

- (a) Integrated test facility
- (b) Test data approach
- (c) Generalized audit software
- (d) Parallel simulation

Solution: (a)

19. First auditor or auditors of a multi-state co-operative society shall be appointed by

- (a) Registrar
- (b) Board
- (c) Members
- (d) Central government

Solution: (b)

20. SQC 1 requires firms to establish policies and procedures for the retention of

- (a) Audit file
- (b) Engagement documentation
- (c) Final Audit file
- (d) Audit Documentation

Solution: (b)

21. Mano Ltd. Conducts quarterly review of operations. It discovers that unrest in a Middle East company may affect the supply of raw materials to it the next quarter. This is an example of :

- (a) Risk assessment
- (b) Control procedure
- (c) Supervision
- (d) control environment

Solution: (a)

22. The Opinion section of the auditor's report shall:

- (a) Identify the entity whose financial statements have been audited;
- (b) State that the financial statements have been audited;
- (c) Identify the title of each statement comprising the financial statements;
- (d) All of the above

Solution: (d)

23. SA 220 sets out the ___ responsibilities with respect to relevant ethical requirements.

- (a) Firm's
- (b) Senior audit assistant
- (c) engagement partner's
- (d) all of the above

Solution: (c)

24. If board fails to appoint first auditor, then member shall appoint within..... days at EGM

- (a) 30
- (b) 60
- (c) 18
- (d) 90

Solution: (d)

25. Audit programme is prepared by

- (a) The auditor
- (b) The client
- (c) The audit assistants.
- (d) The auditor and his audit assistants.

Solution: (d)

26. The auditor should examine subsequent realization of revenue such as dividends, interest, commission, etc to
- (a) Identify cases of unrecorded revenue.
 - (b) Ensure proper disclosure in the balance sheet.
 - (c) Recompute accrual income on the date of balance sheet.
 - (d) Any of the above

Solution: (a)

27. Where the amount involved in fraud is of RS. 1 crore or above then, the auditor shall report to the government
- (a) Within 45 Days
 - (b) Within 60 Days
 - (c) Within 15 days
 - (d) Within 75 days

Solution: (b)

28. What is the primary objective of analytical procedures used in the overall review stage of an audit ?
- (a) To help to corroborate the conclusions drawn from individual components of financial statements.
 - (b) To reduce specific detection risk.
 - (c) To direct attention to potential risk areas.
 - (d) To satisfy doubt when questions arise about a client's ability to continue.

Solution: (a)

29. The auditor shall determine a sample size sufficient to reduce sampling risk to.....

- (a) An acceptable level.
- (b) An acceptably low level
- (c) Reasonable level.
- (d) Zero

Solution: (b)

30. Misappropriation of assets may occur because there is-

- (a) Adequate record keeping with respect to assets.
- (b) Known history of violations of securities laws.
- (c) Lack of complete and timely reconciliations of assets.
- (d) Dispute between shareholders in a closely held entity.

Solution: (c)



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Part - II

Question 1 is compulsory.

Answer any four from remaining five questions.

Question 1.

Examine with reasons whether the following statements are correct or incorrect. (Answer any **seven** out of eight)

- (a) Where the firm is appointed as an auditor of the entity the audit report is signed only in the name of audit firm.
- (b) According to Section 140(1), the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a general resolution of the company.
- (c) Judgemental matters are transactions that are unusual due to either its size or nature and that therefore occur infrequently.
- (d) Government audit does not serve as a mechanism or process for public accounting of government funds.
- (e) Management of the organization is solely responsible for the compliance of auditing standards while preparing financial statements.
- (f) Few members of the Board of Directors oppose the appointment of Mr. N, an employee of the company, as an Internal Auditor, stating that Mr. N is not a chartered accountant and further he is an employee of the company.
- (g) An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 180 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.
- (h) Risk assessment procedures are not performed to obtain an understanding of the entity and its environment.

(7 × 2 Marks each = 14 Marks)

Solution:

- (a) **Incorrect:** Where the firm is appointed as the auditor, the report is signed in the personal name of the auditor and in the name of the audit firm. The partner/proprietor signing the audit report also needs to mention the membership number assigned by the Institute of Chartered Accountants of India along-with registration number for the firm.
- (b) **Incorrect-** According to Section 140(1), the auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the previous approval of the Central Government in that behalf as per Rule 7 of CAAR, 2014.
- (c) **Incorrect:** Significant risks often relate to significant non-routine transactions or judgemental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgemental matters may include the development of accounting estimates

for which there is significant measurement uncertainty. Thus judgemental matters are not always unusual due to their size or nature.

- (d) Incorrect:** Government audit serves as a mechanism or process for public accounting of government funds. It also provides public accounting of the operational, management, programme and policy aspects of public administration as well as accountability of the officials administering them.
- (e) Incorrect:** As per Section 143(9) of the Companies Act, 2013, every auditor shall comply with the auditing standards.
- (f) Incorrect:** As per section 138, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in practice or not), or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies. The internal auditor may or may not be an employee of the company.
- (g) Incorrect:** An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as 'out of order'.
- (h) Incorrect:** Risk assessment procedures refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.

Question 2.

- (A)** "The utility of the audit programme can be retained and enhanced only by keeping the programme and also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed". Discuss stating clearly the advantages of an audit programme.

(5 Marks)

Solution:

The advantages of an audit programme are:

- (i) It provides the assistant carrying out the audit with total and clear set of instructions of the work generally to be done.
- (ii) It is essential, particularly for major audits, to provide a total perspective of the work to be performed.
- (iii) Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.
- (iv) Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, the danger is significantly less and the audit can proceed systematically.
- (v) The assistants, by putting their signature on programme, accept the responsibility for the work carried out by them individually and, if necessary, the work done may be traced back to the assistant.

- (vi) The principal can control the progress of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
- (vii) It serves as a guide for audits to be carried out in the succeeding year.
- (viii) A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of professional auditor.

(B) As per SA 220, “Quality Control for an Audit of Financial Statements” the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. Explain

(4 Marks)

Solution:

Information which assist the Auditor in accepting and continuing of relationship with Client: As per SA 220, “Quality Control for an Audit of Financial Statements” the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. The following information would assist the auditor in accepting and continuing of relationship with the client:

- (i) The integrity of the principal owners, key management and those charged with governance of the entity;
- (ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
- (iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and
- (iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

(C) Explain the meaning of automated environment. Also discuss the key features of an automated environment.

(5 Marks)

Solution:

An automated environment basically refers to a business environment where the processes, operations, accounting and even decisions are carried out by using computer systems – also known as Information Systems (IS) or Information Technology (IT) systems. Nowadays, it is very common to see computer systems being used in almost every type of business. For example, think about how banking transactions are carried out using ATMs (Automated Teller Machines), or how tickets can be purchased using “apps” on mobile phones, etc. In these examples, you can see how these computer systems enable us to transact business at any time and any day.

Some of the key features of an automated environment are as follows:

- Enables faster business operations
- Accuracy in data processing and computation
- Ability to process large volumes of transactions
- Integration between business operations
- Better security and controls
- Less prone to human errors
- Provides latest information
- Connectivity and networking capability

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. For example, if a company uses an integrated enterprise resource planning system (ERP) viz., SAP, Oracle etc., then it is considered more complex to audit. On the other hand, if a company is using an off-the-shelf accounting software, then it is likely to be less automated and hence less complex environment.

Similarly, there are several other aspects that an auditor should consider to determine the level of automation and complexity of a business environment which we will look at in the following sections.

Question 3.

(A) Ram and Hanuman Associates, Chartered Accountants in practice have been appointed as Statutory Auditor of Krishna Ltd. for the accounting year 2017-2018. Mr. Hanuman holds 100 equity shares of Shiva Ltd., a subsidiary company of Krishna Ltd. Comment.

(5 Marks)

Solution:

Auditor Holding Securities of a Company: As per sub-section (3) (d) (i) of Section 141 of the Companies Act, 2013 read with Rule 10 of the Companies (Audit and Auditors) Rule, 2014, a person shall not be eligible for appointment as an auditor of a company, 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. However, the relative may hold security or interest in the company of face value not exceeding ₹ 1 lakh.

Also, as per sub-section 4 of Section 141 of the Companies Act, 2013, 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.

In the present case, Mr. Hanuman, Chartered Accountant, a partner of M/s Ram and Hanuman Associates, holds 100 equity shares of Shiva Ltd. which is a subsidiary of Krishna Ltd. Therefore, the firm, M/s Ram and Hanuman Associates would be disqualified to be appointed as statutory auditor of Krishna Ltd., which is the holding company of Shiva Ltd., because one of the partners Mr. Hanuman is holding equity shares of its subsidiary.

(B) “Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability”. Explain. Also state clearly generalisations about the reliability of audit evidence.

(5 Marks)

Solution:

Reliability of Audit Evidence: SA 500 on “Audit Evidence” provides that the reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalisations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the entity, circumstances may exist that could affect its reliability. For example, information obtained from an independent external source may not be reliable if the source is not knowledgeable, or a management’s expert may lack objectivity. While recognising that exceptions may exist, the following generalisations about the reliability of audit evidence may be useful:

- (1) The reliability of audit evidence is increased when it is obtained from independent sources outside the entity.
- (2) The reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, imposed by the entity are effective.

- (3) Audit evidence obtained directly by the auditor (for example, observation of the application of a control) is more reliable than audit evidence obtained indirectly or by inference (for example, inquiry about the application of a control).
- (4) Audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally (for example, a contemporaneously written record of a meeting is more reliable than a subsequent oral representation of the matters discussed).
- (5) Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies or facsimiles, or documents that have been filmed, digitized or otherwise transformed into electronic form, the reliability of which may depend on the controls over their preparation and maintenance.

(C) The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen.

Explain stating the examples of factors (any four) that the auditor may consider when determining the sample size for tests of controls.

(4 Marks)

Solution:

The level of sampling risk that the auditor is willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

The sample size can be determined by the application of a statistically-based formula or through the exercise of professional judgment. When circumstances are similar, the effect on sample size of factors will be similar regardless of whether a statistical or non-statistical approach is chosen.

Examples of Factors Influencing Sample Size for Tests of Controls: The following are factors that the auditor may consider when determining the sample size for tests of controls. These factors, which need to be considered together, assume the auditor does not modify the nature or timing of tests of controls or otherwise modify the approach to substantive procedures in response to assessed risks.

- When there is an increase in the extent to which the auditor's risk assessment takes into account relevant controls. The more assurance the auditor intends to obtain from the operating effectiveness of controls, the lower the auditor's assessment of the risk of material misstatement will be, and the larger the sample size will need to be. When the auditor's assessment of the risk of material misstatement at the assertion level includes an expectation of the operating effectiveness of controls, the auditor is required to perform tests of controls.
Other things being equal, the greater the reliance the auditor places on the operating effectiveness of controls in the risk assessment, the greater is the extent of the auditor's tests of controls (and therefore, the sample size is increased). Thus, sample size will increase.
- If there is an increase in the tolerable rate of deviation. Then sample size will decrease, as lower the tolerable rate of deviation, larger the sample size needs to be.
- When there is an increase in the expected rate of deviation of the population to be tested then sample size will increase, as higher the expected rate of deviation, larger the sample size needs to be so that the auditor is in a position to make a reasonable estimate of the actual rate of deviation. Factors relevant to the auditor's consideration of the expected rate of deviation include the auditor's understanding of the business (in particular, risk assessment procedures undertaken to obtain an understanding of internal control), changes in personnel or in internal control, the results of audit procedures applied in prior periods and the results of other audit procedures. High expected control deviation rates ordinarily warrant little, if any, reduction of the assessed risk of material misstatement.

- An increase in the auditor's desired level of assurance that the tolerable rate of deviation is not exceeded by the actual rate of deviation in the population will increase the sample size. Thus, the greater the level of assurance that the auditor desires that the results of the sample are in fact indicative of the actual incidence of deviation in the population, the larger the sample size needs to be.
- In case of large populations, the actual size of the population has little, if any, effect on sample size. For small populations however, audit sampling may not be as efficient as alternative means of obtaining sufficient appropriate audit evidence. Therefore, there will be negligible effect on sample size due to increase in the number of sampling units in the population.

Question 4.

(A) IT poses specific risks to an entity's internal control. Explain

(4 Marks)

Solution:

IT also poses specific risks to an entity's internal control, including, for example:

- Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both.
- Unauthorised access to data that may result in destruction of data or improper changes to data, including the recording of unauthorised or non-existent transactions, or inaccurate recording of transactions. Particular risks may arise where multiple users access a common database.
- The possibility of IT personnel gaining access privileges beyond those necessary to perform their assigned duties thereby breaking down segregation of duties.
- Unauthorised changes to data in master files.
- Unauthorised changes to systems or programs.
- Failure to make necessary changes to systems or programs.
- Inappropriate manual intervention.
- Potential loss of data or inability to access data as required.



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(B) Define Emphasis of Matter paragraph. When the auditor shall include an Emphasis of Matter paragraph in the auditor's report? Also explain how the auditor would include an Emphasis of Matter in the auditor's report?

(5 Marks)

Solution:

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.

(C) 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).

Explain stating the techniques available as substantive analytical procedures.

(5 Marks)

Solution:

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).

Question 5.

(A) The auditor should examine the efficacy of various internal controls over advances in case of Banks to determine the nature, timing and extent of his substantive procedures. Explain what is included in the internal controls over advances.

(5 Marks)

Solution:

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.

(B) There are many ways for cash defalcation, one of which is by suppressing cash receipts. List out few techniques of how the receipts are suppressed.

(4 Marks)

Solution:

By suppressing cash receipts:

Few techniques of how receipts are suppressed are:

- (1) Teeming and Lading: Amount received from a customer being misappropriated; also to prevent its detection the money received from another customer subsequently being credited to the account of the customer who has paid earlier. Similarly, moneys received from the customer who has paid thereafter being credited to the account of the second customer and such a practice is continued so that no one account is outstanding for payment for any length of time, which may lead the management to either send out a statement of account to him or communicate with him.
- (2) Adjusting unauthorised or fictitious rebates, allowances, discounts, etc. to customer' accounts and misappropriating amount paid by them.
- (3) Writing off as debts in respect of such balances against which cash has already been received but has been misappropriated.
- (4) Not accounting for cash sales fully.
- (5) Not accounting for miscellaneous receipts, e.g., sale of scrap, quarters allotted to the employees, etc.
- (6) Writing down asset values in entirety, selling them subsequently and misappropriating the proceeds.

(C) ABC Ltd. has issued shares for cash at a premium of Rs 450, that is, at amount in excess of the nominal value of the shares which is Rs 10 for cash. Section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account. Advise the means in which the amount in the account can be applied.

(5 Marks)

Solution:

Shares Issued at Premium: In case a company has issued shares at a premium, that is, at amount in excess of the nominal value of the shares, whether for cash or otherwise, section 52 of the Companies Act, 2013 provides that a Company shall transfer the amount received by it as securities premium to securities premium account and state the means in which the amount in the account can be applied. As per the section, where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a "securities premium account" and the provisions of this Act relating to reduction of share capital of a company shall apply as if the securities premium account were the paid-up share capital of the company.

Application of securities premium account: The securities premium account may be applied by the Company:

- (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- (b) in writing off the preliminary expenses of the Company;
- (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- (e) for the purchase of its own shares or other securities under section 68.

The auditor needs to verify whether the premium received on shares, if any, has been transferred to a “securities premium account” and whether the application of any amount out of the said “securities premium account” is only for the purposes mentioned above.

Question 6.

(A) Discuss the matters which should be specially considered in the audit of accounts of a partnership.

(5 Marks)

Solution:

Matters which should be specially considered in the audit of accounts of a partnership:

1. Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.
2. Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans; purchase of assets, extraordinary contracts entered into and other such matters as are not of a routine nature.
3. Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.
4. Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.
5. Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreements.
6. Confirming that a provision for the firm’s tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners.
7. Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

(B) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor’s report. Discuss

(5 Marks)

Solution:

The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor’s report. SQC 1 “Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services”, requires firms to establish policies and procedures for the timely completion of the assembly of audit files. An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor’s report.

The completion of the assembly of the final audit file after the date of the auditor’s report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions. Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature.

Examples of such changes include:

- Deleting or discarding superseded documentation.
- Sorting, collating and cross referencing working papers.
- Signing off on completion checklists relating to the file assembly process.
- Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.

After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.

SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

(C) Under what circumstances the retiring Auditor cannot be reappointed?

(4 Marks)

Solution:

Circumstances where Retiring Auditor cannot be reappointed: In the following circumstances, the retiring auditor cannot be reappointed-

1. A specific resolution has not been passed to reappoint the retiring auditor.
2. The auditor proposed to be reappointed does not possess the qualification prescribed under section 141 of the Companies Act, 2013.
3. The proposed auditor suffers from the disqualifications under section 141(3), 141(4) and 144 of the Companies Act, 2013.
4. He has given to the company notice in writing of his unwillingness to be reappointed.
5. A resolution has been passed in AGM appointing somebody else or providing expressly that the retiring auditor shall not be reappointed.
6. A written certificate has not been obtained from the proposed auditor to the effect that the appointment or reappointment, if made, will be in accordance within the limits specified under section 141(3) (g) of the Companies Act, 2013.



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