

MOCK TEST PAPER 1
INTERMEDIATE: GROUP – II
PAPER – 6: AUDITING AND ASSURANCE
SUGGESTED ANSWERS / HINTS
Division A-Multiple Choice Questions

Case Scenario 1

Question No.	Answer
(1)	(c) Completion Memorandum
(2)	(b) Inherent Risk
(3)	(c) Both 1 & 2 are correct
(4)	(b) Risk Assessment Procedures
(5)	(b) Only Statement 2 is correct

Case Scenario 2

Question No.	Answer
(1)	(c) Both Statement 1 & 2 are correct
(2)	(b) (i), (ii) & (iii) are correct
(3)	(b) If there is disagreement
(4)	(c) Both Statement 1 & 2 are correct
(5)	(c) (i), (ii) & (iii) are correct

General MCQ's

- (1) (a)
- (2) (d)
- (3) (d)
- (4) (d)
- (5) (a)
- (6) (a)
- (7) (c)
- (8) (c)
- (9) (d)
- (10) (c)

Division B -Descriptive Answers

1. (i) **Incorrect:** Self-interest threat is the threat which occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Further, Advocacy threat is the threat which 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.

- (ii) **Incorrect.** 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. According to 'Audit of sanctions', the auditor has to ensure that each item of expenditure is covered by a sanction, either general or special, of the competent authority.
 - (iii) **Incorrect:** Understanding the Internal Control of a company will help in developing an Audit Programme because it will assist the auditor and his team to understand as to how much they can rely on internal control of the company and what audit procedures would be appropriate to be used during the course of audit.
 - (iv) **Incorrect:** Assertions refer to representations by management that are embodied in the financial statements as used by the auditor to consider the different types of the potential misstatements that may occur.
 - (v) **Correct:** Sampling risk arises from possibility that the auditor's conclusion based upon sample may be different from conclusion that would have been reached if same audit procedures were applied on the entire population. If acceptable sampling risk is low, large sample size is needed.
 - (vi) **Correct:** As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
 - (vii) **Incorrect:** Check list is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. Narrative record is a complete and exhaustive description of the system as found in operation by the auditor.
 - (viii) **Incorrect.** Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begin shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures
2. (a) The firm should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with professional standards and regulatory and legal requirements, and that the firm or the engagement partner issues reports that are appropriate in the circumstances.

Through its policies and procedures, the firm seeks to establish consistency in the quality of engagement performance. This is often accomplished through written or electronic manuals, software tools or other forms of standardized documentation, and industry or subject matter-specific guidance materials. Matters addressed include the following:

- ◆ How engagement teams are briefed on the engagement to obtain an understanding of the objectives of their work.
- ◆ Processes for complying with applicable engagement standards.
- ◆ Processes of engagement supervision, staff training and coaching.
- ◆ Methods of reviewing the work performed, the significant judgments made and the form of report being issued.
- ◆ Appropriate documentation of the work performed and of the timing and extent of the review.
- ◆ Processes to keep all policies and procedures current.

- (b) Planning an audit involves establishing the overall audit strategy for the engagement and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including the following:
 - (a) Helping the auditor to devote appropriate attention to important areas of the audit.
 - (b) Helping the auditor identify and resolve potential problems on a timely basis.
 - (c) Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
 - (d) Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
 - (e) Facilitating the direction and supervision of engagement team members and the review of their work.
 - (f) Assisting, where applicable, in coordination of work done by auditors of components and experts.
 - (c) **Division of Internal Control into Components:** The division of internal control into the following five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit:
 - (i) The control environment;
 - (ii) The entity's risk assessment process;
 - (iii) Monitoring of controls.
 - (iv) Control activities; and
 - (v) The information system, including the related business processes, relevant to financial reporting, and communication.
 - (d) (i) **General (IT) Controls:** Are a type of internal controls that help in mitigating risks that arise due to use of information technology and information systems in a business.
 - (ii) **Material Weakness:** A control deficiency or a combination of deficiencies in internal controls that is important enough to merit the attention of those charged with governance since there is a reasonable possibility that a material misstatement will not be prevented or detected in a timely manner by management.
 - (iii) **Data processing:** Refers to the systematic recording, storage, retrieval, modification and transformation of electronic data using information systems.
3. (a) **Control risk assessment when control deficiencies are identified:** When auditor identifies deficiencies and report on internal controls, he determines the significant financial statement assertions that are affected by the ineffective controls in order to evaluate the effect on control risk assessments and strategy for the audit of the financial statements.

When control deficiencies are identified and auditor identifies and tests more than one control for each relevant assertion, he evaluates control risk considering all of the controls he has tested. If auditor determines that they support a 'rely on controls' risk assessment, or if compensating controls are identified, tested and evaluated to be effective, he may conclude that the 'rely on controls' is still appropriate. Otherwise we change our control risk assessment to 'not rely on controls.'

When a deficiency relates to an ineffective control that is the only control identified for an assertion, he revises risk assessment to 'not rely on controls' for associated assertions, as no other controls

have been identified that mitigate the risk related to the assertion. If the deficiency relates to one WCGW (what can go wrong) out of several WCGW's, he can 'rely on controls' but performs additional substantive procedures to adequately address the risks related to the deficiency.

- (b) **Right to report to the members of the company on the accounts examined by him** – The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under this section and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company' s affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.
- (c) When risks in IT systems are not mitigated the audit impact could be as follows:
- (i) The auditor may not be able rely on the reports, data obtained, automated controls, calculations and accounting procedures in the IT system.
 - (ii) The auditor has to perform additional audit work by spending more time and efforts.
 - (iii) The auditor may have to issue a modified opinion, if necessary.
- (d) Audit committee performs wide functions. The recommendation for appointment of auditors is only one of the several functions performed by audit committee. Under section 177 of companies Act, 2013, audit committee is responsible for following actions :-
- (i) the recommendation for appointment, remuneration and terms of appointment of auditors of the company;]
 - (ii) review and monitor the auditor's independence and performance, and effectiveness of audit process;
 - (iii) examination of the financial statement and the auditors' report thereon;
 - (iv) approval or any subsequent modification of transactions of the company with related parties;
 - (v) scrutiny of inter-corporate loans and investments;
 - (vi) valuation of undertakings or assets of the company, wherever it is necessary;
 - (vii) evaluation of internal financial controls and risk management systems;
 - (viii) monitoring the end use of funds raised through public offers and related matters.

Hence, audit committee oversees range of matters including those related to making recommendation for appointment of auditors etc.

4. (a) Matters to be included as per CARO, 2020 :

Undisputed and Disputed Statutory dues

Clause (vii)

- (a) whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

- (b) where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute).

Internal audit system

Clause (xiv)

- (a) whether the company has an internal audit system commensurate with the size and nature of its business;
- (b) whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor.
- (b) The following are the required disclosures for cash & Cash equivalents to be made by the company as per Schedule III (Part I) to Companies Act, 2013:

Cash and cash equivalents

- (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.
- (c) The following is the disclosure requirement for Studymate Limited with respect to the ageing schedule of the trade receivables in terms of Schedule III (Part I) to the Companies Act, 2013

Trade Receivables ageing schedule

Particulars	(Amount in ₹)					Total
	Outstanding for following periods from due date of payment#	Less than 6 months	6 months-1 year	1-2 years	2-3 years	
(i) Undisputed Trade receivables – considered good						
(ii) Undisputed Trade Receivables – considered doubtful						

(iii) Disputed Trade Receivables considered good						
(iv) Disputed Trade Receivables considered doubtful						

similar information shall be given where no due date of payment is specified, in that case disclosure shall be from the date of the transaction.

Unbilled dues shall be disclosed separately.

5. (a) If management of Deluxe Ltd. does not provide one or more of the requested written representations, CA Akash should:

- (a) Discuss the matter with management;
- (b) Re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and
- (c) Take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705.

(b) **Specific Evaluations by the auditor:** In particular, the auditor shall evaluate whether :

- (i) The financial statements adequately disclose the significant accounting policies selected and applied;
- (ii) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;
- (iii) The accounting estimates made by management are reasonable;
- (iv) The information presented in the financial statements is relevant, reliable, comparable, and understandable;
- (v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and
- (vi) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

(c) (i) **Inventories**

The inventories in any hotel are both readily portable and saleable particularly the food and beverage inventories. It is therefore extremely important that all movements and transfers of such inventories should be properly documented to enable control to be exercised over each individual stores areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed.

Areas where large quantities of inventory are held should be kept locked, the key being retained by the departmental manager. The key should be released only to trusted personnel and unauthorised persons should not be permitted in the stores areas except under constant supervision. In particular, any movement of goods in or out of the stores should be checked. Many hotels use specialised professional valuers to take and value the inventories on a continuous basis throughout the year. Such a valuation is then almost invariably used as the basis of the balance sheet inventory figure at the year end. Although such valuers are independent of the audit client, it is important that the auditor satisfies himself that the amounts included for such inventories are reasonable. In order to satisfy himself of this, the

auditor should consider attending the physical inventory taking and carrying out certain pricing and calculation tests. The extent of such tests could well be limited since the figures will have been prepared independently of the hotel.

(ii) Travel agents & shops:

- (i) For ledgers coming through travel agents or other booking agencies the bills are usually made on the travel agents or booking agencies. The auditor should ensure that money are recovered from the travel agents or booking agencies as per the terms of credit allowed.
- (ii) Commission, if any, paid to travel agents or booking agents should be checked by reference to the agreement on that behalf.

6. (a) Government Guaranteed advances:

- Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets, but regarded as NPA for Income Recognition purpose.
- The situation would be different if the advance is guaranteed by State Government, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

Advances to Staff

Interest-bearing staff advances as a banker should be included as part of advances portfolio of the bank. In the case of housing loan or similar advances granted to staff members where interest is payable after recovery of principal, interest need not be considered as overdue from the first quarter onwards. Such loans/advances should be classified as NPA only when there is a default in repayment of installment of principal or payment of interest on the respective due dates. The staff advances by a bank as an employer and not as a banker are required to be included under the sub-head 'Others' under the schedule of Other Assets.

- (b) Pledge:** A pledge involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance. The legal ownership of the goods remains with the pledger while the lending banker gets certain defined interests in the goods. The pledge of goods constitutes a specific (or fixed) charge.

Set-off: Set-off is a statutory right of a creditor to adjust, wholly or partly, the debit balance in the debtor's account against any credit balance lying in another account of the debtor. The right of set-off enables a bank to combine two accounts (a deposit account and a loan account) of the same person provided both the accounts are in the same name and same right (i.e., the capacity of the account holder in both the accounts should be the same).

For the purpose of set-off, all the branches of a bank are treated as one single entity. The right of set-off can be exercised in respect of time-barred debts also.

(c) The points which merit consideration in the audit of a CLUB w.r.t its members:

- (1) Entrance Fee:** Vouch the receipt on account of **entrance fees** with –
 - members' applications and counterfoils issued to them,
 - on a reference to minutes of the Managing Committee.
- (2) Member Subscriptions:** Vouch members' subscriptions with –
 - the counterfoils of receipt issued to them,

- trace receipts for a selected period to the Register of Members;
 - also reconcile the amount of total subscriptions due with the amount collected and that outstanding.
- (3) **Subscription Arrears/in Advance:** Ensure that –
- **arrears** of subscriptions for the previous year have been correctly brought over,
 - **arrears** for the year under audit and subscriptions received in advance have been correctly adjusted.
 - Subscriptions received in advance should have been properly accounted for.
- (4) **Arithmetical accuracy:** Check totals of various columns of the Register of members and tally them across.
- (5) **Register of Members:** See the **Register of Members** to ascertain –
- the Member's dues which are in arrear and
 - enquire whether necessary steps have been taken for their recovery;
 - the amount considered irrecoverable should be mentioned in the Audit Report.
- (6) **Member Accounts :-** Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.

(d) While verifying the legal and professional expenses of the client company, the auditor should perform the following audit procedures

- Obtain a month-wise and consultant-wise summary.
- In case of monthly retainership agreements, verify whether the expenditure for all 12 months has been recorded correctly.
- For non- recurring expenses, select a sample and vouch for the attributes discussed above.
- The auditor should be cautious while vouching for legal expenses as the same may highlight a dispute for which the entity may not have made any provision and the matter may also not have been discussed/ highlighted to the auditor for his specific consideration.

(e) a) Completeness

b) Measurement

c) Cut Off