

MOCK TEST PAPER
INTERMEDIATE (NEW) GROUP – II
PAPER – 6: AUDITING AND ASSURANCE

Time Allowed – 3 Hours

Maximum Marks – 100

Division A- Multiple Choice Questions

Case Scenario 1 carries 10 Marks

Case Scenario 2 carries 10 Marks

Total 30 Marks

General MCQs carry 2 Marks each

Case Scenario 1

Integrated case study

Mr. Laxman is appointed as statutory auditor of Best Limited for the Financial Year ended 31st March, 2020. During the course of audit, it was found that few doubtful transactions had been committed by finance manager who retired in March, 2020.

The fraud was going on since last 4-5 years and the total amount misappropriated is approximately ₹ 75 lacs. Balance sheet of Best Ltd. reflected a cash balance of ₹ 7 crores. The company has taken a loan of ₹ 2 crores from the bank despite of the huge cash balance with the company.

Also, Companies Act bestows some duties on auditors to report matters to Central Government in case of fraud.

On the basis of above facts answer below questions in relation to Mr. Laxman's role and duties while conducting statutory audit of Best Limited.

1. Mr. Laxman shall obtain _____ that the financial statements are free from fraud and misstatement.
 - (a) Absolute assurance
 - (b) Reasonable assurance
 - (c) Management's assurance
 - (d) Chief Financial Officer assurance
2. Mr. Laxman suspects that cash payments were inflated. Out of the below which could be probable reason for such inflated cash payments.
 - (a) Not accounting for cash sales completely
 - (b) Making payments against purchase vouchers
 - (c) Making payments against inflated vouchers
 - (d) Teeming and Lading
3. As per Section 143 (12) of Companies Act, 2013 & Rule 13 of CAAR, 2014; Mr. Laxman shall
 - (a) report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as prescribed.

- (b) report the matter to the audit committee constituted under section 177 within such time and in such manner as prescribed.
 - (c) report the matter to the audit committee constituted under section 177 and also to the Board within such time and in such manner as prescribed.
 - (d) report the matter to the Board within such time and in such manner as prescribed.
4. Owing to the _____ limitations of an audit, there is _____ risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.
- (a) Inherent, unavoidable
 - (b) Inherent, complete
 - (c) Management, unavoidable
 - (d) Regulatory, control
5. As an auditor what conclusion can Mr Laxman draw looking at the huge cash reserve of the company and corresponding bank loan?
- (a) Report this matter to the Central Government u/s 143(12) as there is a possibility of fraud
 - (b) Obtain sufficient and appropriate audit evidence of existence of fraud
 - (c) Report the matter under CARO, 2020
 - (d) There is nothing to report as it's a normal financial decision. **(5 x 2 = 10 Marks)**

Case Scenario 2

Roop & Co. are the auditors of Onda group of Hotels. This is the first time the firm is auditing an industry in food and beverages and it is day one of the audit. The engagement partner along with his team wants to make a thorough understanding of the entity and its environment in order to identify and assess the risks of material misstatements, whether due to fraud or error. The following are some of the points identified by them on Day 1.

1. The hotel has two banquet halls. The documentation available for verification of banquet hall revenue is only the invoice raised by the hotel and some mail conversations on customer enquiry and finalization of price. In audit trail, it is found that finance approval of the transaction is only after invoice is sent to them for accounting at final settlement. Advance paid by the clients are not vetted through finance team. The auditor suspects a weakness in this system.
2. The auditor also finds a control deficiency in the process of procurement of stores. A goods receipt note is not prepared at the time of receipt of goods. On enquiry with management, the auditor finds that there exists a system control wherein goods receipt note is automatically prepared and approved in the system once the quantity and price of goods is entered against specific vendor. This entry is on real-time basis and system does not allow back dated entries.
3. The auditor enquires of the management as to what is risk assessment process followed by the entity for prevention and detection of risk of material misstatement due to fraud and error. The auditor finds there is no documented risk assessment process.

With the help of the above facts, answer the following questions by choosing the correct option.

Questions:

1. What kind of a risk is portrayed in the booking of revenue with respect to Banquet halls?
 - (a) Inherent risk in the class of transaction

- (b) Control risk in the class of transaction
 - (c) Detection risk in the audit procedures
 - (d) Audit risk in the opinion on the financial statements.
2. Which among the following statement is **incorrect** in the context of Audit Risk?
- (a) The more extensive the audit procedures performed, the lower is the detection risk
 - (b) Greater the risk of material misstatement the auditor believes exist, less is the detection risk that can be accepted and accordingly more persuasive evidence is required by the auditor.
 - (c) Audit risk means the risk that the auditor gives an appropriate audit opinion when the financial statement are materially misstated.
 - (d) Risk of material misstatement at the assertion level is of two kinds – control risk and inherent risk.
3. In the case of procurement of stores, the auditor has tested more than one control for the same assertion. In that given case, what should be his reliance on the control?
- (a) Since compensating controls are identified, if tested and evaluated to be effective, the auditor can rely on the control.
 - (b) Even though compensating controls are there, since one control is ineffective, the auditor should not rely on control for this assertion and should perform extensive procedures.
 - (c) Documentation in electronic medium cannot be accepted, hence, he cannot rely only on system control.
 - (d) Even though compensating controls are there, since one control is ineffective, the auditor should not rely on control for this assertion as well as associated assertions.
4. In the context of SA 315, which among the following is **NOT** a risk assessment procedure?
- (a) Inquiries of management, of appropriate individuals within internal audit function and of others within the entity
 - (b) Analytical Procedures
 - (c) Observation and Inspection
 - (d) Audit Planning.
5. What should be the course of action of the auditor for the entity not having a documented risk assessment process?
- (a) The auditor should obtain management written representations on how risks are identified
 - (b) The auditor shall discuss with management on how risks are identified, addressed and determine whether the absence is appropriate in the circumstances or whether it represents a significant deficiency in internal control.
 - (c) The auditor should advise the management to document the same immediately and accordingly opine on the same in his audit report too.
 - (d) The auditor shall discuss with management on how risks are identified by system and place reliance on the same as documentation in this context is immaterial. **(5 x 2 = 10 Marks)**

General MCQs

1. Which of the following is not an example of an event or condition that may cast significant doubt on entity's ability to continue as a going concern:
- (a) Loss of key management without replacement
 - (b) Adverse key financial ratios

- (c) Inability to pay creditors on due date
 - (d) Current year profit turns to loss after providing depreciation
2. Which of the following is not correct:
- (a) SA 700- Forming an Opinion and Reporting on Financial Statements
 - (b) SA 705- Modified Opinion
 - (c) SA 701- Communicating Key Audit Matters
 - (d) SA 706-Comparative Information
3. A Ltd. has been assigned a Cash Credit limit of INR 20 lacs as against its Book Debts furnished as security. What kind of Security creation is it?
- (a) Pledge
 - (b) Mortgage
 - (c) Assignment
 - (d) Set-off
4.is a possible obligation that arises from the past events and whose existence will be confirmed only by the occurrence/ non occurrence of one or more uncertain future events not wholly within the control of the entity:-
- (a) Provisions
 - (b) Reserves
 - (c) Contingent Liabilities
 - (d) Liability
5. The concept of materiality is applied by the auditor :
- (a) in planning and performing the audit
 - (b) in evaluating the effect of identified misstatements on the audit
 - (c) both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit
 - (d) none of the above is correct
- (5 x 2 = 10 Marks)**

Division B- Descriptive Questions

Question No. 1 is compulsory.

*Attempt any **four** questions from the Rest.*

Total 70 Marks

1. Examine with reasons (in short) whether the following statements are correct or incorrect : (Attempt any 7 out of 8)
- (i) Mr. Z, a team member of auditor of Grateful and Competent Limited was of the opinion that while conducting an audit of a company no distinction is required to be made between revenue expenditure and capital expenditure.
 - (ii) The audit engagement letter is sent by the client to auditor.
 - (iii) A detailed Audit Programme once prepared for a business can be used for all business under all circumstances.

- (iv) Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur.
- (v) One of the directors of Very Fresh Fruits Limited was of the opinion that internal auditor to be appointed must be an employee of Very Fresh Fruits Limited.
- (vi) Audit committee is to be constituted by every public company to ensure better standards of corporate governance.
- (vii) The auditor has to report under section 143 of companies act, 2013 whether company has adequate internal controls in place and overall effectiveness of such internal controls.
- (viii) Tangible assets are depreciated when the asset is actually put to active use. **(7 x 2 = 14 Marks)**
2. Discuss the following:
- (a) There are practical and legal limitations on the auditor's ability to obtain audit evidence.
Explain with the help of examples. **(3 Marks)**
- (b) DEF & Co. Chartered Accountants successfully carried out the audit of Shree Garments for the f.y. 2019-2020. After the completion of the audit, there were found material misstatements due to fraud in the financial statements which were not noticed and reported by the auditor. Management alleges that it is failure on the part of auditor. Comment. **(4 Marks)**
- (c) There are two interlinked perspectives of independence of auditors, one, independence of mind; and two, independence in appearance. Explain. **(4 Marks)**
- (d) "Professional judgment is essential to the proper conduct of an audit." Discuss. **(3 Marks)**
3. (a) The auditor has to make inquires on certain matters under section 143(1) of Companies Act, 2013. Discuss those matters. **(6 Marks)**
- (b) The division of internal control into five components provides a useful framework for auditors to consider how different aspects of an entity's internal control may affect the audit. Mention those components of internal control. **(4 Marks)**
- (c) Your firm has been appointed as an auditor to audit the accounts of an auto parts manufacturer, ABC LTD. Elucidate the matters to be considered by an auditor in developing his overall plan for the expected scope and conduct of audit. **(4 Marks)**
4. (a) Your firm of Chartered Accountants has been appointed as auditor of a Nationalised bank. Explain how will you proceed to carry out audit of provisions and contingencies. **(4 Marks)**
- (b) State clearly the objective of the Auditor as per SA 706. Also define emphasis of matter paragraph and other matter paragraph. **(4 Marks)**
- (c) "ABC & Co." is an Audit Firm having partners "Mr. A", "Mr. B" and "Mr. C", Chartered Accountants. "Mr. A", "Mr. B" and "Mr. C" are holding appointment as an Auditor in 4, 6 and 10 Companies respectively.
- (i) Provide the maximum number of Audits remaining in the name of "ABC & Co."
- (ii) Provide the maximum number of Audits remaining in the name of individual partner i.e. Mr. A, Mr. B and Mr. C.
- (iii) Can ABC & Co. accept the appointment as an auditor in 60 private companies having paid-up share capital less than ₹ 100 crore, 2 small companies and 1 dormant company?
- (iv) Would your answer be different, if out of those 60 private companies, 45 companies are having paid-up share capital of ₹ 110 crore each? **(6 Marks)**

5. (a) Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively. Explain the techniques used to commit fraud by management overriding controls. **(4 Marks)**
- (b) The Comptroller and Auditor General shall be responsible for compiling the accounts of the Union and of each State from the initial and subsidiary accounts rendered to the audit and accounts offices under his control by treasuries, offices or departments responsible for the keeping of such account. Explain. **(4 Marks)**
- (c) Give some examples of circumstances in which it is appropriate to prepare audit documentation relating to the use of professional judgment where the matters and judgments are significant. **(3 Marks)**
- (d) You are an auditor of PQR Ltd. which has spent ₹ 50 lakhs on Research activities of the product during period under audit, Board of Directors want to recognize it as an internally generated intangible assets. Advise and discuss the conditions necessary to be fulfilled to recognize the intangible assets in the financial statements. **(3 Marks)**
6. (a) Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform Fraud investigation.
Explain the other relevant points in the above context i.e. Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform. **(4 Marks)**
- (b) Audit testing done through Statistical sampling 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. Explain and also state advantages of Statistical sampling. **(4 Marks)**

OR

- (c) When the accounts of the branch are audited by a person other than the company's auditor, there is need for a clear understanding of the role of such auditor and the company's auditor in relation to the audit of the accounts of the branch and the audit of the company as a whole. Explain. **(4 Marks)**
- (d) BNP Ltd has reduced its Share Capital to a greater extent in the year for which you are conducting the audit. State how will you proceed for verifying the reduction of Capital. **(6 Marks)**