

**(GI-10, GI-11, VI-2(A) & AI-2(A), DI-1+2 & Drive)**

DATE: 23.03.2024

MAXIMUM MARKS: 100

TIMING: 3¼ Hours

**AUDITING AND ETHICS****DIVISION – A (MULTIPLE CHOICE QUESTIONS)****ANSWER (1 to 5 Carry 2 M Each) & (6 to 15 Carry 1 M Each)****Case Scenario 1 to 5**

- |     |          |              |
|-----|----------|--------------|
| 1.  | Ans. (c) | } {2 M Each} |
| 2.  | Ans. (d) |              |
| 3.  | Ans. (b) |              |
| 4.  | Ans. (d) |              |
| 5.  | Ans. (b) |              |
| 6.  | Ans. (c) | } {1 M Each} |
| 7.  | Ans. (b) |              |
| 8.  | Ans. (c) |              |
| 9.  | Ans. (a) |              |
| 10. | Ans. (a) |              |
| 11. | Ans. (c) |              |
| 12. | Ans. (b) |              |
| 13. | Ans. (b) |              |
| 14. | Ans. (d) |              |
| 15. | Ans. (d) |              |

**ANSWER (16-20) CARRY 2 MARKS EACH**

- |     |          |              |
|-----|----------|--------------|
| 16. | Ans. (a) | } {2 M Each} |
| 17. | Ans. (b) |              |
| 18. | Ans. (c) |              |
| 19. | Ans. (c) |              |
| 20. | Ans. (a) |              |

**DIVISION B-DESCRIPTIVE QUESTIONS****QUESTION NO. 1 IS COMPULSORY****ATTEMPT ANY FOUR QUESTIONS THE REMAINING FIVE QUESTIONS****Answer 1:**

- (i) **Correct:** The concept of materiality is fundamental to the process of accounting. It covers all the stages from recording to classification and presentation. It is very important for the auditor who has constantly to judge whether a particular item is material or not and ensure that a material item is disclosed separately and distinctly.
- (ii) **Incorrect:** The person who is controlling the trade receivables should ensure that proper accounting entries have been passed by crediting respective trade receivables account. The balance of cheque in hand should be disclosed along with the cash and bank balances in the financial statements.
- (iii) **Correct:** Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional. Hence misstatement can arise from error or fraud.

- (iv) **Correct:** In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to derive conclusion only on the respective stratum from where they are drawn and not the whole population .
- (v) **Correct:** Intentional errors are most difficult to detect and auditors generally devote greater attention to this type because out of long and sometimes unfortunate experience, auditors have developed a point of view that, if they direct their procedures of discovering the more difficult intentional errors, they are reasonably certain to locate the more simple and far more common unintentional errors on the way.
- (vi) **Correct:** The auditor shall prepare audit documentation on a timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor’s report is finalised. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.
- (vii) **Correct:** Written representations are requested from those responsible for the preparation and presentation of the financial statements. Those individuals may vary depending on the governance structure of the entity, and relevant law or regulation. However, management (rather than those charged with governance) is often the responsible party.  
Written representations may therefore be requested from the entity’s chief executive officer and chief financial officer, or other equivalent persons in entities that do not use such titles. In some circumstances, however, other parties, such as those charged with governance, are also responsible for the preparation and presentation of the financial statements.
- (viii) **Correct:** The auditor can formulate his entire audit programme only after he has had a satisfactory understanding of the internal control systems and their actual operation. If he does not care to study this aspect, it is very likely that his audit programme may become unwieldy and unnecessarily heavy, and the object of the audit may be altogether lost in the mass of entries and vouchers.

{ 1 Mark for Correct or Incorrect  
 and 1 Mark for Explanation }

**Answer 2:**

- (a) Communication from auditor is important with those charged with governance. An effective two-way communication is important in assisting: -
  - (a) The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor’s independence and objectivity. } {1 M}
  - (b) The auditor in obtaining from those charged with governance information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events; and } {2 M}
  - (c) Those charged with governance in fulfilling their responsibility to oversee the financial reporting process, thereby reducing the risks of material misstatement of the financial statements. } {1 M}

**Answer:**

- (b) To address the issue, the following guiding principles are to be applied: -

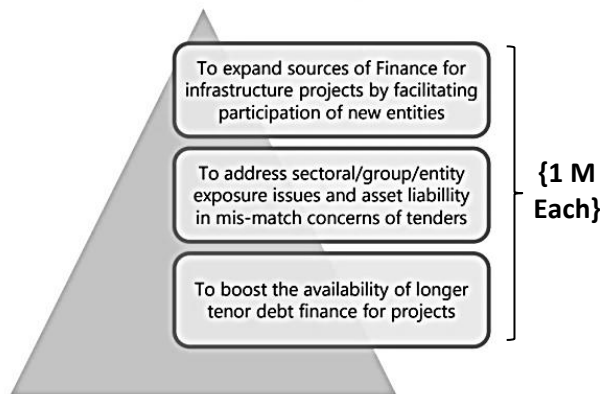
- For the public to have confidence in the quality of audit, it is essential that auditors should always be and appears to be independent of the entities that they are auditing.
- Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.
- When such threats exist, the auditor should either desist from the task or eliminate the threat or at the very least, put in place safeguards which reduce the threats to an acceptable level. All such safeguards measures need to be recorded in a form that can serve as evidence of compliance with due process.
- If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

**{1 M Each}**

**Answer:**

**(c)**

**OBJECTIVE OF TAKEOUT FINANCE**



**Answer:**

**(d)** Manual elements in internal control may be more suitable where judgment and discretion are required such as for the following circumstances:

- Large, unusual or non-recurring transactions.
- Circumstances where errors are difficult to define, anticipate or predict.
- In changing circumstances that require a control response outside the scope of an existing automated control.
- In monitoring the effectiveness of automated controls.

**{1 M Each for Any 3 Points}**

**Answer 3:**

**(a)** Where the company covered under section 135 of the companies act, the following shall be disclosed with regard to CSR activities:-

- (a) amount required to be spent by the company during the year,
- (b) amount of expenditure incurred,
- (c) shortfall at the end of the year,
- (d) total of previous years shortfall,
- (e) reason for shortfall,
- (f) nature of CSR activities,
- (g) details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard,

**{1 M Each for Any 4 Points}**

- (h) where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately.

**Answer:**

(b) The process of audit suffers from certain inbuilt limitations due to which an auditor cannot obtain an absolute assurance that financial statements are free from misstatement due to fraud or error. These fundamental limitations arise due to the following factors: -

(1) **Nature of financial reporting**  
Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors. { 2 M }

(2) **Nature of Audit procedures**  
The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence. For example, an auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence.  
Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence. { 2 M }  
The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. It may be engaged in concealing fraud by designing sophisticated and carefully organized schemes which may be hard to detect by the auditor. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. However, in reality, such documents could be fake or non-genuine.

**Answer:**

(c) For the purpose of identifying and assessing the risks of material misstatement, the auditor shall: -

- (a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements
- (b) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions { 1 M Each for Any 3 Points }
- (c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test and
- (d) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

**Answer:**

(d) The auditor's determination of materiality is a matter of professional judgment, and is affected by the auditor's perception of the financial information needs of users of

the financial statements. In this context, it is reasonable for the auditor to assume that users:

- (a) Have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
- (b) Understand that financial statements are prepared, presented and audited to levels of materiality;
- (c) Recognize the uncertainties inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and
- (d) Make reasonable economic decisions on the basis of the information in the financial statements.

{1 M Each  
for Any 3  
Points}

**Answer 4:**

(a) 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.

- (i) 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.
- (ii) 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. Tolerable error is the maximum error in the population that auditor is ready to accept in a given sample size. Smaller the tolerable error, larger will be the sample size.
- (iii) 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.
- (iv) 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.

{1 M Each  
for Any 4  
Points}

- (v) 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.

**Answer:**

**(b)** The existence of the following relationships may indicate the presence of control or significant influence:

- (i) Direct or indirect equity holdings or other financial interests in the entity.
- (ii) The entity’s holdings of direct or indirect equity or other financial interests in other entities.
- (iii) Being part of those charged with governance or key management (i.e., those members of management who have the authority and responsibility for planning, directing and controlling the activities of the entity).
- (iv) Being a close family member of any person referred to in subparagraph (iii).
- (v) Having a significant business relationship with any person referred to in subparagraph (iii).

**{1 M Each for Any 4 Points}**

**Answer:**

**(c) The auditor should mention**

- (a) Whether the records of the firm appear to be correct & reliable.
- (b) Whether he was able to obtain all information & explanation necessary for his work.
- (c) Whether any restriction was imposed upon him.

**{1 M Each}**

**Answer:**

**(d)** 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.

**{1 M Each}**

**Answer 5:**

**(a)** The ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications. Some of the instances are given under: -

- The entity’s timetable for reporting
- Organization of meetings to discuss of nature, timing and extent of audit work with management
- Discussion with management regarding the expected type and timing of reports to be issued including the auditor’s report
- Discussion with management regarding the expected communications on the status of audit work throughout the engagement.
- Expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed.

**{1 M Each for Any 4 Points}**

**Answer:**

- (b) While the auditor may choose to analyse the monthly trends for expenses like rent, power and fuel, an auditor generally prefers to vouch for other expenses to verify following attributes:
- Whether the expenditure pertained to current period under audit;
  - Whether the expenditure qualified as a revenue and not capital expenditure;
  - Whether the expenditure had a valid supporting documents like travel tickets, insurance policy, third party invoice etc.;
  - Whether the expenditure has been classified under the correct expense head;
  - Whether the expenditure was authorised as per the delegation of authority matrix;
  - Whether the expenditure was in relation to the entity’s business and not a personal expenditure.
- } {1 M Each for Any 4 Points}

**Answer:**

- (c) If the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement:-
- (a) If the auditor has determined that the financial reporting framework to be applied in the preparation of the financial statements is unacceptable or
- (b) If the agreement of management is not obtained on matters relating to understanding of responsibility of management on preparation of financial statements, internal controls for preparation of financial statements, providing access to all information to auditor and unrestricted access to persons within the entity.
- } {1 M}  
} {2 M}

**Answer:**

- (d) The auditor needs to verify that the Sweat Equity Shares issued by the company are of a class of shares already issued and following conditions have been complied with (as per Section 54):
- (a) the issue is authorized by a special resolution passed by the company;
- (b) the resolution specifies the number of shares, the current market price, consideration, if any, and the class or classes of directors or employees to whom such equity shares are to be issued;
- (c) omitted
- (d) where the equity shares of the company are listed on a recognised stock exchange, the sweat equity shares are issued in accordance with the regulations made by the Securities and Exchange Board in this behalf and if they are not so listed, the sweat equity shares are issued in accordance with such rules as may be prescribed.
- } {1 M Each for Any 3 Points}

**Answer 6:**

- (a) Clause (ix) (d) of CARO, 2020 whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated.
- In the given situation, funds have been raised for meeting working capital requirements for Rs. 4 crores. Cash credit facilities for meeting working capital requirements are, by their very nature, short term borrowings. Out of above, Rs. 1 crore have been used by the company for investment in effluent treatment plant which is ostensibly for a long-term purpose.
- Hence, the matter needs to be reported in accordance with requirements of Clause (ix) (d) of CARO, 2020.
- } {1 M}  
} {2 M}  
} {1 M}

**Answer:**

**(b)** The C&AG Act gives the following powers to the C&AG in connection with the performance of his duties-

- (a) To inspect any office of accounts under the control of the Union or a State Government including office responsible for the creation of the initial or subsidiary accounts.
- (b) To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.
- (c) To put such questions or make such observations as he may consider necessary to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which is his duty to prepare.
- (d) In carrying out the audit, the C&AG has the power to dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transactions as he may determine.

**{1 M Each}**

**Answer:**

**(c)** The auditor may also ask management to reconfirm its acknowledgement and understanding of those responsibilities in written representations.

This is particularly appropriate when: -

- Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
- The terms of the audit engagement were prepared in a previous year;
- There is any indication that management misunderstands those responsibilities; or
- Changes in circumstances make it appropriate to do so.

**{1 M Each for Any 3 Points}**

**Answer:**

**(d)** Planning includes the need to consider, prior to the auditor’s identification and assessment of the risks of material misstatement, such matters as: -

1. The analytical procedures to be applied as risk assessment procedures.
2. Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
3. The determination of materiality.
4. The involvement of experts.
5. The performance of other risk assessment procedures.

**{1 M Each for Any 3 Points}**

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