

MOCK TEST PAPER 2
INTERMEDIATE 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 1 Mark each

Case Scenario 1

AA & Associates, an audit firm based in New Delhi, was appointed as the Statutory Auditor of Success Ltd., a listed Company having branches all over India. Success Limited is engaged in the business of manufacturing furniture items from timber which is imported from South Africa. The audit firm has six partners and partner CA A is the engagement partner for Success Ltd.

The audit team consisting of CA A and five more members prepared an audit strategy and audit plan before commencing the audit. CA A was aware of the fact that the understanding of the internal control of the organisation would assist the team in various ways. So, it was decided that the team would first obtain an understanding of the internal control relevant to the audit before commencing the audit.

CA A explained to the team that there is a direct relationship between an entity's objectives and the controls it implements to provide reasonable assurance about their achievement. The entity's objectives, and therefore controls, relate to financial reporting, operations and compliance; however, not all of these objectives and controls are relevant to the auditor's risk assessment. CA A educated the team about the factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit. The team then applied its professional judgment to decide whether a control, individually or in combination with others, is relevant to the audit.

One of the team members, CA P scheduled a meeting with the Director of Success Ltd., Mr. D, to understand the risk assessment process of the entity. The entity's risk assessment process formed the basis for the risk to be managed. CA P, on the basis of his judgment, found the process to be appropriate, and it helped him in identifying the risks.

Once the risks were identified, CA P had to determine whether any of the risk identified is, in his judgment, a significant risk. CA P considered all the factors which he should have considered to exercise his judgement as to which risks are significant risks. He was aware that significant risks often relate to certain type of transactions and matters.

In the meanwhile, CA A met the CFO of the Company, Mr. C to obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting. Mr. C explained to CA A the various monitoring activities undertaken by the management to monitor the internal control performance of the company.

Based on the above information, answer the following questions:

1. CA A was aware of the fact that the understanding of the internal control of the organization would assist the team in various ways. Which of the following is not achieved by an understanding of the internal control system?
 - (a) Identifying breakdown due to human error.

- (b) identifying types of potential misstatements.
 - (c) designing the nature, timing, and extent of further audit procedures.
 - (d) identifying factors that affect the risks of material misstatement.
2. Which of the following factors is not relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit?
- (a) The diversity and complexity of the entity's operations.
 - (b) Applicable legal and regulatory requirements.
 - (c) The nature of the entity's business, including its organization and ownership characteristics.
 - (d) Nature, timing, and extent of further audit procedures.
3. CA P obtained an understanding of the risk assessment process of the entity. Which of the following is a risk assessment process to be followed by an entity?
- (i) Identifying business risks relevant to financial reporting objectives.
 - (ii) Estimating the significance of the risks.
 - (iii) Assessing the likelihood of their occurrence.
 - (iv) Deciding about actions to address those risks.
- (a) (i), (ii), (iii),
 - (b) (i), (ii)
 - (c) (i), (ii), (iii), (iv)
 - (d) (ii), (iii)
4. CA P considered all the factors which he should have considered to exercise his judgment as to which risks are significant risks. Which of the following is a factor which he would have considered to determine the same?
- (a) Whether the risk is a risk of error.
 - (b) The complexity of transactions.
 - (c) Whether the risk involves significant transactions with non-related parties.
 - (d) The degree of objectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty.
5. Which among the following is incorrect with reference to last para of the case study regarding the auditor to obtain an understanding of the major activities that the entity uses to monitor internal control over financial reporting :
- (a) It involves assessing the efficiency of controls on a timely basis and taking necessary remedial actions.
 - (b) Management accomplishes it through ongoing activities, separate evaluations etc.
 - (c) Management's monitoring activities may include using information from communications from external parties.
 - (d) In small entities, management's monitoring of control is often accomplished by management's or the owner-manager's close involvement in operations.
- (5 x 2 = 10 Marks)**

Case Scenario 2

Suresh Rana & Associates have been appointed as the statutory auditors of HAIL Ltd. by the Comptroller & Auditor General for the FY 2021-22. HAIL Ltd. is a Government company engaged in the manufacture of metro train coaches. During the course of audit, CA Suresh extended his scope of audit to cover efficiency, effectiveness and economy audit. CA Suresh Rana also asked his audit team to conduct expenditure audit as part of the audit engagement of HAIL Ltd.

During the course of audit, CA Suresh also found that the company has constructed its new stockyard for parking its metro coaches and maintenance of its metro coaches. However, the stockyard was not being used by the company for the designated purpose and the company continued using the rented stockyard. Suresh considered such expenditure as infructuous and avoidable expenditure.

The engagement partner also discussed with his team regarding the areas to be covered while conducting the audit of receipts. The reporting responsibilities of the engagement team were also discussed by the engagement partner with his team.

Based on the above facts, answer the following:-

1. **Statement 1:** Government audit provides public accounting of operational, management programme and policy aspects of public administration as well as accountability of officials administering them.
Statement 2: Government audit is equipped and intended to function as an investigating agency, to pursue every irregularity or misdemeanour to its logical end.
 - (a) Only statement 1 is correct
 - (b) Only statement 2 is correct
 - (c) Both 1 & 2 are correct
 - (d) Both 1 & 2 are incorrect
2. _____ is conducted to ensure that the various programmes, schemes, and projects where large financial expenditure have been incurred are run economically and are yielding results expected of them:-
 - (a) Propriety audit
 - (b) Audit against Rules and orders
 - (c) Performance Audit
 - (d) Audit against Provision of funds
3. While conducting audit against provision of funds, the statutory auditors, M/s Suresh Rana & Associates must check:-
 - (a) That each item of expenditure is covered by a sanction either general or special of a competent authority.
 - (b) That the expenditure incurred has been on the purpose for which the grant and appropriation has been provided and the amount of expenditure does not exceed the appropriation made.
 - (c) That the expenditure conforms to the relevant provision of the constitution.
 - (d) That the expenditure is in accordance with the financial rules, regulations and orders issued by the competent authority.

4. Which part of expenditure audit covers the scrutiny of the expenditure incurred on the construction of stockyard by the company which is considered as infructuous and avoidable by CA Suresh Rana?
 - (a) Propriety Audit
 - (b) Audit against provision of funds
 - (c) Audit of sanctions
 - (d) Performance Audit
5. While conducting the audit of receipts of HAIL Ltd., which of the following area is to be covered as part of Audit of Receipts?
 1. Whether all revenues or other debts due to government have been correctly assessed, realised and credited to government account by the designated authorities of HAIL Ltd.
 2. Whether adequate checks are imposed to ensure the prompt detection and investigation of irregularities, double refunds, fraudulent or forged refund vouchers or other loss of revenue through fraud or willful omission or negligence to levy or collect taxes or to issue refunds.
 3. Whether the expenditure incurred has been on the purpose for which the grant and appropriation had been provided and that the amount of such expenditure does not exceed the appropriation made.
 4. Whether the various schemes/projects are executed and their operations conducted economically and whether they are yielding the results expected of them.
 - (a) Only statement 1 is correct
 - (b) Statements 1 & 2 are correct
 - (c) Statements 1,2,3,4 are correct
 - (d) Statements 1,2,3 are correct

(5 x 2 = 10 Marks)

General MCQs

1.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
2. Judging the significance of a matter requires _____ of the facts and circumstances.
 - (a) objective analysis
 - (b) subjective analysis
 - (c) Both subjective and objective analysis
 - (d) qualitative analysis

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3. Audit evidence is necessary to support the auditor's opinion and report. It is _____ in nature and is primarily obtained from audit procedures performed during the course of the audit.
 - (a) cumulative
 - (b) regressive
 - (c) selective
 - (d) objective

4. Statement I: As per the Standard on Auditing (SA) 520 "Analytical Procedures", the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among financial data.
 Statement II: Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.
 - (a) Only Statement I is correct
 - (b) Only Statement II is correct
 - (c) Both statements are correct
 - (d) Both Statements are incorrect

5. Auditor Compares Gross Profit Ratio with that of Previous year and it is discovered that there has been a fall in the ratio. This is an example of :
 - (a) Analytical Procedure
 - (b) Test of Controls
 - (c) Walk Through Test
 - (d) Audit Sampling

6. Article 151 requires that the reports of the C&AG relating to the accounts of the Union/State shall be submitted to the _____ who shall cause them to be laid before House of Parliament/State Legislature
 - (a) President/Governor
 - (b) Prime Minister/ Chief Minister
 - (c) Union Finance Minister/State Finance Minister
 - (d) Union Cabinet

7. The Auditor of a Sole Proprietor Concern is appointed by
 - (a) CAG
 - (b) Bank
 - (c) Sole Proprietor himself
 - (d) District Administration

8. Which of the following is not correct:-
 - (a) AS 18 – Related Party Disclosures
 - (b) AS 10 – Property, Plant & Equipment

- (c) AS 28 – Impairment of Assets
 - (d) AS 16 – Intangible Assets
9. Which of the following is the responsibility of the auditor:
- (a) Preparation and presentation of the financial statements in accordance with applicable financial reporting
 - (b) Design, implementation and maintenance of internal controls
 - (c) Express an opinion on the Financial Statements
 - (d) To obtain limited assurance.
10. _____ 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

(10 x 1=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) The level of sampling risk that the auditor is willing to accept will not affect the sample size.
 - (ii) If auditor purchased goods on credit from the company and company allowed auditor a period of credit, this does not disqualify him to be an auditor.
 - (iii) Control environment can prevent, detect and correct a material misstatement.
 - (iv) There is an inverse relationship between detection risks and the combined level of inherent and control risks.
 - (v) R Ltd. has asked for email responses for the purpose of external confirmation. The auditor, however, feels that external confirmation received electronically involves the risk of its reliability.
 - (vi) Electronic payment of Income Tax cannot be made by an assessee from the account of any other person.
 - (vii) The Constitution of India contains no specific provisions regarding the appointment, salary and duties and powers of the C&AG. Moreover, the constitution does not guarantee the independence of the C&AG of India.
 - (viii) The term “**relative**”, as defined under the Companies Act, 2013, means¹ anyone who is closely related to another.

(7 x 2 = 14 Marks)

2. Discuss the following:
- (a) The auditor has to form an opinion on the financial statements within a reasonable period of time and at a reasonable cost. Explain the above statement with reference to "Timeliness of Financial Reporting and the Balance between Benefit and Cost". **(4 Marks)**
 - (b) You have been appointed as an auditor of MKP Ltd. for the first time. Discuss briefly, the factors to be considered by you while establishing overall audit strategy. **(4 Marks)**
 - (c) External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. Apart from confirmations for bank balances and accounts receivables, what are the other situations where external confirmation procedures may provide relevant audit evidence in responding to assessed risks of material misstatement? **(3 Marks)**
 - (d) Fraudulent financial reporting often involves management override of controls that otherwise may appear to be operating effectively.
 Illustrate any three techniques by which fraud can be committed by management overriding controls. **(3 Marks)**
3. (a) The auditor shall obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the classes of transactions in the entity's operations that are significant to the financial statements, controls surrounding journal entries etc. Explain the other considerations in this regard. **(4 Marks)**
- (b) Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. Explain. Also discuss the objectives of an auditor regarding Going concern as per relevant standard on auditing. **(4 Marks)**
 - (c) When a business operates in a more automated environment it is likely that we, as auditors, will see several business functions and activities happening within the systems. Explain which of the aspect you will consider relevant as an auditor. **(3 Marks)**
 - (d) There is a growing realisation that the traditional approach to audit is economically wasteful because all efforts are directed to check all transactions without exception. Explain. **(3 Marks)**
4. (a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time. Explain **(4 Marks)**
- (b) While auditing the accounts of ABC Ltd, a member of audit team is not clear about :
 - (i) the criteria regarding classification of liability into current liability and non-current liability.
 - (ii) Classification of Reserves and Surplus
 You being the senior member of audit team guide the member of the audit team about such criteria and classification as per general instructions for preparation of balance sheet as per Schedule III. **(6 Marks)**
 - (c) Proceedings have been initiated against the company ABC Ltd for holding one of its property as benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder. State the disclosure requirements to be complied with by ABC Ltd as per Schedule III to the Companies Act, 2013. **(4 Marks)**

5. (a) XYZ Limited is engaged in the business of Shoes having geographical presence across India. Following details are available from the last audited financial statements of XYZ Limited for the financial year 2020-21 :

Particulars	₹
Paid-up Capital as on 31st March 2021	9.8 Crores
Turnover for Financial Year 2020-21	98 Crores
Outstanding Loan from Bank as on 31st March 2021	25 Crores
Liability on Outstanding Debentures as on 31st March 2021	26 Crores

Comment on the applicability of constitution of Audit Committee for XYZ Limited for the financial year 2021-22 based on the above information. **(4 Marks)**

- (b) Section 147 of the Companies Act, 2013 prescribes punishments for contraventions by the Company, its officers and auditors. Explain the provisions of Section 147 of the Companies Act, 2013. **(4 Marks)**
- (c) State the matters to be included in auditor's report as per CARO, 2020 regarding - Verification of inventory and working capital limits. **(3 Marks)**
- (d) Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not considered as a substitute or alternative for a number of important items. What are those items? **(3 Marks)**
6. (a) In carrying out audit of income, the auditor is primarily concerned with obtaining reasonable assurance that the recorded income arose from transactions, which took place during the relevant period and pertained to the bank, there is no unrecorded income and the income is recorded at appropriate amount. Explain the Audit Approach and Procedures regarding following points in the above context :
- (i) RBI's Directions
- (ii) Materiality
- (iii) Revenue Certainty
- (iv) Revenue Uncertainty **(4 Marks)**
- (b) Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be. Analyse and Explain **(4 Marks)**

OR

- (c) Government audit has not only adopted the basic essentials of auditing as known and practised in the profession to suit the requirements of governmental transactions but has also added new concepts, techniques and procedures to the audit profession. Explain stating clearly the definition of Government auditing as discussed in U.N. Handbook on Govt Auditing and Developing Countries and also state Objectives of Govt audit. **(4 Marks)**
- (d) What are the special steps involved in conducting the audit of an Educational Institution? (Write any 12 points) **(6 Marks)**