

Paper 3 : Advanced Auditing and Professional Ethics (Old course)

1 The basic assumption underlying the use of analytical procedures is:

- (a) It helps the auditor to study relationship among elements of financial information
- (b) Relationship among data exist and continue in the absence of known condition to the contrary
- (c) Analytical procedures will not be able to detect unusual relationships
- (d) None of the above

2. Direct confirmation procedures are performed during audit of accounts receivable balances to address the following balance sheet assertion

- (a) Right and obligations
- (b) Valuation
- (c) Completeness
- (d) Existence

3 The auditor shall express _____ opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements

- (a) Adverse
- (b) Qualified
- (c) Disclaimer of opinion
- (d) clean

4The agreed terms of the audit engagement shall be recorded in an audit engagement letter which shall include the following except-

- (a) Responsibilities of the auditor
- (b) Description of methods to be followed for obtaining audit evidence
- (c) Responsibilities of management
- (d) Objective and scope of the audit of the financial statements

5 The measure of the quality of audit evidence about its relevance and reliability in providing support for the conclusions on which the auditor's opinion is based is:

- (a) Sufficiency of audit evidence
- (b) Appropriateness of audit evidence
- (c) Accounting estimates

(d) Reasonableness of audit evidence

6 The auditor's _____ safeguards the auditor's ability to form an audit opinion without being affected by any influences.

- (a) Objectivity
- (b) Independence
- (c) Confidentiality
- (d) Integrity

7 Which of the following company is not exempted from reporting under CARO, 2016?

- (a) Banking company.
- (b) Insurance company.
- (c) Company licensed to operate under section 8 of the Companies Act, 2013.
- (d) Private limited company having paid up capital of Rs. 5 crore.

8 Section 144 of the Companies Act, 2013 does not excludes the statutory auditor of the company to render the services of -

- (a) Investment advisory
- (b) Investment banking
- (c) Branch auditor
- (d) Actuarial

9 As per SA 550 on Related Parties, existence of which relationship indicate the presence of control or significant influence?

- (a) Friend of a family member of a person who has the authority and responsibility for planning.
- (b) Holding debentures in the entity.
- (c) The entity's holding of debentures in other entities.
- (d) The entity's holding of equity in other entities.

10. When does an auditor shall modify the opinion in the auditor's report?

- (a) When, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement.
- (b) When, unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

- (c) (a) and (b) both.
- (d) Either (a) or (b).

11 For a given level of audit risk, the acceptable level of detection risk bears _____ relationship to the assessed risks of material misstatement at the assertion level.

- (a) direct.
- (b) Inverse
- (c) Either (a) or (b)
- (d) none of the above

12 Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels. Which of the following is an example of control activities:

- (a) Authorization.
- (b) Performance reviews.
- (c) Information processing.
- (d) All of the above

13 If, as a result of a misstatement resulting from fraud, the auditor encounters exceptional circumstances that bring into question his ability to continue performing the audit, he shall-

- (a) Withdraw from the engagement immediately.
- (b) Report to Audit team regarding withdrawal.
- (c) Determine the professional and legal responsibilities applicable in the circumstances.
- (d) Ask the management for his withdrawal.

14 In order to form the opinion, the auditor shall conclude as to whether the auditor has obtained _____ about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

- (a) reasonable assurance
- (b) absolute assurance
- (c) Limited assurance
- (d) None of the above

15 When is evidential matter, generally, considered sufficient in case of stock exchange member audit?

- (a) When it constitutes entire population
- (b) When it is objective and relevant
- (c) When it is enough to provide a basis for giving reasonable assurance regarding truthfulness
- (d) When auditor collects and evaluates it independently

16 The scope of the audit of Depositories including reference to the pronouncements of the ICAI, which the auditor adheres to, generally is communicated to the client in the

- i) auditor's report
- ii) engagement letter
- iii) representation letter

- (a) only (i)
- (b) Both (i) and (ii)
- (c) Both (i) and (iii)
- (d) All of the above

17. Which of the following information should a successor auditor obtain during the inquiry of the predecessor auditor before accepting engagement?

- i) Information about integrity of management
- ii) Disagreement with management concerning auditing procedures
- iii) Review of internal control system.
- iv) Organisation structure

- (a) (i) and (ii)
- (b) (ii) and (iii)
- (c) (i) , (ii) and (iii)
- (d) (i) and (iii)

18. In an investigation relating to possible misappropriation of cash, the cashier says that every day the cash is counted and is reviewed by the Finance Head. Your specimen review indicates that the daily cash summary was not signed off by of the Finance Head. In this situation you should:

- (a) conclude that the cashier is not telling truth
- (b) consider extending investigation procedures like corroborative enquiry with the Finance Head, review of appropriate daily cash summaries etc.
- (c) conclude that the Finance Head is not a responsible person
- (d) conclude that daily cash summary is not relevant for the investigation

19. Current period adjustments are those adjustments that are made:

- (a) only on the first occasion of the preparation and presentation of consolidated financial statements
- (b) only on the first occasion of the audit of consolidated financial statements
- (c) in the accounting period for which the consolidation of financial statements is done
- (d) None of the above

20 Which of the following best suits the description – “The susceptibility of an assertion that could be material, either individually or in aggregate, before consideration of any related Internal Controls.”

- (a) Inherent Risk
- (b) Detection Risk
- (c) Control Risk
- (d) None of the above

21 CA. D, a chartered accountant in practice availed of a loan against his personal investments from a bank. He issued 2 cheques towards repayment of the said loan as per the instalments due. However, both the cheques were returned back by the bank with the remarks "Insufficient funds". As per Chartered Accountants Act, 1949, under which clause CA D is liable for misconduct .

- (a) Clause (6) of Part I of the First Schedule
- (b) Clause 2 of Part I of the Second Schedule
- (c) Clause 12 of Part I of the First Schedule
- (d) Clause 2 of Part IV of the First Schedule

22. As an auditor appointed under section 44AB of the Income Tax Act, 1961, under which clause of Form 3CD, you will report for amounts deemed to be profits and gains under section 32AC, 33AB or 33ABA or 33AC

- (a) clause 24
- (b) clause 40
- (c) clauses 31
- (d) clause 23

23. As per CARO, 2016, the auditor is required to report whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934. If so, whether the registration has been obtained.

- (a) Under Clause (xi) of paragraph 3 of the CARO, 2016,

- (b) Under Clause (xvi) of paragraph 3 of the CARO, 2016,
- (c) Under Clause (xv) of paragraph 3 of the CARO, 2016,
- (d) Under Clause (xiv) of paragraph 3 of the CARO, 2016,

24. As per Clause (i)(c) of Paragraph 3 of the CARO, 2016, the auditor is required to report on :

- (a) whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof.
- (b) whether the company has entered into any non-cash transactions with directors or persons connected with him
- (c) whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated;
- (d) whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets;

25. LM Ltd. had obtained a Term Loan of rupees 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in short term deposits. Under which clause of CARO 2016 the auditor is required to report

- (a) Under Clause (viii) of paragraph 3 of the CARO, 2016,
- (b) Under Clause (xi) of paragraph 3 of the CARO, 2016,
- (c) Under Clause (x) of paragraph 3 of the CARO, 2016,
- (d) Under Clause (ix) of paragraph 3 of the CARO, 2016,

26. NMP Ltd is in the business of retail and has been suffering losses. The turnover of the company has been same over the last 3-5 years. The company has Oracle as its ERP package. The internal auditor of the company observed that there is no process to review the supplier master on a periodic basis to identify the cases of incorrect updation / redundant supplier codes, key fields were not made mandatory in Oracle at the time of vendor empanelment and maker checker mechanism was also not enabled in Oracle.

There is no mechanism to track redundant supplier codes and block them for further transactions. For 5,750 out of 9,076 active suppliers (63.3%), no transaction had occurred in the past 180 days. For 4,972 out of these 5750, no transaction occurred in the past 1 year. For 35 out of 9,076 active suppliers, the state code in the GST Identification Number (GSTIN) updated in the supplier master did not match the state mentioned in supplier's address. Payments valuing INR 27 crores have been made to such suppliers.

Management explained that for redundant supplier codes, annual review will be conducted by the purchase team to identify such codes and, post an approval from finance, purchasing will be blocked for the respective vendors. For GSTIN and State mismatch, management has already commenced assessment to identify the reasons for such errors and all such inconsistencies will be rectified in next 6 months. Please suggest in terms of reporting.

- (a) Management responses look reasonable and this matter should be dropped.
- (b) The matter is more of related to hygiene and may not have any impact on the financial reporting and hence should be ignored.
- (c) Internal auditor need to report this matter.
- (d) Internal auditor should look at the significance of the matter. Material and on the basis of the same should decide about reporting this matter.

27. DPP Ltd is in the business of software and is in growing phase. The company's turnover has been increasing year on year and profit margins are good. The company is also planning IPO in next 2-3 years depending on the market assessment at that point of time.

It was observed by the internal auditors of the company that it does not have a documented Segregation of Duty (SOD) Matrix. Access controls were tested on basis of leading practices and following observations were identified:

- Users apart from Finance & Accounts team were having access to critical financial transactions.
- Users apart from Quality department were having access to Quality Clearance transaction for raw material and finished goods.
- Multiple users having access to Purchase Order Approval though it should be confined to HODs/Purchase Heads.

Management of the company explained to the auditor that the company is new and this may be required for a well established company. Please advise.

- (a) Generic accounts increase the risk associated with accountability and might lead to unauthorized access which could result into impact on financials. It will also affect the transparency and auditing trail that corresponds with the account. Hence there should be a proper SOD matrix.
- (b) Generic accounts increase the risk associated with accountability and might lead to unauthorized access which could result into impact on financials. It will also affect the transparency and auditing trail that corresponds with the account. There should be a process of SOD though it is not necessary to document that.
- (c) Management is right and accordingly it is not relevant for the internal auditor.
- (d) Since currently the operations of the company are running smoothly, there is no need for complicating the internal business environment by setting up SOD matrix.

28. KSHTZ Ltd, listed company, is in the business of stainless steel and is more than 50 years old. The company's turnover is INR 11000 crores and has good profit margins which have been improving over the last 2 years. The company is also planning to raise funds in another 5-6 months. The company has SAP as its ERP package.

Recently there has been a change in the internal audit team. The new internal auditors observed that there have not been any approved policies and procedure in place in their audit period from 1 April 2018 to 30 September 2018. For e.g.

- Information Security Policy and Procedure
- Change Management Policy

- User Access Management Policy.

Also the policies and procedures do not have any version control, owner and review details, etc.

Management of the company explained to the auditor that the company does not require this and hence this point should be ignored. Please advise.

- Absence of well defined and approved policies and procedures may lead to management's intended practices and objectives not being clearly communicated to and understood by organization's employees and hence there should be approved policies and procedures in place.
- Absence of well defined and approved policies and procedures may lead to management's intended practices and objectives not being clearly communicated to and understood by organization's employees. There should be a process to follow policies and procedures though it is not necessary to document that.
- Management is right and accordingly it is not relevant for the internal auditor.
- Absence of well defined and approved policies and procedures has not impacted the company till date and if the management has reasons not to keep this then the same should not be considered by the internal auditor.

29. ACE Pvt Ltd is a large company and has diverse operations. The company is planning to get listed to raise funds. Over the last years, the company did not use much of technology and with the changing times, the management has also identified the need to bring mechanisms in place to improve upon the use of technology. The internal auditors of the company while review of Business Continuity Planning/ Disaster Recovery Plans observed that the Identified Disaster Recovery Site of the company was in the same seismic zone as the Primary Site. Therefore the effectiveness of the Disaster Recovery (DR) Plan was not verified.

The management discussed this matter with the internal audit team and explained that the present DR plan is to protect against hardware failure and building level exposure. They will plan for city level DR along with Annual Business Plan in another year.

Please suggest which one of the following options is correct.

- DR plan is not of much relevance and should not be focused upon by the internal auditor in his report.
- DR plan is an outdated plan and in today's scenario it is not required. Hence internal auditor should drop this.
- Absence of Disaster Recovery Site in different seismic zone might lead to failed or delayed recovery of business operations in an event of natural disaster. It is important for the management to plan this and hence internal auditor should also report this.
- Since the management has a plan for DR in near future this matter is not relevant to be reported.

30. ASOP Ltd is in the business of trading and manufacturing of FMCG. The turnover of the company has been increasing, however, the company has not been able to maintain its margins constant which are declining. The internal auditors of the company raised observations on the sales schemes of the company. As per the SOP, all schemes are required to be approved by the CEO of the company. However, per process it was observed that all schemes were approved by Chief Sales and Marketing Officer (CSMO). Review of sample 89 support schemes for the months

of May 2018 and June 2018 highlighted that 19% (i.e. 17 schemes) were not approved by the CSMO.

Management replied that there is a need for revision of SOP to reflect current paradigm. They shall amend the SOP to reflect the same. Please advise how should these matters be dealt by the internal auditors?

- (a). Since the management has agreed on the observation of the internal auditor, internal auditor should drop these points.
- (b) SOPs are not aligned to on-ground practices followed by concerned officials. SOPs should be updated and till then there should be a mechanism to follow the existing SOP.
- (c) SOPs are not aligned to on-ground practices followed by concerned officials and the same should be reported by the internal auditor.
- (d) Internal auditor should look at the materiality and basis that can ignore this as this will not have much impact.

31. BCP Ltd is in the business of manufacturing of cranes. It's a wholly owned subsidiary of a Chinese company and follows policies and procedures of the parent company. The company's annual turnover is INR 1000 crores. The company operates through dealers in India for making sales and pays incentives to them on the basis of delivery based schemes and other schemes which are introduced from time to time.

It was observed by the internal auditors of the company that incentives amounting to INR 10 crores were paid to dealers on account of delivery based schemes for the month of October 2018. Review of cranes installations for the same period highlighted that incentive amounting to INR 30 lakhs had been paid against invalid claims. This was primarily because of absence of verification of the delivery claims with the installation data.

Management replied that disbursement basis 100% verified installations has been defined as per the process. Revision in process has been done to prevent inordinate delays in reimbursements to the dealers. Please advise how should these matters be dealt by the internal auditors?

- (a) Since the management has agreed on the observation of the internal auditor, internal auditor should drop these points.
- (b) The impact of the matter is not significant and hence the same should be dropped.
- (c) Incentive paid against non-genuine claims bear financial implications for the Company. Verified installation data should be taken for considering incentive payout. This matter should be highlighted by the internal auditor in his report.
- (d). Internal auditor should ask the management to take corrective action and basis that drop this point as this is matter which is of financial implication which needs to be considered by the statutory auditors of the company.

32. PRP Ltd is a service company and is in the business of manpower consultancy. The company also has some manufacturing operations based out of Orissa. The annual turnover of the company is INR 1500 crores. The employee base of the company is very big. Please advise what internal audit procedures should be considered by the internal audit team for the audit of labour cost vis-à-vis wages.

- i. Comparing the time booked in the booking sheets with clock cards on a sample basis.

- ii. For a Piece rated wage job: a. In case of an in-process job, checking that the output booked in the booking sheet is in line with the standard output possible in the stated time. In case of a major variance, enquiring into its justification and authenticity. b. In case of a finished job, checking the output booked in the booking sheet with the actual output generated for the period as per the production sheet. c. In case of variances, enquiring into the same.
 - iii. In case of a person doing more than one piece - rated job during the period, checking that: Total Time Booked – Overtime Hours = Normal Hours Available in the Period.
 - iv. Test checking the following with the master lists: a. Grade booked b. Operator code c. Job code.
 - v. Average Earning Job a. Verifying on a sample basis that the job categorised as “average earning” job does not have any piece rate as per the master file. b. Comparing the standard time required for output booked as per the master file with the actual time booked. In case of a major variance, enquiring into its justification and authenticity. c. Test checking the calculation of wages as per the laid down formula for arithmetical accuracy.
- (a) i, ii, iii, iv and v.
 - (b) i, ii, iii and iv.
 - (c) i, iii, iv and v.
 - (d) i, ii, iii and v.

33. OQR Ltd is in the business of manufacturing of tractors and cranes. The company has a policy to provide after sales services to the customers in respect of its products. Please advise what internal audit procedures should be considered by the internal audit team for the audit of after sales service.

- i. Assess replacement trends, nature of failures and replacement policies.
 - ii. Examine the percentage of replacements of manufacturing defects vis-à-vis off-take.
 - iii. Examine which type of products/models has a higher failure record and why.
 - iv. Check whether any particular dealer's failure percentage vis-à-vis his turnover higher than the norm. If so, why.
 - v. Check whether there are adequate technical audit on awards of replacement.
 - vi. Evaluate the effectiveness of after-sales service with regard to its scope and consumer satisfaction. Is this service prompt and timely?
- (a) i, ii, iii, iv and vi.
 - (b) i, iii, iv, v and iv.
 - (c) i, ii, iii, iv and v.
 - (d) i, ii, iii, iv, v and vi.

34. SX Ltd is in the business of steel manufacturing having a turnover of INR 10,100 crores. The company has many plants. Each plant has a canteen and some income also gets generated in the canteen every year.

Being the internal auditor what internal audit procedures may be applied to audit the canteen income?

- i. Check the records maintained for the canteen operations to support all financial transactions.

- ii. Review the agreements and contracts in case the canteen is run by an outside party.
- iii. Compliance with laws and regulations applicable for operation of canteen - The Prevention of Food Adulteration Act & Rules, 1954, The Shops and Establishment Act, FEMA, GST, Companies Act, etc.
- iv. Verify leakages that may take place, e.g., by way of non-deductions from staff or excessive consumption of food in the mess, despite fixed menus which are helpful in providing some measurement of the likely consumption of food articles.

Which of the above mentioned procedures would be relevant?

- (a) i, ii, iii and iv.
- (b) i, ii and iii.
- (c) i, ii and iv.
- (d) i, iii and iv.

35. TPL Pvt Ltd is in the business of software and consultancy services. The annual turnover of the company is INR 899 crores and profits are INR 199 crores. The company is planning to get listed in the overseas market within a year. If that doesn't happen then the company may look for funding through private placement.

For some projects the company receives grants from government. These projects run upto 5-10 years. XYZ & Co LLP is the internal auditor of the company. Please advise what internal audit procedures should be considered by the internal audit team for the audit of grants received.

- i. Check the donations received with the copies of receipts.
 - ii. Check sanction letters for any conditions attached with the donations.
 - iii. Examine the statements submitted for utilisation of grant.
 - iv. Verify the grants received from the Government or other authorities with reference to all the correspondences.
 - v. Verify all the bank statements of the company to trace the grants received and its utilization.
- (a) i, ii, iii, iv and v.
 - (b) i, ii, iii and iv.
 - (c) i, iii, iv and v.
 - (d) i, ii, iii and v.

36. ONZ Ltd is in the business of trading of consumer equipments. The company's turnover is INR 347 crores. The company has not been doing well over the last few years due to which its profitability has gone down significantly.

The company charges cartage/freight from its customers. Because there is a huge cost incurred in this respect, the company ensures that this amount is recovered on time.

During the performance of the internal audit procedures, the internal auditors of the company found that in some cases freight was charged in the bills manually, rather than through the automated system of generating an invoice. Internal auditor raised this point to the management. The management replied that it happens only in exceptional cases that the freight is charged manually on automated generated invoice.

How would you deal with this as an auditor?

- (a) Internal auditor should report this matter.

- (b) Internal auditor should discuss with management about way forward and drop this point.
- (c) Internal audit observation is not right.
- (d) Internal auditor should ignore on the grounds of materiality.

37. MNO Ltd borrowed an amount of INR 5 crores from a financial institution during the year. The company had existing borrowings of INR 1800 crores from various banks. However, the company took loan from a financial institution for the first time.

The rate of interest charged on the new loan was based on market rate of interest and there was no security for this loan. During the course of the internal audit, internal auditor could not find the borrowing agreement for the new loan and raised this point with the management. The management explained that new loan was required for a special purpose for which all other documents are available for auditor to verify – disbursement proof in the bank statements, repayments. However, the agreement was not prepared because the person who arranged the loan from financial institution was known to the company and basis verbal understanding this has been done. Please advise internal auditor.

- (a) Internal auditor should report this matter as this can be a serious deficiency.
- (b) Because all other proofs are available, internal auditor should ignore this point.
- (c) Internal auditor should report this matter to Reserve Bank of India.
- (d) Considering the insignificant amount of this new loan as compared to total borrowings of the company, this may be ignored by the internal auditor.

38. AAS Ltd is in the business of fast food chains. During the internal audit of accruals/ expenses of the company, the internal audit team observed that for some of the entries passed the narration was wrongly written as if the expense is related to the travelling expense. The vouchers were passed by the finance personnel of the company but no review mechanism was seen for this. Management explained that there is a review mechanism but this is only about narration of expenses which should not be relevant for the internal auditor. How should the internal auditor deal with this matter?

- (a) The Company should perform the review of entries to check such cases and same thing should be reported by the internal auditor.
- (b) The Company's management seems reasonable here.
- (c) This matter should be considered on the basis of materiality.
- (d) Internal auditor should further investigate as this is indicative of fraud.

39. Medivision Industries designs and manufactures spectacles. Medivision's year end was 31 March 2018 and its draft financial statements show a profit before tax of Rs.60 lakh. The fieldwork stage for this audit has largely been completed but there are few outstanding issues.

On 1 January 2018, Medivision began the commercial production of a new range of lightweight frames which have been proven to keep their shape regardless as to how roughly they are treated. Up to 31 December 2017, the company had correctly capitalised development costs of Rs.45 lakh relating to this project. The directors believe that the new frames will have a product life of three years. The financial statements show development costs at a carrying amount of Rs.45 lakh. Medivision's accounting policy states that it amortises intangible assets on a straight-line basis.

The auditor's report for Medivision is due to be signed in the next week or so, and you have been unable to resolve a disagreement with the directors concerning the amortisation of the development costs. The directors have refused to include any amortisation on the basis that sales of the product have not yet commenced.

Which of the following options correctly summarises the impact on the auditor's report if the issue remains unresolved?

- (a) The auditor to provide an 'Unmodified opinion', since the directors are correct not to include any amortisation on the basis that sales of the product have not yet commenced.
- (b) The auditor to provide an 'Unmodified opinion' with emphasis of matter paragraph about the amortisation charge on the capitalised development costs.
- (c) The auditor to provide a Modified opinion - Adverse opinion since having obtained sufficient appropriate evidence, concludes that the misstatement is both material and pervasive.
- (d) The auditor to provide a Modified opinion – Qualified opinion due to material misstatement of not recording the amortization charge on the capitalised development costs, which is material but not pervasive.

40 You are an audit supervisor of Swanminathan & Associates and are currently planning the audit of your client, Zonal Co which manufactures elevators. Its year end is 31 March 2018 and the forecast profit before tax is Rs 25.26 Lakhs.

At the beginning of the year, Zonal purchased a patent for Rs. 5.3 lakhs which gives them the exclusive right to manufacture specialised elevator equipment for five years. In order to finance this purchase, the entity borrowed Rs. 4.5 lakhs from the bank which is repayable over five years.

Which of the following is a response to the audit risk identified by you in planning the audit for the reporting year?

- (a) The audit team need to agree the purchase price to supporting documentation and to confirm the useful life is five years. Recalculate the amortisation charge to ensure the accuracy of the charge and that the intangible is correctly valued at the year end.
- (b) The company has borrowed Rs.4.5 lakhs from the bank via a five-year loan. This loan needs to be correctly split between current and non-current liabilities in order to ensure correct disclosure.
- (c) In accordance with Ind AS 38 Intangible Assets, the patent should be included as an intangible asset and amortised over its five-year life.
- (d) Also, as the level of debt has increased, there should be additional finance costs. There is a risk that this has been omitted from the statement of profit or loss leading to understated finance costs and overstated profit.

41. Teamsg International Co is a manufacturer of electrical equipment. It has factories across the country and its customer base includes retailers as well as individuals, to whom direct sales are made through their website. The company's year-end is 31 March 2018. You are an audit supervisor of Suraj & Co and are currently reviewing documentation of Teamsg's internal control in preparation for the interim audit.

In the past six months Teamsg has changed part of its manufacturing process and as a result some new equipment has been purchased, however, there are considerable levels of plant and equipment which are now surplus to requirement. Purchase requisitions for all new equipment have been authorised by production supervisors and little has been done to reduce the surplus of old equipment.

Which of the following control can be recommended to address the internal control deficiency in the respect of the acquisition of new equipment and treatment of the old equipment.

- (a). Regular review of the data on the unused equipment on the master file by a responsible official and the review to be evidenced.
- (b). Supplier statement reconciliations should be performed monthly for all suppliers and these should be reviewed by a responsible official.
- (c). Capital expenditure authorisation levels to be established. Production supervisors should only be able to authorise low value items, any high value items should be authorised by the board.
- (d). Observe the review process by senior factory personnel, identifying the treatment of any old equipment.

42. You are a manager in the audit department of Narang & Co, and you are dealing with several ethical and professional matters raised at recent management meetings, all of which relate to audit clients of your firm:

One of your client Bernwood Co has a year ending 31 March 2018. During this year, the company established a pension plan for its employees, and this year end the company will be recognising for the first time a pension deficit on the balance sheet, in accordance with Ind AS 19 Employee Benefits. The finance director of Bernwood Co has contacted the audit engagement partner, asking if your firm can provide an actuarial valuation service in respect of the amount recognised.

Which of the following options needs to be considered by the audit engagement partner?

- (a) The issue is whether there is a self-review threat, as the valuation of the amount recognised would be recorded in the financial statements. The audit partner should decline the work of valuation service.
- (b) The issue is whether the audit firm would be likely to possess the requisite competence to provide such a valuation service. The audit partner should decline since not professionally qualified to provide the valuation service.
- (c) Narang & Co. needs to assess the materiality of the figure, and the degree of subjectivity involved. If it considers that safeguards like using separate personnel, performing a second partner review, could reduce the threat to an acceptable level, then it can go ahead with both the audit and the valuation service.
- (d) The audit partner could go ahead with the valuation service and disclose the fact in its audit report about the service provided during the period. This will safeguard and reduce the threat to an acceptable level.

43. PR Co. designs and manufactures specialised furniture for offices in and around the city of Mumbai. The revenue has been gradually increasing over the last few years. The main concern for PR Co is finding credit-worthy customers who will make the payment on due dates. You are assigned as the audit team member to test the controls in sales and purchase system of the entity. The year end of the entity is 31 March 2018. One of the control objectives of the sales system of PR Co is to ensure that goods and services are sold to credit-worthy customers.

Which of the following control activities would assist the entity in achieving this objective?

- (a) All sales orders above Rs.10 lakh is based on authorised price lists.
- (b) Credit limits for all the customers are checked before sales orders are accepted.
- (c) Overdue debts are chased each month by the credit controller.

- (d) The aged-debt listing is reviewed by the finance director of PR Co on a monthly basis.

44. You are an audit manager of DC & Co and you are currently responsible for the audit of Beautypal Co, a company which develops and manufactures health and beauty products and distributes these to wholesale customers. Its draft profit before tax is Rs.43 lakhs and total assets are Rs.38 lakhs for the financial year ended 31 March 2018. The final audit is due to commence shortly, and the following matter has been brought to your attention:

Beautypal Co has a large portfolio of property, plant and equipment (PPE). In January 2018, the company carried out a full review of all its PPE and updated the useful lives, residual values, depreciation rates and methods for many categories of asset. The finance director felt the changes were necessary to better reflect the use of the assets. This resulted in the depreciation charge of some assets changing significantly for this year.

Which of the following substantive procedure should the auditor perform to obtain sufficient and appropriate audit evidence in relation to matter of depreciation on property, plant and equipment?

- (a) Review the capital expenditure budgets for the next few years to assess whether the revised asset lives correspond with the planned period until replacement of the relevant asset categories.
- (b) Inspect non-current asset accounts for a sample of purchases to ensure they have been properly allocated.
- (c) Consider whether the proceeds on disposals of PPE are reasonable and recalculate the profit or loss disposal.
- (d) For a sample of fully depreciated assets, inspect the register to ensure no further depreciation is charged.

45. As an internal auditor of LMN Bank Ltd., you have to verify the vouchers for the quarter ending 30th June 2018 of a branch at Ahmedabad. While verifying the vouchers, your team noticed that many of the bearer cheques processed by the teller have not been stamped as "paid", when discussed with the branch manager he stated the reason as ignorance on the part of official who has been assigned the duty of verifying the vouchers. As an internal auditor, what should be your next course of action:

- (a) Considering the matter as immaterial, ignore it for the internal audit report.
- (b) The Branch manager should be advised to rectify the discrepancy and the observation is closed in the internal audit report noting the corrective action taken.
- (c) The matter should be immediately reported to those charged with governance of LMN Bank Ltd.
- (d) Report the matter in Executive summary paragraph of Internal Audit Report as it is a significant internal control lapse.

46. ALM Ltd. is a trading company engaged in the business of selling readymade garments with a turnover of around Rs. 85 crore in the year 2017-18. Your firm has been appointed as statutory auditors for the year 2018-19. In the process of audit for the half year ending 30th September, 2018 your senior has instructed you to verify the debtors of the company. While verifying the same it came to your notice that the company is not taking balance confirmations from the debtors and the balance shown in the books of company is considered final for the preparation of accounts. As a statutory auditor what should be your decision on the debtors balances:

- (a) Statutory auditor should review the internal audit report and ensure as per section 143 of the Companies Act, 2013 that the company has adequate internal financial controls in place.
- (b) There is no need to take debtors confirmation as it is immaterial for the purpose of Audit Report.
- (c) The auditor is required to take external confirmation independently and wherever the auditor gets negative or no response or the response is doubtful an alternative audit procedure should be followed.
- (d). A management representation letter should be obtained by the auditor.

47. As a Central Statutory auditor of KG Ltd. for the year 2018-19 you need to verify the bank balances for the half year ending 30th September 2018. The company is holding Bank accounts in five different banks, but you found that the bank reconciliation is not complete for some of the bank accounts. When discussed with the management they explained that the number of transactions in these accounts is very huge on daily basis and there are some old entries (existing in the reconciliation statement from the year 2008 and they are not material in nature) so it is difficult to reconcile these bank accounts. As a Central Statutory Auditor what will be your decision:

- (a) The unusually old outstanding entries, as are not material in nature, should be removed from reconciliation statement and the balance in books of accounts should be considered as the balance for the balance sheet purpose.
- (b) The auditor should confirm the appropriateness of the old outstanding entries by taking bank confirmations for the same to reduce audit risk and obtain a management representation letter on pending reconciliation.
- (c) The auditor should disclose the matter in Notes to accounts of the audit report with respect to incomplete bank reconciliation.
- (d) The auditor should communicate it to those charged with governance as deficiency in internal control.

48. You are an article assistant in PQR & Associates. You are assigned an internal audit of X Ltd., a leading company in business of dairy products. While evaluating internal controls associated with related party relationships and transactions, you come across some discrepancies. What is the basic information to be collected by you related to related party relationships and transactions?

- i. The identity of the entity's related parties including changes from the prior period
 - ii. The nature of the relationships between the entity and these related parties
 - iii. Understanding of business activities of related parties
 - iv. Whether the entity has entered into any transaction with these related parties during the period and, if so, the nature and extent, and the purpose of the transaction
 - v. Materiality of related party transactions
- (a) i, ii & v
 - (b) i, ii & iv
 - (c) ii, iii & iv

(d) iii, iv & v

49. AMS & Co is a computer hardware specialist and has been trading for over 6 years. The company is funded through overdrafts and loans and by several large shareholders. The financial year end is 31 March 2017.

AMS had significant growth in business in previous years; however, in the current year a new competitor BOM & Co, has entered the market and through competitive pricing has gained considerable market share from AMS. One of AMS's customers has stopped trading with them and has moved its business to BOM. In addition, a few specialist developers have left the company and joined the new company BOM. AMS has found it difficult to replace these employees due to the level of their skills and knowledge. AMS has just received notification that its main supplier who provides the company with specialist electrical equipment has ceased to trade.

Which of the following audit procedures should NOT be performed in assessing whether or not AMS is a going concern?

- (a) Evaluating management's plans for the future of the business, by finding out from the financial director whether the company has gained any new customers to replace the customers lost
- (b) Review board meeting minutes for evidence of progress on recruiting specialist developers to replace the ones who have left to join BOM.
- (c) Analyse and discuss the entity's last 2 years of financial statements to determine whether it is consistent with the cash flow forecast.
- (d) Review the correspondence with the shareholders to assess the probability that any of the shareholders choose to increase or sell their investment

50. ASM Motor Cars co. manufactures a range of motor cars and its year end is 31 March 2018. You are the audit supervisor of Khanna & Associates and currently preparing the audit programmes for the year-end audit of ASM. The entity undertakes continuous production of cars, 24 hours a day, seven days a week. An inventory count is to be undertaken at the year end and Khanna & Associates will attend. You are responsible for the audit of work in progress (WIP) and will be part of the team attending the count as well as the final audit. WIP constitutes the partly assembled cars at the year end and this balance is likely to be material. ASM values WIP according to percentage of completion, and standard costs are then applied to these percentages.

Which of the following is NOT a substantive procedure the audit could perform to obtain sufficient and appropriate audit evidence in relation to the valuation of work in progress?

- (a) Discuss with management how the percentage completions are attributed to WIP
- (b) Observe the procedures carried out in the count in assessing the level of WIP; consider reasonableness of the assumptions used
- (c) During the count, verify all the percentage completions if they are in accordance with ASM's policies
- (d) Review the level of variances between standard and actual costs

Solution

1	(b)	2	(d)	3	(a)	4	(b)	5	(b)
6	(b)	7	(d)	8	(c)	9	(d)	10	(d)
11	(b)	12	(d)	13	(c)	14	(a)	15	(c)
16	(d)	17	(a)	18	(b)	19	(c)	20	(a)
21	(d)	22	(a)	23	(b)	24	(a)	25	(d)
26	(c)	27	(a)	28	(a)	29	(c)	30	(b)
31	(c)	32	(a)	33	(d)	34	(c)	35	(b)
36	(a)	37	(a)	38	(a)	39	(d)	40	(a)
41	(c)	42	(c)	43	(c)	44	(a)	45	(b)
46	(c)	47	(b)	48	(b)	49	(c)	50	(c)