

CA Intermediate: Auditing and Ethics (Test – Chapter1)

(Marks: 30) (Time: 1 Hour)

Section A: Multiple Choice Questions

MCQs 1-4 carry 1 mark each and MCQs 5-7 carry 2 marks each. (Total 10 marks)

1. In various engagement standards issued by Auditing and Assurance Standards Board under the authority of council of ICAI, a chartered accountant should be able to provide different levels of assurance on various engagements. State which levels of assurance are being referred to in the engagement standards –

(a) Absolute or high	(b) Medium or low	(c) Reasonable or limited	(d) Acceptable or low
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2. Due to inherent limitations of an audit, there is an _____ that some mis-statements will _____.

(a) Reasonable assurance; not be detected	(b) Unavoidable risk; not be detected	(c) Avoidable risk; not be detected	(d) Unavoidable risk; not be prevented
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3. Professional judgment is the application of _____ in making appropriate decisions.

(a) Training	(b) Knowledge	(c) Experience	(d) All of these
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4. Statement (1): Accounts are prepared by auditor prior to get them audited.
Statement (2): Statutory audit can be conducted only by a chartered accountant.

(a) Only Statement (1) is true	(b) Only Statement (2) is true	(c) Statements (1) and (2) both are true	(d) Both the statements are false
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5. Engagement Standards are issued by _____ under the authority of _____.

(a) AASB; President of ICAI	(b) AASB; Council of ICAI	(c) Council; President of ICAI	(d) AASB; Central Government
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6. Consider following statements in relation to “Limited assurance engagement”:-
Statement I - It involves obtaining sufficient appropriate evidence to draw reasonable conclusions.
Statement II - Review of interim financial information of a company is an example of limited assurance engagement.

(a) Statement I is correct. Statement II is incorrect.	(b) Both Statements I and II are correct.	(c) Both Statements I and II are incorrect.	(d) Statement I is incorrect. Statement II is correct.
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7. Your friend who is studying Auditing tells you that auditor can force an employee of the company to provide him required information and documents. Can he do so?

(a) Yes, he can do so. It is necessary to obtain audit evidence.	(b) Yes, he can do so. There are express rights given to him in this respect.	(c) No, he cannot do so. He can only request for providing him with necessary information and documents. But it cannot be forced by him.	(d) No, he cannot do so. He has no right of seeking information and documents. Therefore, question of forcing does not arise.
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Section B: Descriptive Questions

Question 1: State with reasons whether following Statements are correct or incorrect
(2 Marks each, total 6 Marks)

- Audit is independent examination of operations conducted by management.**
Incorrect: Audit is independent examination of *financial statements* of an entity to express opinion thereon. It is thus examining financial information, not operations of entity.
Auditing has existed in ancient times also in many societies of world including India.
- Correct:** The reference to auditing is found in **Kautilya's Arthshastra** in 4th century BC, it talks about fixed accounting year, a process for closure of accounts and audit for the same. There were concepts of periodical checking and verification even in those times. There are references in his monumental work to misstatements in financial statements due to abuse of power.
- The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.**
Correct: As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

Question 2 : "The purpose of audit is to express an opinion on the financial statements. The auditor expresses an opinion on financial statements in a written audit report. He shall see that financial statements would not mislead anybody." Discuss. (5 marks)

Answer:

The purpose of audit is to express an opinion on the financial statements. *The auditor expresses an opinion on financial statements in a written audit report.*

- To express his opinion, he shall see that financial statements would not mislead anybody by ensuring that: -
 - the **accounts** have been drawn up with reference to **entries** in the books of account;
 - the entries in the books of account are adequately **supported** by sufficient and appropriate evidence;
 - **none** of the entries in the books of account has been **omitted** in the process of compilation;

- the information conveyed by the statements is **clear and unambiguous**;
- the financial statement amounts are properly **classified, described and disclosed** in conformity with applicable accounting standards; and
- the statement of accounts presents a **true and fair** picture of the **operational results** and of the **assets and liabilities**.

Question 3: An audit does not provide absolute assurance. Discuss how nature of audit procedures itself is one of the reasons due to which audit cannot provide absolute assurance. (5 marks)

Answer:

- 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. (Practical limitation)
- 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. (legal limitation)
- The management may consist of dishonest and unscrupulous people and may be, itself, involved in fraud. Frauds are concluded by designing sophisticated and carefully organised schemes. It may produce fabricated documents before auditor to lead him to believe that audit evidence is valid. He may be accepting invalid audit evidence on the basis of unauthentic documents.
- It is quite possible that entity may have entered into some transactions with related parties. Such transactions may be only paper transactions and may not have occurred in reality. The auditor may not be aware of such relationships or audit procedures may not be able to detect probable wrong doings.

Question 4: “Reasonable assurance engagement like audit provides reasonable assurance which is a high level of assurance. Limited assurance engagement like review provides lower level of assurance than audit.” It is only a moderate level of assurance. State the difference between a reasonable assurance engagement and a limited assurance engagement. (4 marks)

Answer:

<i>Reasonable assurance engagement</i>	<i>Limited assurance engagement</i>
Reasonable assurance engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement.
It draws reasonable conclusions on the basis of sufficient and appropriate evidences.	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
Example of reasonable assurance engagement is an audit engagement.	Example of limited assurance engagement is a review engagement.