

# CA INTER | PAPER 5

## [NEW SCHEME]

### AUDITING & ETHICS

[QP's, RTP and MTP from May 2022 onwards]

*[September 2024 MTP and RTP also included]*

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# 1. NATURE, OBJECTIVE AND SCOPE OF AUDIT

## MCQS BASED QUESTIONS

1. Which of the following is not an advantage of audit?
  - a. It provides high quality financial information.
  - b. It acts as a moral check on employees.
  - c. It enhances risk of management bias.
  - d. It helps in safeguarding interests of shareholders.
2. Which of the following is NOT TRUE about an assurance engagement?
  - a. It relates to providing assurance about historical financial information only.
  - b. The practitioner obtains sufficient appropriate evidence.
  - c. There is some information to be examined by practitioner.
  - d. A written assurance report in appropriate form is issued by practitioner.
3. Which of the following is TRUE about Engagement Standards?
  - a. Engagement standards ensure proper rights to practitioners in course of performance of their duties.
  - b. Engagement standards ensure preparation and presentation of financial statements in a standardized manner.
  - c. Engagement standards ensure uniformity by practitioners in course of performance of their duties.
  - d. Engagement standards ensure savings in resources of clients.
4. 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.
5. Which of the following is TRUE about Standards on auditing?
  - a. These deal mainly with voluntary responsibilities of auditors.
  - b. These deal mainly with mandatory responsibilities of auditors.
  - c. Their sole purpose is to help government authorities in augmenting revenues.
  - d. These deal mainly in carrying out audit according to legal provisions.

### **Answers to the MCQs based Questions**

1.	(c)	2.	(a)	3.	(c)	4.	(d)	5.	(b)
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## CORRECT /INCORRECT

**State with reasons (in short) whether the following statements are correct or incorrect:**

**Q.NO.1. The basic objective of audit does not change with reference to nature, size or form of an entity.**

**Correct:** An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.

**Q.NO.2. The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.**

**Correct:** As per SA 200 “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

**Q.NO.3. 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.

## CASE STUDY BASED QUESTIONS

### **CASE STUDY 1:**

Rohit, Gurpreet, Ali and Goreti are friends since their school days based in Mumbai. They have cleared CA foundation exams in the same attempt and now plan to appear for CA Intermediate exams. All of them are avid news listeners and regularly keep track of business news even on social media.

They are trying to understand new subjects including auditing. Rohit, Gurpreet and Ali have also started attending *Live Coaching Classes (LCC) being conducted by Board of studies of ICAI*. Goreti has not been able to join *Live Coaching Classes* yet as she was away on a holiday with her parents. However, she plans to catch it up with her friends very soon. Ali had also joined the classes but he had skipped some lectures.

During one informal get together, their discussions centred around new subject of auditing. They discussed many things regarding its nature, scope, benefits and other general practical issues. Goreti was regular in keeping track of audited results of companies being published in leading newspapers. Her view was that audited financial statements of companies give 100% guarantee to different stake holders. It is the main reason behind so much reliance upon auditing. But she could not understand why wrong doings in financial matters are being discovered after many years have gone by.

Ali also concurred with her view and added that when financial statements are audited, each and every transaction appearing in books of accounts is verified. However, he could not give clarity to Goreti.

Gurpreet was of the opinion that audit was conducted on the basis of sample checking. He was also of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of the companies.

Not to be left behind, Rohit also jumped in the fray. He supported Gurpreet and also added something of his own.

### **Based on above, answer the following questions:**

1. Gurpreet was of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of companies. What kind of assurance does audit of financial statements provide?
  - a. It provides reasonable assurance meaning a moderate level of assurance.
  - b. It provides reasonable assurance meaning a low level of assurance.
  - c. It provides reasonable assurance meaning a high level of assurance.
  - d. It provides reasonable assurance meaning an absolute level of assurance.
2. Rohit added 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.
3. Ali had listened in one of the classes that audit covers all aspects of an entity and concluded that each and every transaction of entity is verified by auditor. Goreti also seemed to be in agreement with him but she was of the view that besides this, it also meant that audit should be so organized to cover all areas of an entity. Which of following statements is appropriate in this regard?
- a. Only view of Ali is correct.
  - b. Only view of Goreti is correct.
  - c. Views of both Ali and Goreti are correct.
  - d. Views of both Ali and Goreti are incorrect.
4. All of them also discussed about benefits of auditing. Which of the following is not a likely benefit of auditing?
- a. Since auditing is connected to future events, audited information can be easily relied upon by users.
  - b. Errors or frauds may be discovered during audit.
  - c. Government authorities can make use of audited accounts for different purposes.
  - d. It can help in bringing out deficiencies in maintenance of financial records.
5. Goreti told her friends that she had read a news report about how a company had misled its auditors by producing some fabricated documents. Which of following statements seems to be appropriate in this regard?
- a. It was wrong on the part of auditor to rely upon fabricated documents. He must have discovered it as the same falls within the scope of his duties.
  - b. Although it was wrong on the part of auditor to rely upon fabricated documents, he cannot do anything in the matter. He has to report on the basis of documents provided to him. He has no duty in this regard.
  - c. Auditor has to conduct audit by exercising professional skill. But he is not an expert in discovering genuineness of documents. Hence, management consisting of dishonest persons may have led him to rely upon fabricated documents deliberately.
  - d. Management cannot mislead auditor due to high level of knowledge and expertise possessed by him. The above is an outlier case-one of the rare odd cases.



## Answer to Questions involving Case Study 1

1. (c)            2. (c)            3. (d)            4. (a)            5. (c)

### CASE STUDY 2

Me and You Private Limited has been newly incorporated. The plant of the company has recently started production with the help of funds provided by a bank for purchase and installation of machinery. Further, the company is also utilizing working capital credit facilities from the same bank for meeting its day to day working capital requirements like for purchase of raw materials, labour payment etc. However, just within six months of its operations, the management feels that working capital funds are inadequate and situation is creating liquidity issues in the company.

The management of the company has approached its bankers and requested for enhancement in working capital credit facilities. The bank manager is insisting upon financial statements of the company for half year along with report providing assurance in this respect duly signed by Chartered Accountant as audit is far away. It also requires projected financial statements for coming years along with a report from CA providing assurance regarding these projections to consider request of management.

The management approaches CA P, who has qualified recently and started practising. Reports providing assurance for half yearly results and projected financial statements are sought from CA P. The Management provides necessary information and records to him in this regard.

Assume, in above case, the company only provides trial balance, financial statements in draft/preliminary form along with accompanying records for the relevant half year to CA P and requests him to provide duly signed financial statements with a report for mutually agreed professional fees.

#### Based on above, answer the following questions: -

1. The management of company has engaged CA P to issue a duly signed report for half year. Which of the following standards, if any, issued by ICAI are relevant for CA P?
  - a. Standards on Review Engagements
  - b. Standards on Auditing
  - c. Standards on Related Services
  - d. There are no standards for issuing report in such situation.
2. Which of the following statements is MOST APPROPRIATE in given case situation?
  - a. CA P can assist management in preparation of financial statements of the company. However, issue of a report in such a case is outside the scope of work.
  - b. CA P can assist management in preparation of financial statements of the company and he can issue an audit report.
  - c. CA P can assist management in preparation of financial statements of the company and he can issue a compilation report in this respect.
  - d. The responsibility of preparation of financial statement is of company's management. CA P

cannot assist management in preparation of financial statements of the company. However, he can issue a review report.

3. In the above said scenario for issuance of signed financial statements for half year by CA P, as discussed in last para of Case Study, identify the MOST APPROPRIATE statement: -
  - a. Standard on Quality control (SQC 1) is not applicable as CA P cannot issue audit report.
  - b. Standard on Quality Control (SQC 1) is not applicable as CA P cannot issue review report.
  - c. Standard on Quality Control (SQC 1) is applicable in such type of engagement.
  - d. Standard on Quality Control (SQC 1) is not applicable as CA P is barred from issuing any report in such type of engagement.
4. The banker of company has also requested for projected financial statements for coming years along with a report from CA regarding these projections to consider request of management. Which of the following standards issued by ICAI are relevant for CA P in such a situation, if any?
  - a. Standards on Review Engagements
  - b. There are no standards for issuing such type of reports.
  - c. Standards on Related Services
  - d. Standards on Assurance Engagements
5. Suppose CA P also accepts work of issuing projected financial statements with a report to be signed by him. The management has projected turnover of Rs.100 core for the next year, Rs.150 crore & Rs.200 crore for following years respectively as compared to present turnover of Rs.25 crore in current half year. Identify the MOST APPROPRIATE statement in this situation: -
  - a. CA P has to satisfy himself regarding arithmetical accuracy of projected data.
  - b. CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover and its consistency with actuals.
  - c. CA P has to satisfy himself regarding arithmetical accuracy of data along with its proper presentation to banker.
  - d. CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover, its consistency with actuals, disclosure and presentation.

**Answer to Questions involving Case Study 2**

1.	c	2.	c	3.	c	4.	d	5.	d
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# MCQ'S FROM RTP'S, MTP'S, QP'S

## MULTIPLE CHOICE QUESTIONS (MCQS)

1. **The persons with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity are :** (RTP NOV'23)
- a. management
  - b. Those charged with governance –
  - c. audit committee
  - d. board of directors
- Ans: (b)
2. **The Auditor of a Sole Proprietor Concern is appointed by** (MTP MAY'22)
- a. CAG
  - b. Bank
  - c. Sole Proprietor himself
  - d. District Administration
- Ans: (c)
3. **Which of the following is Incorrect:** (MTP MAY'23)
- a. An auditor conducting an audit in accordance with SAs is responsible for obtaining absolute assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.
  - b. As described in SA 200, owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.
  - c. The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error.
  - d. The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud.
- Ans: (a)
4. **With respect to auditing, which of the following statement is correct:** (MTP MAY'23)
- a. Audited financial statements are absolutely free from all material misstatement due to fraud or error.
  - b. An audit is an official investigation into alleged wrongdoing and auditor has specific legal powers to conduct investigation
  - c. The auditor can obtain only a reasonable assurance about whether the financial statement as a whole are free from material misstatement and report on it.
  - d. An auditor's opinion is an assurance as the future viability of the enterprise or the efficiency or effectiveness of the management.

Ans: (c)

**5. Which of the following is the responsibility of the auditor: (MTP MAY'22)**

- 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.

Ans: (c)

**6. Jasmine was of the view that audited financial statements are not a guarantee against probable wrong doings in the financial matters of companies. What kind of assurance does audit of financial statements provide? (MTP MAY 24)**

- (a) It provides reasonable assurance meaning a low level of assurance.
- (b) It provides reasonable assurance meaning a high level of assurance.
- (c) It provides reasonable assurance meaning an absolute level of assurance.
- (d) It provides reasonable assurance meaning a moderate level of assurance.

Ans: (b)

## 2. ETHICS AND TERMS OF AUDIT ENGAGEMENTS

### MCQS BASED QUESTIONS

1. Identify the most appropriate statement:
  - a. SA 220 applies at the level of firm.
  - b. SQC 1 is premised on the basis that firm is subject to SA 220.
  - c. SA 220 is premised on the basis that firm is subject to SQC 1.
  - d. SA 220 applies to all engagements.
2. Professional skepticism includes-
  - a. Overlooking unusual circumstances.
  - b. Using inappropriate assumptions in determining extent of audit procedures.
  - c. Over generalising when drawing conclusions from audit observations.
  - d. Being vigilant to conditions that might indicate possibilities of fraud.
3. Which of the following is not a fundamental principle governing professional ethics?
  - a. Professional competence and due care
  - b. Integrity
  - c. Objectivity
  - d. Safeguards to independence
4. Which of the following is not necessary to establish preconditions for an audit?
  - a. Acceptability of financial reporting framework.
  - b. Acknowledgment of cooperation from management in designing audit procedures.
  - c. Acknowledgment from management of providing access to persons within company.
  - d. Acknowledgment of management in understanding its responsibility for preparation of financial statements.
5. Identify the most appropriate statement in context of SQC 1.
  - a. Assembly of engagement files should be completed in not more than 60 days after date of auditor's report in case of audit engagements.
  - b. Engagement files should be completed before date of auditor's report in case of audit engagements.
  - c. Engagement files should be completed in not more than 60 days after completion of an engagement.
  - d. Engagement files should be completed on date on which audit report is signed in case of audit engagements.

#### Answers to the MCQs based Questions

1.	c	2.	d	3.	d	4.	b	5.	a
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## **CORRECT /INCORRECT**

**State with reasons (in short) whether the following statements are correct or incorrect:**

**1. The audit engagement letter is sent by the client to auditor.**

**Incorrect:** As per SA 210 “Agreeing the Terms of Audit Engagements”, the Audit engagement letter is sent by the auditor to his client.

**2. The Audit Engagement documentations should ordinarily be retained by the auditor for minimum of six years from the date of the auditor's report or the date of the group auditor's report, whichever is later.**

**Incorrect:** SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor’s report, or, if later, the date of the group auditor’s report.

## **CASE STUDY BASED QUESTIONS**

Das & Co, a firm of auditors, is offered appointment as auditor of a company, a prospective new client. CA Sukanya, one of partners, is dealing with new client. While meeting with officers of the company, she comes to know that Sushant, CFO of the company, was her class mate. In fact, both of them had started CA together. However, Sushant had left CA mid-way due to repeated failures and tried his luck to pursue MBA (finance) from one of leading institutions.

During initial discussions, it transpires that company is going to launch new services in the field of “weather-forecasting”. Such services would be available on web site of company and micro weather information would be available on payment of charges. The company requests audit firm to be visibly associated with their marketing blitz.

Assume that firm chooses to accept the offer and writes to previous auditor, Walker & Co., to advise whether there exist any professional reasons for them not to accept the proposed offer. However, Walker & Co. do not reply to the request of Das & Co.

During preliminary discussions, it also became known that the said company has acquired all shares of another company. Under relevant provisions of law, financial statements of both companies needed to be consolidated and audited. Despite this knowledge, Das & Co. failed to advise their client regarding audit of consolidated financial statements.

The company also offers auditors contract for providing IT services pertaining to information system of company.

### **Based on above, answer following questions:**

1. Considering discussion about Sukanya and Sushant, which of the following statements seems most appropriate?
  - a. The above discussion is irrelevant in context of proposed offer.
  - b. The proposed offer should be accepted by firm. The engagement team may be headed by CA Sukanya for better coordination and results.
  - c. The proposed offer should be accepted by firm. The engagement team may be headed by a different partner of the firm.
  - d. The matter is too trivial to be reported by CA Sukanya to other partners of firm.
2. Keeping in view request of the company to be visibly associated with company’s new services, identify which type of threat is being faced by audit firm.
  - a. Self-interest threat
  - b. Familiarity threat
  - c. Self-review threat
  - d. Advocacy threat
3. The previous auditors, Walker & Co., have not replied to communication of Das & Co. Which fundamental principle of professional ethics is not followed by them?
  - a. Objectivity

- b. Professional behaviour
  - c. Professional competence and due care
  - d. Integrity
4. Das & Co. have failed to advise the company regarding audit of consolidated financial statements. Which fundamental principle of professional ethics is violated by Das & Co.?
- a. Professional behaviour
  - b. Integrity
  - c. Objectivity
  - d. Professional competence and due care
5. Which of the following statements is most appropriate regarding providing offer of work of IT services by auditors to the company?
- a. Such offer may create a self-review threat.
  - b. Such offer may create an advocacy threat.
  - c. Such offer does not constitute any threat.
  - d. Such offer may create self-review and advocacy threats.

**Answer to Questions involving Case Study**

1.	c	2.	d	3.	b	4.	d	5.	a
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## MCQ'S FROM RTP'S, MTP'S, QP'S

# SQC 1- QUALITY CONTROL FOR FIRMS WHICH PERFORM AUDITS AND REVIEWS OF HISTORICAL FINANCIAL INFORMATION AND OTHER ASSURANCE AND RELATED SERVICE ENGAGEMENTS

1. \_\_\_\_\_ requires firms to establish policies and procedures for the retention of \_.
- The retention period for audit engagements ordinarily is no shorter than from the date of the auditor's report, or, if later, the date of the group auditor's report (RTP May '22)
- SA 220, audit evidence, six years
  - SA 200, audit documentation, seven years
  - SQC 1, engagement documentation, seven years
  - SA 230, documentation, six years

Ans: (c)

# **3. AUDIT REPORT**

## **MCQS BASED QUESTIONS**

1. While expressing an unmodified opinion on financial statements, the auditor shall not use which of the following phrases?
  - a. present fairly in all material respects
  - b. give a true and fair view
  - c. with the foregoing explanation
  - d. All of the above
  
2. .... is a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to the user's understanding of the financial statements.
  - a. Emphasis of Matter Paragraph
  - b. Other Matter Paragraph
  - c. Key Audit Matter
  - d. Management Responsibility Paragraph.
  
3. Statement 1: Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements.  
Statement 2: Instead of modifying an opinion in accordance with SA 705, the statutory auditor can use Key Audit Matter paragraph in the audit report with an unmodified opinion.
  - a. Only Statement 1 is correct
  - b. Only Statement 2 is correct
  - c. Both the statements are correct
  - d. Non
  - e. e of the statement is correct
  
4. Which of the following is not correct?
  - a. SA 700 - Forming an Opinion and Reporting on the Financial Statements
  - b. SA 701- Key Audit Matters in the Independent Auditor's Report
  - c. SA 705- Comparative Information- Corresponding figures and Comparative Financial Statements
  - d. SA 706- Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report
  
5. Responsibilities of Joint Auditors are governed by:
  - a. SA 200
  - b. SA 229
  - c. SA 299

d. SA 230

6. During course of audit of a company, it is noticed by auditor that Profit before tax of company is Rs. 5 lakhs. Depreciation on building reflected in Schedule of PPE forming part of financial statements has been computed for Rs.10 lacs. The correct depreciation, according to him, should be Rs.25 lacs. The above description as a whole is an example of ?
- (a) Misstatement
  - (b) Assertion
  - (c) Sampling method
  - (d) Audit risk

Answers to the MCQs based Questions

1. (c)      2. (a)      3. (d)      4. (c)      5. (c)  
6. (a)

### **CORRECT/INCORRECT**

**State with reasons (in short) whether the following statement is correct or incorrect:**

1. **The auditor shall express a qualified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.**  
**Incorrect:** The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.
2. **There is no need of addressee in the Auditor's report.**  
**Incorrect:** The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement. Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed. The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.
3. **The auditor shall modify the opinion in the auditor's report only when the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement.**  
**Incorrect:** The auditor shall modify the opinion in the auditor's report when:
- The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
  - The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

4. **The auditor shall express a disclaimer of 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.**

**Incorrect:** The auditor shall express an adverse 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.

**5. Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements.**

**Incorrect:** 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 a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation.

**6. When the auditor has to express an adverse opinion, he need not communicate with those charged with governance as this may have an impact on payment of his audit fees.**

**Incorrect:** When the auditor expects to modify the opinion in the auditor's report, the auditor shall communicate with those charged with governance the circumstances that led to the expected modification and the wording of the modification.

**7. Instead of modifying an opinion in accordance with SA 705, the statutory auditor can use Key Audit Matter paragraph in the audit report with an unmodified opinion.**

**Incorrect:** Communicating key audit matters in the auditor's report is not a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705 (Revised).

**8. The concept of "joint audit" has legal foothold under the Companies Act, 2013.**

**Correct:** Under provisions of section 139(3), the members of a company may resolve to provide that audit shall be conducted by more than one auditor. Hence, the concept of "joint audit" has legal foothold also under Companies Act, 2013.

## CASE STUDY BASED QUESTIONS

M/s AB & Company is a firm of Chartered Accountants based in Mumbai. Mr. A and Mr. B are the Partners of the Firm. The Firm is engaged in various assignments including Audits. The partners are taking a summary of their work in order to prepare themselves to finalize the Audit and issue the audit report to various clients. You are requested to go through the following and answer the questions that follow:

- ✓ During the audit of M/s Persistent & Co, Mr. A found that the firm has changed the method of Depreciation from WDV to SLM but has not given the retrospective effect. Mr. A has calculated the difference of depreciation but M/s Persistent & Co. has stated that they don't want to change the financial statements and if auditor persists they may give the effect in the next financial year.
- ✓ During the audit of M/s Dubious Brothers, Mr B observed that the firm had a very large amount of cash sales and there were no details of the customers to whom the sales were made. Further, cash generated was not even deposited into bank regularly. When Mr. B asked the firm to give him an opportunity to count cash, the manager of the firm said that the cash is with the owner and it cannot be made available to the auditor for the checking purpose. The manager also declined to give an opportunity for stock verification to Mr B.
- ✓ During the audit of M/s Honest & Associates, Mr. A came to know that the firm has changed its method of valuation of stock. This change has a material impact on the financial statement of the firm. The firm has made relevant disclosures in the financial statements and has given proper accounting treatment to this exercise.

**Based on above, answer following questions:**

1. In case of M/s Persistent & Company, what would be an ideal Audit Opinion?
  - a. Unmodified
  - b. Qualified
  - c. Mention the fact in Emphasis of Matter Paragraph
  - d. Disclaimer
2. In case of M/s Dubious Brothers, what Audit Opinion should the Auditor give?
  - a. Qualified
  - b. Adverse
  - c. Disclaimer
  - d. Unmodified
3. According to you, what would be appropriate course to take in case of M/sHonest & Associates?
  - a. Issue Qualified Opinion
  - b. Issue Adverse Opinion
  - c. Mention the fact of change in method in Emphasis of Matter Paragraph

- d. Issue Disclaimer of Opinion
4. When the Auditor, after conclusion of an Audit exercise, is of the opinion that there are material misstatements in the Financial Statements, but they are not pervasive, then what should an Auditor do?
- a. Issue Unmodified Opinion
  - b. Issue Qualified Opinion
  - c. Issue Disclaimer of Opinion
  - d. Mention it in Emphasis of Matter Paragraph
5. When the Auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, Auditor shall give:
- a. Modified Opinion
  - b. Qualified Opinion
  - c. Disclaimer of Opinion
  - d. Unmodified Opinion

**Answers to Questions involving case study**

1. (b)      2. (c)      3. (c)      4. (b)      5. (d)

## MCQ'S FROM RTP'S, MTP'S, QP'S

### **SA 700- FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS**

1. Which of following is not an element of audit report in accordance with SA 700?

- a. Title
- b. Addressee
- c. Audit strategy
- d. Auditor's opinion

(MTP NOV'23)

Ans: (c)

### **SA 705- MODIFICATIONS TO THE OPINION IN THE INDEPENDENT AUDITOR'S REPORT**

1. An auditor disclaims opinion when\_?

- a. He is unable to obtain audit evidence and concludes that possible effects on financial statements of undetected misstatements could be material.
- b. He is unable to obtain audit evidence and concludes that possible effects on financial statements of undetected misstatements could be both material and adverse.
- c. He is unable to obtain audit evidence and concludes that possible effects on financial statements of undetected misstatements could be both material and pervasive.
- d. He is unable to obtain audit evidence and concludes that possible effects on financial statements of undetected misstatements could be both material and perverse.

(MTP NOV'23)

Ans: (c)

## REPORTING REQUIREMENTS UNDER COMPANIES ACT

1. Which of the following is FALSE regarding UDIN? (Unique document identification number)
  - a. It is to be generated on UDIN portal.
  - b. Its basic objective is to help ICAI in keeping and maintaining an online registry of different services provided by all of its members.
  - c. It has to be generated and stated for each audit report signed by a Chartered Accountant.
  - d. It has to be generated and stated for each certificate signed by a Chartered Accountant.

(MTP NOV'22)

Ans: (b)

2. **UDIN (Unique Document Identification Number) is required to be stated by practising Chartered Accountant on: -**
  - a. Each audit report only
  - b. Each audit report and each certificate
  - c. Each audit report issued under Companies Act, 2013 only
  - d. Each audit report issued under Companies Act, 2013 only and each certificate

(MTP NOV'23)

Ans: (b)

3. An auditor of a company has found that accountant of a company has entered bogus purchase bills for Rs.50 lacs in its books of accounts. Which of following is most appropriate regarding auditor's duty as far as reporting is concerned under Companies Act, 2013?
  - (e) Report the matter to jurisdictional ROC
  - (f) Report the matter to Secretary, MCA
  - (g) Report the matter to Board of Directors of company
  - (h) Report the matter to jurisdictional ROC as well as GST authority

Ans: (D)

## CARO

1. **During the course of audit of a listed company, CA P finds that solar power generating plant capitalized in books for ₹5.00 crore during the year does not exist. It became known that only bills were arranged and no assets were actually procured. Besides, financial statements also reflect depreciation of ₹1.50 core on above. The bills of capitalized asset were approved by procurement head. The matter was reported to audit committee by CA P. However, no response was received. Considering above, choose the most appropriate option: -**
  - a. The matter needs to be reported to MCA in ADT-4. It also requires reporting under CARO,2020.
  - b. The matter needs to be reported to MCA in ADT-4. It does not require reporting under CARO,2020.
  - c. The matter need not be reported to MCA. However, it requires reporting under CARO,2020.



- d. The matter needs neither reporting to MCA nor under CARO,2020 (MTP NOV'22)

Ans: (a)

**2. For which of following company, provisions of CARO,2020 would be applicable?**

- a. Boost Up Training (OPC) Private Limited
- b. RCI Bank Limited
- c. PST Industries Limited
- d. Moon Insurance Limited

(MTP NOV'23)

Ans: (c)

**3. While reporting under CARO, 2020, it is duty of statutory auditor of company to report: -**

- a. Fraud of less than Rs.1 crore committed by officers or employees of company during the year
- b. Fraud of Rs.1 crore or more committed by officers or employees of company during the year
- c. Fraud of Rs.5 crore or more committed by officers or employees of company during the year
- d. Any fraud by the company or on the company noticed or reported during the year

(MTP NOV'23)

Ans: (d)

## **4. COMPLETION AND REVIEW**

### **MCQS BASED QUESTIONS**

1. An auditor of a company communicates significant findings from audit with those charged with governance in the company. Which of the statements is false in regard to communication made?
  - a. Evaluation of adequacy of communication process is required on part of the auditor.
  - b. Planned scope and timing of audit has also to be communicated.
  - c. Communication of rationale behind audit procedures is necessary.
  - d. Significant difficulties encountered during audit, if any, have to be communicated.
2. Written representations are: -
  - a. Necessary audit evidence
  - b. Sufficient appropriate audit evidence
  - c. Not audit evidence
  - d. Audit evidence depending upon auditor's professional judgment
3. Which of the following is false regarding communication of misstatements identified during course of an audit?
  - a. The auditor should request those charged with governance for correction of identified misstatements.
  - b. The auditor should obtain written representation acknowledging management belief that effect of uncorrected misstatements is material.
  - c. The auditor should obtain written representation acknowledging management belief that effect of uncorrected misstatements is immaterial.
  - d. The auditor should communicate effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.
4. Which of the following is not an example of subsequent event?
  - a. Event occurring between date of financial statements and date of auditor's report.
  - b. Event occurring on date of financial statements.
  - c. Event occurring after filing audit report with tax authorities. Had such an event been known earlier, auditor would have amended report.
  - d. Event occurring during course of performing audit procedures after date of financial statements.
5. Which of the following is not an example of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern?
  - a. Adverse key financial ratios
  - b. Inability to invest in modernisation of plant

- c. Inability to pay creditors on time
- d. Inability to pay salary of staff

**Answers to the MCQs based Questions**

1. (c)      2. (a)      3. (b)      4. (b) 5. (b)

## **CASE STUDY BASED QUESTIONS**

CA. Gaurav Gogoi is about to conclude audit of a company. It has been noticed during the course of audit that there is shortage of important raw material supplies being imported from China due to prevailing geo-political situation. The company has shared with him its plan to deal with the situation. He is satisfied with assessment of the company for dealing with the matter. The issue is disclosed in financial statements and considering management's assessment, it is felt that use of going concern assumption by company in preparation of financial statements is appropriate. Besides, he also wants to be sure that all subsequent events till now have been considered and accounted for, where ever necessary, in financial statements.

Before concluding audit, he requests written representations from management regarding its responsibilities. However, it is noticed that such written representations provided by management use qualifying language.

He has also communicated significant findings from audit in writing with those charged with governance in the company and has retained copy of relevant mails. Besides, there are certain matters which were communicated by him orally from time to time during the course of audit to those charged with governance.

**Based on above, answer the following questions: -**

1. As regards description of matter above concerning issue of going concern, which of the following statements is most appropriate for auditor's report?
  - a. The auditor should express an unmodified opinion.
  - b. The auditor should express a qualified opinion as material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.
  - c. Besides expressing an unmodified opinion, the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" drawing attention to the note in which such disclosure is made in financial statements along with related matters.
  - d. Such an issue does not affect auditor's opinion.

2. As regards going concern basis of accounting is concerned, which of the following statements is true?
  - a. A company showing net loss in its financial statements is essentially not a going concern.
  - b. Following going concern assumption of accounting is primary duty of auditor.
  - c. In case, a company is not a going concern, its financial statements must be prepared on liquidation basis.
  - d. Audit procedure seeking confirmation from banker regarding outstanding balance relates to verification of going concern assumption.
  
3. Which of the following statements is true in respect of auditor's responsibilities in respect of subsequent events?
  - a. There is no obligation for an auditor to perform audit procedures for events occurring between date of financial statements and date of auditor's report.
  - b. There is no obligation for an auditor to perform audit procedures after signing of auditor's report, even if he comes to know of an event, which if known to him earlier would have caused him to amend the audit report.
  - c. The auditor has only to rely upon written representation of management regarding subsequent events. He has no other means to know about such events.
  - d. The auditor should perform necessary audit procedures to know about events occurring between the date of financial statements and date of auditor's report.
  
4. As regards use of qualifying language in written representations, which of the following statement is most appropriate?
  - a. It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.
  - b. Written representations should be unconditional. Such a wording is not acceptable.
  - c. Such a wording dilutes intent of written representations. However, it can be accepted by auditor only in exceptional circumstances.
  - d. Qualifying language in written representations is compulsory.
  
5. As regards auditor's responsibility regarding matters communicated orally with those charged with governance, which of following is most appropriate?
  - a. Matters communicated orally have to be documented by the auditor stating when and to whom these were communicated.
  - b. Matters communicated orally need not be put into writing. It is sufficient for auditor to have communicated orally.

- c. Matters communicated orally need not be put into writing. It is not practically feasible.
- d. Matters communicated orally have to be documented by the auditor stating to whom these were communicated.

**Answers to MCQs involving case study**

1.	c	2.	c	3.	d	4.	a	5.	a
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## MCQ'S FROM RTP'S, MTP'S, QP'S

### **SA 560- SUBSEQUENT EVENTS**

1. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
- Discuss the matter with management and, where appropriate, those charged with governance.
  - Determine whether the financial statements need amendment.
  - Inquire how management intends to address the matter in the financial statements.
  - All of the above **(MTP MAY'23)**

Ans: (d)

### **SA 570- GOING CONCERN**

1. Which of the following is not an example of an event or condition that may cast significant doubt on entity's ability to continue as a going concern:
- Loss of key management without replacement
  - Adverse key financial ratios
  - Inability to pay creditors on due date
  - Current year profit turns to loss after providing depreciation **(MTP MAY'22)**

Ans: (d)

2. A company is engaged in business of obtaining eggs from one day old chicks. Which of the following is NOT an example of an event or condition that may cast significant doubt on the ability of the company to continue as a going concern?
- Mortality of 90% of livestock of the company
  - Decision by Govt. to ban commercial rearing of birds amidst protests by activists for preventing cruelty to animals
  - Shifting of farm labour to respective villages due to MGNREGA scheme of Govt. causing acute scarcity throughout the year
  - Increase in cost of feed of chicks by 20% during the year. **(RTP NOV'22)**

Ans: (d)

3. Following are examples of events or conditions that may cast significant doubt on an entity's ability to continue as a going concern. Which of following is an example of operating event/conditions?
- Adverse key financial ratios
  - Inability to pay creditors on due dates

c. Indications of withdrawal of financial support by creditors

d. Shortages of important supplies

**(MTP NOV'23)**

Ans: (d)

# 5. AUDIT DOCUMENTATION

## MCQS BASED QUESTIONS

1. Which of the following statement is appropriately suited to preparation of audit documentation?
  - a. Audit documentation has to be prepared simultaneously as audit progresses.
  - b. Audit documentation has to be prepared 60 days after date of audit report.
  - c. Audit documentation has to be prepared when information is required by regulator.
  - d. Audit documentation has to be prepared 60 days after completion of audit work.
2. Audit documentation is owned by: -
  - a. Client
  - b. Auditor
  - c. Team member responsible for documentation
  - d. Regulator
3. Which of the following is least likely to be included in audit documentation of a company engaged in manufacturing and export of goods?
  - a. Previous years audited financial statements
  - b. Projected cash flow statement for next twelve months provided by management in support of going concern assumption
  - c. Statements showing dispatch of overseas consignments in accordance with delivery schedules of overseas buyers
  - d. Statement showing verification of ageing of trade receivables as on date of balance sheet
4. Which of the following is false in relation to audit documentation when an external auditor relies upon work of internal auditor?
  - a. Evaluation of objectivity and competence of internal auditor has to be documented.
  - b. Nature of work used and reason for relying upon work used forms part of documentation.
  - c. Documentation on whether quality control is exercised in internal audit work forms part of audit documentation.
  - d. Documentation on what specific recommendations were given by internal auditor for risk assessment to external auditor forms part of audit documentation.

### Answers to the MCQs based Questions

1.	a	2.	b	3.	c	4.	d
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## **CORRECT/INCORRECT**

**State with reasons (in short) whether the following statements are correct or incorrect:**

**1. As per SA 230 on “Audit Documentation”, the working papers are not the property of the auditor.**

**Incorrect:** As per SA 230 on “Audit Documentation” the working papers are the property of the auditor and the auditor has right to retain them. He may at his discretion can make available working papers to his client. The auditor should retain them long enough to meet the needs of his practice and legal or professional requirement.

**2. Mr. A is a statutory auditor of ABC Ltd. The branch of ABC Ltd. is audited by Mr. B, another Chartered Accountant. Mr. A requests for the photocopies of the audit documentation of Mr. B pertaining to the branch audit.**

**Incorrect:** SA 230 issued by ICAI on Audit Documentation, and “Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

## CASE STUDY QUESTIONS

CA Rajan Pillai is heading the engagement team conducting audit of a company. While audit is in progress, consider following issues regarding audit documentation:-

- A. Audit programme was prepared assigning responsibilities for different types of works to be performed to team members. The engagement team consists of 4 members Mohit (CA final student), Rohit (CA final student), Shobhit (Paid CA) and CA Rajan Pillai (partner of audit firm).
- B. The team has determined materiality for financial statements as a whole. The team has assessed risks of material misstatements to be low.
- C. CA Shobhit is responsible for attending inventory count process and putting down its documentation part.
- D. During the course of audit, many related party transactions have come to notice.

**On the basis of above, answer the following questions:**

1. Work relating to verification of revenue was assigned to Mohit in audit programme. However, it is being performed by Rohit actually. Verification of trade receivables was planned to be carried out by Rohit in audit programme. However, it being performed by CA Rajan Pillai due to last minute practical issues. Which of the following statements is most appropriate in this regard relating to audit documentation?
  - a. Audit programme contains names of persons and work to be performed. It is immaterial whether work assigned to one person is performed by another person.
  - b. Audit programme was already prepared. Only persons assigned specific responsibilities can perform those duties.
  - c. It is necessary that audit programme be suitably updated or notes are given in working papers to this effect so that planned duties are in accordance with actual work performance.
  - d. Changes in audit programme or notes clarifying the matter are required only when a person not forming part of engagement team is deputed to perform a duty. Otherwise, this issue of inter-shuffling of team members is frivolous.
2. As regards materiality, which of the following statements is most appropriate in context of audit documentation?
  - a. Materiality has already been determined. There is no need to put it into working papers.
  - b. Materiality depends upon professional judgment of auditor. Whatever amount has been determined can be documented in working papers.
  - c. Materiality arrived on basis of professional judgment along with factors considered in the determination has to be documented.
  - d. Materiality has been arrived upon professional judgment. It also depends upon professional judgment of auditor whether he wants to document it or not.
3. As regards team's assessment that risk of material misstatements is low, which of the following statements is odd one relating to documentation of risk?

- a. Discussion amongst engagement team members and detail of significant decisions reached has to be documented.
  - b. Details of risk assessment procedures have to be documented.
  - c. Details about how understanding of each component of internal control was obtained has to be documented.
  - d. Precise calculation of risk of material misstatements has to be documented.
4. CA Shobhit is responsible for attending physical inventory count of the company. Which of the following is not true in this regard relating to audit documentation?
- a. Dates on which physical inventory count process was attended by him should be documented. It may also include photographs of that dateshowing his attendance of inventory counting process at a particular location.
  - b. Detail of test counting undertaken should form part of audit documentation.
  - c. Detail of obsolete goods found should form part of audit documentation.
  - d. Reports showing that stocks conform to quality control standards in accordance with law are essential part of audit documentation
5. As regards related party transactions, which of the following should not be part of audit documentation?
- a. Management representation letter in this regard
  - b. Related party transaction policy of the company
  - c. Documentation to show that such transactions are at arm's length basis
  - d. Documentation to show that such transactions are at close length basis.

**Answers to Questions involving case study**

1.	c	2.	c	3.	d	4.	d	5.	d
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## MCQ'S FROM RTP'S, MTP'S, QP'S

1. Judging the significance of a matter requires\_of the facts and circumstances.
- objective analysis
  - subjective analysis
  - Both subjective and objective analysis
  - qualitative analysis
- (MTP MAY' 22)

Ans :(a)

2. CA Amar is the statutory auditor of XYZ Ltd. for the FY 2020-21. During the process of assembling the audit file, CA Amar briefed his team as to what all changes can be made to the audit documentation at that stage. Which of the following changes cannot be made to the audit documentation during the final assembly process?
- Sorting, collating & cross referencing of working papers.
  - Signing off completion checklists relating to the file assembly process.
  - Deleting or discarding superseded documents.
  - Recalculation of Depreciation.
- (MTP MAY'23)

Ans: (d)

3. The auditor may consider it helpful to prepare and retain as part of the audit documentation a summary (sometimes known as a completion memorandum) that describes-
- evidence identified during the audit
  - the significant matters identified during the audit and how they were addressed
  - the significant evidence identified during the audit
  - the significant matters identified during the audit
- (MTP MAY'23)

Ans: (b)

4. Which of the following is not a likely purpose of audit documentation
- It helps to show that audit was conducted in accordance with requirements of SQC 1.
  - It serves as a record of matters of continuing significance to future audits.
  - It assists engagement team to plan and perform the audit.
  - It can directly help auditor in expanding client base.
- (MTP NOV'23)

Ans: (d)

5. A company has started its manufacturing operations from a newly constructed building. CA Z is statutory auditor of company. Which of following is not likely to be an example of audit documentation?
- E-mail correspondence with CFO of company concerning significant matters
  - Audit programme
  - Response to external confirmation requests
  - Structural engineer's report on strength of building
- (MTP NOV'23)

Ans: (d)

6. \_\_\_\_\_ refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

- a. Audit Techniques
- b. Audit evidence
- c. Audit Documentation
- d. Audit Procedures record

(MTP MAY'23)

Ans: (c)

# **6. AUDIT EVIDENCE**

## **MCQS BASED QUESTIONS**

1. Which of the following is not one of functions of internal auditor of an organization?
  - a. Performing assurance activities
  - b. Performing consulting activities to improve governance of organization
  - c. Performing risk management activities
  - d. Expressing independent opinion on financial statements of organization
  
2. An auditor finds during course of an audit that the entity has entered into many related party transactions. Which of the following statements is true?
  - a. The risk that management may override controls in respect of related party transactions is lower.
  - b. The risk that management may override controls in respect of related party transactions is higher.
  - c. There is no effect on the risk that management may override controls in respect of related party transactions.
  - d. Risk of overriding of controls by management has no relationship at all with related party transactions.
  
3. Which of the following is not an objective of a company's policies for ensuring "internal financial controls"?
  - a. Efficient conduct of business
  - b. Safeguarding of assets
  - c. Prevention and detection of frauds and errors
  - d. Assessing audit risk
  
4. Which of the following is not an advantage of statistical sampling?
  - a. Sample size does not increase in proportion to size of area tested.
  - b. Sample selection is more objective.
  - c. It provides a means of deriving a calculated risk and corresponding precision.
  - d. In case of verifying compliance with specific legal requirements, it is suitable.
  
5. A company auditor receives external confirmation from an entity to whom company has sold goods. The said amount is properly classified in financial statements of company. Which of the following statements is not true in this regard?
  - a. It shows that said trade receivable exists.

- b. It shows that said trade receivable is properly valued.
- c. It shows that company has a right to said trade receivable.
- d. It shows that amount of said trade receivable has been recorded in proper account.

**Answers to the MCQs based Questions**

1.	d	2.	b	3.	d	4.	d	5.	b
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**CORRECT/INCORRECT**

**State with reasons (in short) whether the following statements are correct or incorrect:**

**1. Purchase invoice is an example of internal evidence.**

**Incorrect:** Internal evidence is the evidence that originates within the client’s organisation. Since purchase invoice originates outside the client’s organisation, therefore, it is an example of external evidence.

**2. Sufficiency is the measure of the quality of audit evidence.**

**Incorrect:** Sufficiency is the measure of the quantity of audit evidence. On the other hand, appropriateness is the measure of the quality of audit evidence.

**3. Inquiry alone is sufficient to test the operating effectiveness of controls.**

**Incorrect:** Inquiry along with other audit procedures (for example observation, inspection, external confirmation etc.) would only enable the auditor to test the operating effectiveness of controls. Inquiry alone is not sufficient to test the operating effectiveness of controls.

**4. When auditor inquires the management as part of the audit procedures it should be formal written form only and not informal oral inquiries.**

**Incorrect:** When auditor inquires the management as part of audit procedures such inquiries may range from formal written inquiries to informal oral inquiries.

**5. Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur.**

**Incorrect:** Assertions refer to representations by management that are embodied in the financial statements as used by the auditor to consider the different types of the potential misstatements that may occur.

**6. The method which involves dividing the population into groups of items is known as block sampling.**

**Incorrect:** The method which involves dividing the population into groups of items is known as cluster sampling whereas block sampling involves the selection of a defined block of consecutive items.

**7. Universe refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.**

**Incorrect:** Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

**8. Non Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.**

**Incorrect:** Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.

**9. Sample need not be representative.**

**Incorrect:** Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

**10. The objective of stratification is to increase the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.**

**Incorrect:** The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

**11. When statistical sampling is used to select a sample, sample need not be representative because the statistical sampling takes care of the representation.**

**Incorrect:** Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

**12. Stratified Sampling is used for homogeneous population.**

**Incorrect:** Stratified sampling is used when the population is diversified i.e heterogeneous. The population is divided into sub population having similar characteristics. Sample are then chosen from these sub populations which are called as Stratum. Therefore, stratified sampling is not useful in case of homogeneous population.

**13. Non statistical sampling is considered to be more scientific than the statistical sampling.**

**Incorrect:** Statistical sampling uses scientific method of choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non statistical sampling, auditors' judgment and past experience is used to choose samples without any scientific method.

**14. In case of Statistical sampling, auditor's bias in choosing sample is involved.**

**Incorrect:** Statistical sampling uses scientific method choosing samples from a given population.



The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non statistical sampling, auditor's judgment and past experience is used to choose samples without and scientific method. Hence, personal bias is involved in Non statistical sampling and not Statistical.

**15. In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population.**

**Incorrect:** 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.

**16. Low acceptable sampling risk requires larger sample size.**

**Correct:** Sampling risk arises from possibility that the auditor's conclusion based upon sample may be different from conclusion that would have been reached if same audit procedures were applied on the entire population. If acceptable sampling risk is low, large sample size is needed.

**17. 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 only.**

**Incorrect.** 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 both financial and non- financial data.

**18. Auditor can depend on routine checks to disclose all the mistakes or manipulation that may exist in accounts.**

**Incorrect.** Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis in addition to reasonable tests.

**19. Only purpose of analytical procedures is to obtain relevant and reliable audit evidence when using substantive analytical procedures.**

**Incorrect.** Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Analytical procedures are used for the following purposes:

- i. To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
- ii. To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

**20. Analytical Procedures are required in the planning phase only.**

**Incorrect.** Analytical Procedures are required in the planning phase and it is often done during

the testing phase. In addition these are also required during the completion phase.

**21. Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time.**

**Incorrect.** Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.

**22. Ratio analysis is useful in analyzing revenue and expense account only.**

**Incorrect:** Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts

**23. Reasonableness test rely only on the events of the prior period like other analytical procedures.**

**Incorrect:** Unlike trend analysis, Reasonableness test does not rely on events of prior periods, but upon non-financial data for the audit period under consideration.

**24. The statutory auditor of the company can apply analytical procedures to the standalone financial statements of a company only and not to the consolidated financial statements.**

**Incorrect:** Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

## **CASE STUDY BASED QUESTIONS**

### **CASE STUDY 1**

CA Drishti Khandelwal is conducting audit of a company engaged in manufacturing of towels and bedspreads. The company is having its own manufacturing set-up. However, it also gets some manufacturing processes outsourced from third parties. The company has three locations having substantial quantities of inventories in the same city. Besides, due to outsourcing of some processes, inventories are also held in premises of third parties in the same city. As part of audit procedures, she is performing many audit procedures required by different Standards on Auditing.

In particular, she is attending physical inventory count process of the company at year end in accordance with requirements of SA 501. The inventory of the company includes raw materials consisting mainly of natural and dyed yarns, work in process in different stages of manufacturing and finished stocks of towels and bedspreads.

She is also planning sending confirmations to parties to whom the company has sold goods. On reviewing trade receivables list, she finds that the list also contains large number of parties having small balances. She further finds that these receivables have arisen due to sale of bedspreads to small time retailers and possibility of difference in balances as per company's records and as per records of these small-time retailers is low. Risk of misstatements in relation to trade receivables has been assessed as low. Besides, there is nothing to suggest that small-time retailers would disregard such requests.

While conducting audit, she is testing controls operating in the company. She is also conducting tests of various items of income and expenditure as well as balances appearing in balance sheet. She intends to rely upon sampling extensively.

**Based on above description, answer the following questions:**

1. Which of the following statements is most appropriate regarding inventory count by auditor in accordance with SA 501?
  - a. She should inspect the inventory to ascertain its existence and condition at all locations, observe how company personnel are carrying out count procedures and perform test counting.
  - b. She should inspect the inventory to ascertain its existence at all locations, observe how company personnel are carrying out count procedures and perform test counting. The matter of condition of inventories falls in domain of expert.
  - c. She should inspect the inventory to ascertain its existence at selected location, observe how company personnel are carrying out count procedures and perform test counting. The matter of condition of inventories falls in domain of expert.
  - d. She should inspect the inventory to ascertain its existence and condition at all locations and perform counting of each and every item.

2. As regards inventories lying with third parties, which of following statements meets requirements of SA 501?
  - a. She should request confirmation from third parties regarding quantity and condition of inventories held on behalf of the company as well as request third parties to allow her to inspect inventories held by them. Both requirements are necessary to be complied with.
  - b. She should request confirmation from third parties regarding quantity and condition of inventories held on behalf of the company or request third parties to allow her to inspect inventories held by them. Compliance of any one of these or both is required for purposes of SA 501.
  - c. There is no obligation cast upon an auditor in respect of inventories lying with third parties.
  - d. She should request confirmation from third parties regarding quantity, condition and value of inventories held on behalf of the company or request third parties to allow her to inspect inventories held by them. Compliance of any one of these is sufficient for purposes of SA 501.
3. Keeping in view description regarding trade receivables, identify the most appropriate statement in context of SA 505?
  - a. She should not plan and design confirmation requests for large number of parties having small balances.
  - b. She should plan and design positive confirmation requests for large number of parties having small balances.
  - c. She should plan and design positive confirmation requests for large number of parties having small balances and meticulously analyse exception rate
  - d. She should plan and design negative confirmation requests for large number of parties having small balances.
4. As regards sampling, which of the following statements is most appropriate in terms of requirements of SA 530?
  - a. Sampling is used in tests of transactions as well as tests of controls.
  - b. Sampling is used in tests of balances as well as tests of controls.
  - c. Sampling is used in tests of details.
  - d. Sampling is used in tests of details as well as tests of controls.
5. Since she intends to rely upon sampling extensively, which of the following statements is true about sampling risk?
  - a. Sampling risk can be eliminated.
  - b. Increase in sampling risk would lead to decrease in detection risk.
  - c. Decrease in sampling risk would lead to increase in detection risk.
  - d. Sampling risk will always be in existence.

## Answers to questions involving Case Study 1

1.	a	2.	b	3.	D	4.	d	5.	d
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### CASE STUDY 2

Financial statements of a firm have been put up for audit before CA Manushi. On going through financial statements, she wants to verify assertions contained in financial statements and has planned certain procedures for carrying out detailed checking.

1. She plans to verify some major bills debited in “Machinery repair” account. The purpose of it is to ensure that bills are entered correctly and their classification is proper.
2. She plans to verify that all balances appearing under trade payables are genuine and not fake.
3. She plans to compare amount of wages paid in current year and last year. It is also planned to verify relationship between the number of employees and wages paid in both years.
4. She is of the view that it is necessary to examine title deeds of “land” appearing in financial statements of the firm.
5. The firm is engaged in export of goods to Europe. The sales invoices raised in Euros are converted into Indian rupees as per applicable norms.

#### **Based on above description, answer the following questions:**

1. As regards description given regarding verification of bills debited in “Machinery repair” account, identify what she intends to perform?
  - a. Tests of Controls
  - b. Tests of transactions
  - c. Tests of balances
  - d. Risk assessment procedures
2. Identify which type of assertion she intends to focus when she wants to ensure genuineness of trade payables.
  - a. Occurrence
  - b. Cut-off
  - c. Existence
  - d. Accuracy
3. As regards comparison of wages of current year and last year and comparison of relationship between the number of employees and wages paid in both years, identify what she is trying to do?
  - a. She is intending to perform tests of details.
  - b. She is intending to perform tests of transactions.
  - c. She is intending to perform tests of balances.
  - d. She is intending to perform substantive analytical procedures.

4. In case of examination of title deeds of “land”, which of the following fits into most appropriate description of such an audit procedure?
- Observation
  - Inspection
  - External confirmation
  - Enquiry
5. She wants to verify whether conversion of foreign currency into Indian rupees is proper or not. Identify what she is trying to do?
- Reperformance
  - Recalculation
  - Observation
  - Inspection

**Answers to questions involving Case Study 2**

1.	b	2.	c	3.	d	4.	b	5.	b
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# QUESTIONS FROM RTP'S, MTP'S, QP'S

## **SA 500- AUDIT EVIDENCE**

**1. Audit evidence includes**

- (a) information contained in the accounting records underlying the financial statements
- (b) both information contained in the accounting records underlying the financial statements and other information.
- (c) other information.
- (d) information contained in the accounting records underlying the financial statements or other information.

**(MTP 2 MARKS MTP-OCT'19-MTP-APRIL-2019 , APRIL '21 , NOV '21 & APRIL '23)**

**Ans: (b)**

**2. 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

**(MTP 1 MARK OCT 19, APR'22, RTP NOV'19)**

**Ans: (a)**

**3. In relation to completed engagements, procedures designed to provide evidence of compliance by engagement teams with the firm's quality control policies and procedures is known as:**

- (a) Monitoring
- (b) Inspection
- (c) Subsequent Audit procedures
- (d) Compliance procedures

**(MTP 1 MARK SEP'22)**

**Ans: (b)**

**4. Mr. H and his team members in detail checked and evaluated the books of accounts and relevant documents of WT Limited. This is an example of which audit procedure:**

- (a) Inspection.
- (b) Re-performance.
- (c) Recalculation.
- (d) Observation.

**(MTP 1MARK SEP'22)**

**Ans: (a)**

**5. Statement 1: Audit procedures consist of Risk Assessments Procedures and other procedures.  
Statement 2: Substantive procedures consist of test of details and analytical procedures.**

- (a) Only Statement 1 is correct
- (b) Only Statement 2 is correct
- (c) Both 1 & 2 are correct
- (d) Both 1 & 2 are incorrect

(MTP 1MARKS SEP'22, RTP MAY'20)

Ans: (c)

6. CA X, auditor of Green Shoots Private Ltd. is going through financial statements of the company. On perusing notes to accounts, he finds ageing of trade payables reflecting in accordance with requirements of Schedule III of Companies Act, 2013. He wants to be sure that ageing of trade payables forming part of notes of accounts is proper and carries out ageing independently to confirm its veracity.

Identify audit procedure(s) being performed by CA X.

- (a) Analytical procedures
- (b) Recalculation
- (c) Re-performance
- (d) Observation

(MTP 1 Marks Oct'22)

Ans: (c)

7. \_\_\_\_\_ may be defined as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. It includes both information contained in the accounting records underlying the financial statements and other information.

- (a) Audit procedure
- (b) Audit evidence
- (c) Audit plan
- (d) Audit programme

(MTP 1 MARK SEP '23)

Ans: (b)

8. While auditing the books of accounts of Mehra Limited for the financial year 2022-23, the auditor of the company used an audit procedure according to which complete documents and records of the company were checked in detail in order to obtain audit evidence. Explain the audit procedure used by the auditor of company.

- (a) Recalculation
- (b) Analytical Procedures
- (c) Inquiry
- (d) Inspection

(MTP 1 MARK SEP '23)

Ans: (d)

9. CA Tarini is in process of formulating audit plan for conducting audit of a company engaged in business of dealing in commodity futures. Which of the following is not likely to be an



**appropriate audit procedure to be included in audit plan for the above said company?**

- (a) Verification of turnover of company
- (b) Verification of cost of raw material consumed
- (c) Examination of company's accounting policy for revenue recognition
- (d) Verification of contract notes with brokers

**(MTP 1 MARK OCT '23)**

**Ans: (b)**

## **SA 610- USING THE WORK OF INTERNAL AUDITORS**

**1. CA M is internal auditor of Crayon Products Limited. Which of the following is not TRUE about scope of internal audit?**

- (a) Internal audit is an independent assurance activity.
- (b) Internal audit helps in improving internal control of the company.
- (c) Internal audit cannot review non-financial activities of company.
- (d) Internal audit can review compliance of company with various laws and regulations.

**(MTP NOV'22)**

**Ans: (c)**

## **AUDIT SAMPLING**

**1. The relationship between tolerable error and sample size is**

- a. Inverse
- b. Direct
- c. Close
- d. There is no relationship.

**(MTP MAY'23)**

**Ans: (a)**

## **ANALYTICAL PROCEDURES**

**1. \_\_\_\_\_ implies analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years.**

- (a) Trend analysis
- (b) Ratio analysis
- (c) Structural modelling
- (d) Account fluctuations analysis

**(MTP MARCH 22)**

**Ans: (a)**

**2. 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

**(MTP MAY' 22, NOV'22)**

Ans: (b)

**3. 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

**(MTP MAY' 22, MAY'23)**

Ans: (a)

**4. The auditor of Vishwas Ltd wants to know from you which of the following methods are analytical procedures**

- i. Comparison of client and industry data
  - ii. Comparison of client data with similar prior period data
  - iii. Comparison of client data with client-determined expected results
  - iv. Comparison of client data with auditor-determined expected results
- a. I, II and III only
  - b. I &, II only
  - c. III &, IV only
  - d. I, II, III and IV

**(NOV'22)**

Ans: (d)

**5. CA D, during the course of audit of a company engaged in export business, notices that credit facilities taken by company during the year from a bank for Rs.10 crores have almost been fully utilized during the year. On going through sanction letter provided by bank to company, it is observed that rate of interest stipulated in sanction letter is 8% p.a. Financial statements of company show bank interest amounting to Rs.60.00 lacs. Which type of substantive analytical procedure is being used by CA D?**

**(MTP MAY 24)**

- (i) Trend analysis
- (j) Ratio analysis
- (k) Reasonableness tests
- (l) Structural modelling

Ans:(C)

## CASE STUDY BASED QUESTIONS

### CASE SCENARIO 1

Watch IT India Private Limited is a company engaged in business of manufacturing smart watches. The company had a slow start in the beginning as company's products were gaining traction with customers. However, momentum has picked up during the year. The company wants to appoint M/s Tripathi & Associates, a CA firm as their auditor for year 2023-24 by replacing their existing auditors M/s Sreepath and Co. M/s Tripathi & Associates are willing to accept the engagement. They communicated with previous auditors before accepting the engagement. However, M/s Sreepath and Co. have failed to respond.

CA Kishan, partner of M/s Tripathi & Associates explained to his team members about importance of Engagement letter. He also arranged a team discussion on matters relating to acceptance of terms of engagement.

First point of consideration was concerning preconditions for an audit. Mr. Arun, a team member could recollect few of them. Those included determining whether financial reporting framework used in the preparation of financial statement is acceptable, management providing auditor with access to all relevant information and additional information upon auditor's request. It was further elaborated by Arun that management has to provide unrestricted access to employees within entity as may be required by auditor for obtaining audit evidence. Team members were asked to list factors that may necessitate revision of Engagement letter in case of recurring audits. Mr. Kumar, another team member replied that revision may be required in cases involving significant change in ownership, recent changes in senior management, change in financial reporting framework adopted in preparation of financial Statements, modest change in nature or size of the entity's business, change in legal and regulatory requirements etc.

Mr. Ram, one of the team members raised a doubt. He enquired regarding recourse available to incoming auditor in case management makes it clear before acceptance of engagement by auditor regarding its inability in providing support to him in respect of certain procedures expected to be performed during course of audit. In this respect, specific question was raised relating to sending of confirmation requests to material trade payables reflecting in financial statements of a company. Trade payables pertain to material input and input services acquired and utilised by company during the year. Lack of support by management in such a case would, in effect, signify management's refusal to allow auditor to send confirmation requests at the outset before engagement is accepted by auditor.

**Based on above, answer the following questions:**

**2.1** As regards doubt of Mr. Ram described in last para of case scenario, which of the following statements is likely to be in accordance with Standards on Auditing?

- (a) The auditor needs to inquire into management's reasons for the refusal and perform alternative audit procedures to obtain relevant and reliable audit evidence.

- (b)** The auditor needs to evaluate implications of management's refusal on auditor's assessment of risk of material misstatement and perform alternative audit procedures to obtain relevant and reliable audit evidence.
- (c)** The auditor should not accept such an engagement.
- (d)** The auditor needs to evaluate implications of management's refusal on risk of fraud and perform alternative audit procedures to obtain relevant and reliable audit evidence.

**2.2** When CA Kishan, the partner, asked about preconditions for an audit, Mr. Arun could recollect only few of them. Read the passage and find out which among the following points were missed.

- (i)** Obtaining management responsibility on specific legal aspects governing the organisation.
- (ii)** Obtaining management responsibility on Standards on Auditing applicable to the organisation.
- (iii)** Obtaining management responsibility for the preparation of financial statements as per applicable financial reporting framework.
- (iv)** Obtaining management responsibility on necessary Internal controls to enable preparation of financial statements which are free from material misstatement whether due to error or fraud.

Choose the correct answer from below options.

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

**2.3** From what Mr. Kumar replied about the factors requiring a revision of Engagement letter one point was incorrect. Read the passage and find that incorrect factor.

- (a)** A significant change in ownership
- (b)** A recent change in management
- (c)** A change in financial reporting framework adopted in preparation of Financial Statements
- (d)** A modest change in nature or size of the entity's business

**2.4** M/s Sreepath & Co. have failed to respond to incoming auditors. In this regard, choose the most appropriate option: -

- (a)** It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of objectivity governing professional ethics.
- (b)** It was ethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It does not involve violation of any of fundamental principles governing professional ethics.
- (c)** It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of Professional competence and due care

governing professional ethics.

- (d) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of professional behaviour governing professional ethics.

(MTP MAY 24)

Question No.	Answer
2.1	(B)
2.2	(B)
2.3	(A)
2.4	(A)

### Case Scenario 2

Bandhu Charitable Trust is considering appointment of MNO & Associates, Chartered Accountants, as independent auditors of its financial statements. The Trust is engaged in providing affordable healthcare services. It is in interest of both auditor and client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent. It is, therefore, important that each party should be clear about nature of engagement. It should exactly specify the scope of work. Such an “engagement letter” is exchanged between Trust management and auditors.

While performing audit procedures, it is noticed by auditors that bills of two vehicles are not in name of Trust but in name of trustees. However, payment of these vehicles was made from bank account of Trust. The said vehicles are used for activities of Trust.

It is also noticed that a sum of Rs.50.00 Lakh is reflected in Trust’s financial statements in name of Gamma Instrument and Equipment in schedule of creditors. The said amount is outstanding since two years. The auditors sent confirmation request to the said supplier and seek management’s co-operation in this regard. However, management of the Trust informs the auditor regarding certain dispute going on with the supplier of equipment due to some quality issues. It is further informed that dispute is near settlement and it would not be proper to send confirmation request as it can affect negotiation process.

**Based on the above facts, answer the following: -**

- As regards exchange of engagement letter between Trust management and auditors is concerned, which of following statements is likely to be true?
  - Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It includes reference to the expected form and content of report to be issued by them and a statement that there may be circumstances in which such report may differ from its expected form and content.
  - Engagement letter is sent by Bandhu Charitable Trust to MNO & Associates. It includes reference to the expected form and content of report to be issued by auditors. However, it does not include a statement that such report may differ from its expected form and content.

- (c) Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It includes reference to expected form and content of report to be issued by them. However, it does not include a statement that such a report may differ from its expected form and content.
- (d) Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It does not include reference to the expected form and content of report to be issued by them.
2. Considering the issues related to vehicles as described in the case study, identify the most appropriate statement.
- (a) Auditors have identified misstatement concerning “Existence” assertion made by Trust management.
- (b) Auditors have identified misstatement concerning “Rights and Obligations” assertion made by Trust management.
- (c) Auditors have identified misstatement concerning “Accuracy” assertion made by Trust management.
- (d) Auditors have identified misstatement concerning “Completeness” assertion made by Trust management.
3. What course of action should the auditor take regarding the amount payable to the equipment supplier when management has communicated that sending a confirmation request could negatively impact the negotiation process?
- (a) The auditor should issue adverse opinion in auditor’s report.
- (b) The auditor should seek audit evidence as to the validity and reasonableness of the reasons for refusal and perform alternative audit procedures.
- (c) The auditor should withdraw from engagement as Trust management’s refusal is a limitation on scope of independent audit.
- (d) The auditor should disclaim opinion in auditor’s report.

#### MCQs

4. CA Prince, after developing the audit strategy for Vedika Limited, develops an audit plan but finds a need to revise the materiality levels set earlier and therefore, a deviation from the already set audit strategy is felt necessary. In this case, he should
- (a) Drop the audit and withdraw from the engagement.
- (b) Devise a new audit plan and then, change the strategy as per the Revised Plan.
- (c) First Modify the audit strategy and thereafter, prepare the audit plan according to the modified strategy.
- (d) Continue with the Audit Plan without considering the Audit Strategy.

5. Jasmine was of the view that audited financial statements are not a guarantee against probable wrong doings in the financial matters of companies. What kind of assurance does audit of financial statements provide?
- (e) It provides reasonable assurance meaning a low level of assurance.
  - (f) It provides reasonable assurance meaning a high level of assurance.
  - (g) It provides reasonable assurance meaning an absolute level of assurance.
  - (h) It provides reasonable assurance meaning a moderate level of assurance.
6. CA Raman instructed his article Raju to verify whether employee benefit expense of Prep Limited has been fairly allocated between the operating expense incurred in production activities and general expense. Which of the following assertions is being addressed by this instruction?
- (a) Completeness
  - (b) Presentation and Disclosure
  - (c) Measurement
  - (d) Occurrence

1.	(a)	2.	(b)	3.	(b)	4.	(c)	5.	(b)	6.	(b)
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# **7. AUDIT OF DIFFERENT TYPES OF ENTITIES**

## **MCQS BASED QUESTIONS**

1. The audit of municipal corporation of a large metro city is in progress. Which of the following is not likely an objective of such as audit?
  - a. To report on the adherence to legal and administrative requirements
  - b. To report on whether value is being fully received for money spent
  - c. To report on the weakness of systems of financial control
  - d. To provide better civic amenities to residents of metro city
2. “Save Democracy” is an NGO working in cause of promoting democracy and democratic institutions in many countries including India. Its Indian counterpart has received funds from a renowned “Flower Trust” of US. As auditor of NGO, which of the following laws/orders would be relevant to you in context of above information?
  - a. Income Tax Act, 1961
  - b. Foreign Contribution Regulation Act, 2010
  - c. Companies Act, 2013
  - d. Orders issued by Ministry of Social Justice and Empowerment
3. The appointment of first auditor of a multi-state cooperative society is made by:
  - a. Central Registrar
  - b. Board of society
  - c. Members of society
  - d. Central Government
4. Consider following revenue sources of Union Government.
  - a. Revenues from direct taxes
  - b. Revenues from Goods and Services Tax
  - c. Revenues from Custom Duties
  - d. Revenues from Excise DutiesOut of P, Q, R and S, which of the following flow to “Consolidated Fund of India”?
  - a. P, Q and R
  - b. P, Q and S
  - c. P and Q
  - d. P, Q, R and S
5. An LLP files compliance returns with:
  - a. Registrar of firms & societies
  - b. Central Registrar
  - c. Registrar of Companies
  - d. Local fund audit wing



## Answers to the MCQs based Questions

1.	d	2.	b	3.	b	4.	b	5.	c
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### CORRECT / INCORRECT

State with reasons (in short) whether the following statement is correct or incorrect:

1. **Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the Finance Minister may on the advice of the C&AG prescribe.**

**Incorrect-** Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C&AG prescribe.

2. **According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.**

**Correct-** According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations i.e. the expenditure is incurred with due regard to broad and general principles of financial propriety.

3. **Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads: (a) general administration and revenue collection, (b) public health, (c) public safety, (d) education, (e) public works, and (f) others such as interest payments.**

**Correct-** Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads: (a) general administration and revenue collection, (b) public health, (c) public safety, (d) education, (e) public works, and (f) others such as interest payments, etc., mostly related to civic amenities and local area development and maintenance.

4. **The external control of municipal expenditure is exercised by the Central Government through the appointment of auditors to examine municipal accounts.**

**Incorrect-** The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. However, the municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit.

5. **NGOs may be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives.**

**Correct-** NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situations. These would include religious

organisations, voluntary health and welfare agencies, charitable organisations, hospitals, old age homes, research foundations etc. The scope of services rendered by NGOs is extremely wide.

**6. The accounts of every LLP shall be audited in accordance with rule 24 of LLP Rules 2009.**

**Incorrect-** Rule 24 of LLP Rules 2009 provides that any LLP, whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty five lakh rupees, is not required to get its accounts audited. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rules.

**7. The auditor of an LLP may be appointed by the Designated Partners or other Partners whosoever is available at the time of appointment.**

**Incorrect-** The auditor is to be appointed by the designated partners of the LLP. However, the Partners may appoint the auditors only if the Designated Partners have failed to appoint them.

**8. The Comptroller and Auditor General does not have any authority to audit the accounts of stores and inventory kept in any office or department of the Union or of a State.**

**Incorrect-** The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State. Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG.

**9. An Operating Lease is a kind of Financing arrangement.**

**Incorrect-** A Finance Lease is a Financing arrangement. An Operating lease, on the other hand, is a simple arrangement where, in return for rent, the lessor allows the lessee to use the asset for a certain period.

**10. An auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts in the case of audit of a Hotel.**

**Correct-** The auditor should ensure that proper valuation of occupancy-in- progress at the balance sheet date is made and included in the accounts for proper recording of closing and opening entries and maintenance of accounts on Accrual basis as per the Matching concept.

**11. The first auditor of a Multi-State co-operative Society will be appointed in Annual General Meeting.**

**Incorrect-** Section 70 of the Multi-State Co-operative Societies Act, 2002 provides that the first auditor or auditors of a Multi-State co-operative society shall be appointed by the board within one month of the date of registration of such society and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. If the board fails to exercise its powers under this sub-section, the Multi-State Co-operative Society in the general meeting may appoint the first auditor or auditors.

**12. Small LLPs are mandatorily required to get their Books of account audited.**

**Incorrect-** The accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009, which provide that any LLP whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty-five lakh rupees, is not required to get its accounts audited. Further , a Small LLP is any LLP the Contribution of which, does not exceed twenty-five lakh rupees (INR 25,00,000) or such higher amount, not exceeding five crore rupees, as may be prescribed; and the Turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed forty lakh rupees (INR 40,00,000) or such higher amount, not exceeding fifty crore rupees, as may be prescribed; Hence, the provisions of audit are not applicable on Small LLP's. Therefore, the Small LLPs can prepare its financial statement merely with the signatures of the Designated Partners.

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## CASE STUDY BASED QUESTIONS

### CASE STUDY

Consider the following five descriptions: -

- A. Audit of “Implementation of Nagpur Metro Rail Project” was conducted by the Comptroller and Auditor General of India.

Following is extract of few audit findings placed on website [cag.gov.in](http://cag.gov.in).

“The location of New Airport station was not ideal from the viewpoint of ridership due to sparse population in and around the station and also from the accessibility point of view.

Cotton Market station, the second additional station was projected to have high peak hour peak direction trips but the work was kept on hold midway citing fund crunch due to non-release of pending contribution from stakeholders. However, the situation could have been managed through prioritization of works.”

- B. Another set of audit findings in respect of audit of Haryana Power Generation Corporation Limited, a wholly owned government company responsible for operation of power generation plants in state of Haryana is as under: -

“The main reason for low generation was higher variable cost of thermal power stations which resulted in backing down of plants.”

- C. A report was tabled in Parliament highlighting main features of direct taxes administration of country as mandated in Constitution of India. This report primarily discussed compliance to the provisions of the Income Tax Act, 1961 and the associated rules and procedures etc. as applied to administration of direct taxes including irregularities noticed in finalizing assessments etc.

- D. Radial finance corporation Limited is a government company. The audit of the company is conducted by statutory auditors appointed by Comptroller and Auditor General of India.

- E. Bharat Insurance Company Limited is a general insurance government owned company. The statutory auditor is appointed by Comptroller and Auditor General of India.

The annual report for a particular year also contains comments of statutory auditors on matters such as whether company has carried out reconciliations in respect of its inter-company balances with other government owned insurance companies.

**Based on above, answer following questions:**

1. Based upon plain reading of audit findings stated at Para (A), identify type of audit carried out by office of the Comptroller and Auditor General of India.
  - a. Audit against provision of funds
  - b. Propriety audit
  - c. Performance audit
  - d. Compliance audit

2. Keeping in view audit findings in respect of Haryana Power Generation Corporation Limited, identify type of audit carried out.
  - a. Audit of Government Company
  - b. Audit against rules and orders
  - c. Compliance audit
  - d. Performance audit
3. Which of the following is the most appropriate statement in context of report tabled in Parliament regarding administration of direct taxes?
  - a. It is likely to be a report prepared for submission to the President under Article 151 of the Constitution of India by Comptroller and Auditor General of India.
  - b. It is likely to be a report prepared for submission to the Prime Minister under Article 151 of the Constitution of India by an independent task force of experts.
  - c. It is likely to be a report prepared for submission to the President under Article 151 of the Constitution of India by Central Board of Direct Taxes.
  - d. It is likely to be a report prepared for submission to the Prime Minister under Article 151 of the Constitution of India by Central Board of Direct Taxes.
4. Who is empowered to conduct “supplementary audit” in case of Radial finance Corporation Limited, a government company?
  - a. Central Government
  - b. Another independent auditor appointed by CAG
  - c. CAG
  - d. Another independent auditor appointed by Ministry of Corporate Affairs
5. As regards comments of auditors specified in respect of audit report of above insurance company, which of the following is likely to be most appropriate statement?
  - a. Such are likely to be comments of test audit carried out by CAG.
  - b. Such are likely to be comments in respect of directions to statutory auditor by CAG for reporting on specific aspect of their audit work.
  - c. Such are likely to be comments of supplementary audit carried out by CAG
  - d. Such are likely to be comments of statutory auditors in accordance with requirements of Standards on Auditing

**Answers to Questions involving case study**

1.	c	2.	d	3.	a	4.	c	5.	B
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## **QUESTIONS FROM RTP'S, MTP'S, QP'S**

### **CORRECT/INCORRECT**

**State with reasons (in short) whether the following statements are correct or incorrect:**

**Question 1:**

**State with reasons (in short) whether the following statements are correct or incorrect:**

**According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations. (MTP MAY'23, NOV'23)**

**Answer**

Correct- According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations i.e. the expenditure is incurred with due regard to broad and general principles of financial propriety.

# **8. AUDIT STRATEGY, AUDIT PLANNING AND**

## **AUDIT PROGRAMME**

### **MCQS BASED QUESTIONS**

1. Which of the following is not considered in planning an audit generally?
  - a. Understanding of legal and regulatory framework of an entity
  - b. Need to consider determination of materiality
  - c. Evaluating audit evidence
  - d. Need to consider involvement of expert
2. Which of the following is true about audit plan?
  - a. Once an audit plan has been finalized for an engagement, changes cannot be made to it.
  - b. Audit plan includes scope, timing and direction of planned risk assessment procedures.
  - c. Changes in audit plan cannot lead to change in audit strategy.
  - d. Audit plan has to be documented by auditor.
3. Which of the following is not included in an audit programme normally?
  - a. Extent of checking
  - b. Date of checking
  - c. Nature or type of procedure
  - d. Planning of risk assessment procedures
4. Which of the following is not an advantage of an audit programme?
  - a. It acts as a guide for audit of coming years.
  - b. It fixes responsibility of assistants.
  - c. It serves as a shelter for assistants.
  - d. It serves a proof of work done by auditor.
5. Which of the following is most important principle for formulating an audit plan?
  - a. Gaining knowledge of client's workforce
  - b. Gaining knowledge of client's business
  - c. Gaining knowledge of client's vendors
  - d. Gaining knowledge of tax laws applicable to client

#### **Answers to the MCQs based Questions**

1.	(c)	2.	(d)	3.	(d)	4.	(c)	5.	(b)
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## **CORRECT/INCORRECT**

State with reasons (in short) whether the following statements are correct or incorrect:

- 1. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.**

**Correct.** Once the overall audit strategy has been established, an audit plan can be developed to achieve the audit objectives through the efficient use of the auditor's resources. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.

- 2. Establishing an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan is prerogative of the management.**

**Incorrect.** The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.

- 3. Planning is a discrete phase of an audit.**

**Incorrect.** Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures.

- 4. A detailed Audit Programme once prepared for a business can be used for all business under all circumstances.**

**Incorrect.** Businesses vary in nature, size and composition; work which is suitable to one business may not be suitable to others; efficiency and operation of internal controls and the exact nature of the service to be rendered by the auditor are the other factors that vary from assignment to assignment. On account of such variations, evolving one audit programme applicable to all business under all circumstances is not practicable.

- 5. The audit plan is more detailed than the overall audit strategy.**

**Correct.** The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.

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## CASE STUDY BASED QUESTIONS

Kaur & Associates, a sole proprietor firm of Simran Kaur, is offered appointment as auditor of a company engaged in manufacturing of automobile components for the first time. She is fact checking about the integrity of promoters of the company and key managerial persons. Matters such as competence of staff to perform the engagement are also considered by her. The appointment is subsequently accepted by her.

She is also taking into account number and location of branches of the company, requirements of Schedule III of Companies Act, 2013 and expected time by which audit has to be completed keeping in view statutory requirements. Initially, she has thought it proper to inquire key employees of the company in procurement and marketing departments and planned for the same. She has also planned to visit three plants of the company. The purpose of planned inquiry and visit is to identify and assess risk of material misstatements.

A detailed set of instructions has been prepared by her office and it has been handed over to assistants in engagement team. These set of instructions include details of extent of checking and nature of audit procedures to be performed regarding purchases, sales, items of income, items of expenditure etc. During the course of execution of above set of instructions, it has been brought to her notice that company is also producing substantial quantities of scrap generated during manufacturing process. However, no instructions have been given to engagement team in this regard.

**Based on above, answer following questions:**

1. Auditor is fact checking about promoters and key managerial persons. She is also considering competence of staff to perform engagement. What is she trying to do?
  - a. She is establishing audit strategy.
  - b. She is conducting preliminary engagement activities.
  - c. She is designing audit plan.
  - d. She is checking her compliance of ethical requirements.
2. Consideration of number and location of branches, requirements of financial reporting framework and expected time of completion are relevant factors primarily for which of the following -
  - a. Developing audit plan
  - b. Establishing overall audit strategy
  - c. Designing audit programme
  - d. Designing risk assessment procedures
3. Taking into account description of planned inquiry and visit, which of the following statements is TRUE?
  - a. Planned inquiry and visit fall in area of audit strategy.

- b. Planned inquiry and visit are planned risk assessment procedures and fall in field of audit plan.
  - c. The said description is not related to audit planning.
  - d. Planned inquiry and visit fall in scope of audit programme.
4. What is detailed set of instructions given to assistants in engagement team known as?
- a. Audit guidelines
  - b. Audit plan
  - c. Audit Programme
  - d. Audit Procedures
5. The issue of generation of scrap has been overlooked in detailed set of instructions given to engagement team. What should be proper course of action by CA Simran Kaur?
- a. She should ignore this information as audit has already begun.
  - b. She should modify earlier set of instructions.
  - c. She should leave the matter to wisdom of engagement team.
  - d. She should put the ball in court of management as she was not provided with complete information earlier.

**Answers to Questions involving case study**

1.	(b)	2.	(b)	3.	(b)	4.	(c)	5.	(b)
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## MCQ'S FROM RTP'S, MTP'S, QP'S

**1. The agreed terms of the audit engagement shall be recorded in an audit engagement letter or other suitable form of written agreement and shall include: (MTP MAY 22)**

- i. The objective and scope of the audit of the financial statements;
- ii. The responsibilities of the auditor;
- iii. The responsibilities of management;
- iv. Identification of the applicable financial reporting framework for the preparation of the financial statements; and
- v. Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.

Which of the following is correct?

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

Ans: (b)

**2. sets the scope, timing & direction of the audit and guides the development of the more detailed plan. (MTP MAY 22)**

- a. Audit Programme
- b. Overall Audit Strategy
- c. Completion Memorandum
- d. Audit Plan

Ans: (b)

**3. The overall audit strategy and the audit plan remain the responsibility. (MTP MAY'23)**

- a. auditor's
- b. management's
- c. those charged with governance.
- d. both management and those charged with governance.

Ans: (a)

**4. Which of the following statements is MOST APPROPRIATE? (RTP NOV'22)**

- a. Audit programme is a detailed plan of audit strategy
- b. Audit programme cannot be reviewed
- c. Audit programme is a detailed plan of applying audit procedures
- d. Audit programme is relevant for year for which it is prepared, it is useless for subsequent years.

Ans: (c)

## CASE STUDY BASED QUESTIONS

### CASE SCENARIO 1

Priority Limited is a large company engaged in manufacturing of terry towels making steady profits on a year-to-year basis. PMR & Associates, statutory auditors of the company since last two years, are in process of establishing audit strategy for conducting statutory audit under Companies Act, 2013 for year 2023-24.

The company has 5 branches which are audited by independent auditors appointed under Companies Act, 2013. It also has a wholly owned subsidiary company which is audited by another audit firm under name of JKL & Associates. The engagement team has noticed that company has maintained several bank accounts and there is substantial movement in fixed deposits during the year leading to risk of misstatement in cash and cash equivalents. The engagement team has planned procedures regarding the same.

(i) At planning stage, engagement partner is also trying to set materiality for financial statements as a whole. The following information extracted from financial statements is given as under: -

Particulars	(Amount in Rs.crores)
Revenue	100
Total Assets	40
Profit before Tax	8
Total Liabilities (excluding Equity)	30

(ii) While designing a sample for verifying revenues of company as part of tests of details, engagement partner has determined "tolerable misstatement" for Rs.5.00 Lakh in order to address the risk that aggregate of individual immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements. One of the newly joined engagement team members has little conceptual understanding of "tolerable misstatement" determined by engagement partner. He also has no idea of the effect of change in tolerable misstatement on sample size.

(iii) During course of audit, while performing tests of details, engagement team has come across certain misstatements in selected sample pertaining to verification of revenues. The team has projected misstatements to population of revenues. The team wants to comply with the Standards on Auditing strictly.

**Based on the above facts, answer the following: -**

7. The auditors of company are in process of establishing audit strategy. Which of the following is not a relevant factor in establishing overall audit strategy in the given case scenario?

- (a) Consideration of 5 branches which are audited by independent auditors
- (b) Consideration of wholly owned subsidiary company audited by another audit firm
- (c) Expected time of holding AGM in accordance with provisions of Companies Act, 2013
- (d) Nature, timing and extent of planned procedures for cash and cash equivalents

8. For Priority limited, which benchmark would the engagement partner most likely to use for setting materiality for the financial statements as a whole?
- (a) A percentage of Revenue
  - (b) A percentage of Total assets
  - (c) A percentage of Profit before tax
  - (d) A percentage of Total liabilities (excluding equity)
9. In the given case scenario, assume that the engagement partner has decided to increase tolerable misstatement to Rs.10.00 Lakh while designing sample described. Select the correct statement.
- (a) It would lead to decrease in sample size.
  - (b) It would lead to an increase in sample size.
  - (c) It would have no effect on sample size.
  - (d) It is not possible to draw inference on sample size due to increase in tolerable misstatement.
10. While performing procedures on designed sample, the engagement team identified certain misstatements in selected sample and projected these to the entire population of revenues. According to the requirements of the Standards on Auditing, which statement is correct in this regard?
- (a) Anomalous misstatement is auditor's best estimate of misstatement in population.
  - (b) The projected misstatement plus anomalous misstatement, if any, is best estimate of misstatement in population.
  - (c) When projected misstatement exceeds tolerable misstatement, sample provides a reasonable basis for conclusion about tested population.
  - (d) When projected misstatement plus anomalous statement, if any, exceeds tolerable misstatement, sample provides a reasonable basis for conclusion about tested population.

7.	(d)	8.	(c)	9.	(a)	10.	(b)
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# **9. RISK ASSESSMENT AND INTERNAL CONTROL**

## **MCQS BASED QUESTIONS**

1. Which of the following is true regarding materiality?
  - a. It is unaffected by nature of an item.
  - b. It is unaffected by requirements of law or regulations.
  - c. It is not a matter of professional judgment.
  - d. It is not always a matter of relative size.
2. The operations of a company are automated substantially. Which of the following statements is most appropriate in this respect?
  - a. It results in complex business environment.
  - b. It results in simple business environment and easier audit.
  - c. Automation has no relationship with complexity of business environment.
  - d. It results in simple business environment. However, it increases complexity of audit.
3. Who is responsible for maintaining effective internal financial controls?
  - a. Statutory auditor
  - b. Audit Committee
  - c. Management
  - d. Shareholders
4. Which of the following is not a risk to a company's internal control due to its IT environment?
  - a. Potential loss of data
  - b. Inability to access data when required
  - c. Unauthorized access to data
  - d. Processing of large volumes of data
5. Which of the following is not an example of "General IT controls"?
  - a. Controls pertaining to Disaster recovery plan
  - b. Controls pertaining to batch preparation
  - c. Controls pertaining to data security
  - d. Controls pertaining to validation of input data in an application

### **Answers to the MCQs based Questions**

1.	d	2.	a	3.	c	4.	d	5.	d
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## CORRECT/INCORRECT

State with reasons (in short) whether the following statements are correct or incorrect:

**1. There is direct relationship between materiality and the degree of audit risk.**

**Incorrect:** There is an inverse relationship between materiality and the degree of audit risk. The higher the materiality level, the lower the audit risk and vice versa. For example, the risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low but the risk that it could be misstated by an extremely small amount might be very high.

**2. Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.**

**Incorrect:** Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

**Control risk, on the other hand is** the risk that a misstatement that could occur in an assertion about a class of transaction, account balance or disclosure and that could be material, either individually or when aggregated with other misstatements, will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

**3. Tests of control are performed to obtain audit evidence about the effectiveness of Internal Controls Systems.**

**Correct:** Tests of Control are performed to obtain audit evidence about the effectiveness of:

- a. the design of the accounting and internal control systems that is whether, they are suitably designed to prevent or detect or correct material misstatements and
- b. the operation of the internal controls throughout the period.

**4. Maintenance of Internal Control System is the responsibility of the Statutory Auditor.**

**Incorrect:** The management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business. Maintenance of Internal Control System is responsibility of management because the internal control is the process designed, implemented and maintained by those charged with governance/management to provide reasonable assurance about the achievement of entity's objectives.

## **CASE STUDY BASED QUESTIONS**

### **CASE STUDY 1:**

CA Paritosh is auditor of a company. The financial statements of the company have just been received for audit. Following issues have been flagged pertaining to the financial statements of the company for purpose of risk assessment: -

- i. The revenue of company has fallen from Rs.50 crore in last year to Rs.5 crore in current year (for which financial statements have been received for audit) due to lack of demand in the market for company's products.
- ii. Due to advent of new products in the market, company's products are fast becoming outdated.
- iii. A large customer having an outstanding balance of Rs.5 crore has failed to pay to the company despite efforts made by the company.
- iv. Inventory holding period has increased from 30 days in last year to 90 days.
- v. The company also gets carried out job operations from third parties. Therefore, parts of inventories are lying with third parties.

**Based on above, answer the following questions: -**

1. Regarding drastic fall in revenue of the company, which of the following is an audit risk?
  - a. Fall in revenue would result in fall of profits for the company.
  - b. Drastic fall in revenue may imply that company is not able to carry out its operations in foreseeable future due to lack of demand in the market for company's products. There is a risk that going concern disclosure is omitted to be made in financial statements.
  - c. The company can explore some new line of activity, if demand of its products is falling.
  - d. Fall in revenue would mean lower tax liabilities for the company.
2. The company's products are getting outdated in the market. Which of the following is an audit risk?
  - a. The company should devise strategies to sell products in the market.
  - b. Inventories may be understated in such a scenario.
  - c. Inventories may be overstated in such a scenario.
  - d. The company should launch a 1+1 free offer for its customers.
3. A large customer has failed to pay to the company. Identify audit risk from below:
  - a. Receivables may be misstated if irrecoverable debt is not written off.
  - b. Receivables may be overstated if irrecoverable debt is not written off.
  - c. Writing off irrecoverable debt would impact profits of company adversely.
  - d. Failure to recover outstanding debt would impact cash flows of company adversely.
4. Identify audit risk involved when inventory holding period has increased from 30 days to 90 days.
  - a. There is a risk of overstatement of inventories.



- b. There is a risk relating to existence of inventories.
  - c. There is a risk that slow movement of stocks would increase tax liability when GST rates are increased.
  - d. There is a risk relating to holding and storage cost of inventories.
5. Part of inventories are lying with third parties. Identify audit risk involved.
- a. There is a risk that third parties do not manufacture according to specifications of the company.
  - b. There is a risk that by getting job work done from third parties, company is increasing its costs.
  - c. There is a risk that sufficient and appropriate evidence would not be available in respect of quantity and condition of inventories lying with third parties.
  - d. There is a risk that sufficient and appropriate evidence would not be available for quality control in respect of inventories lying with third parties.

**Answers:**

1.	(b)	2.	(c)	3.	(b)	4.	(a)	5.	(c)
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**CASE STUDY 2:**

CA Piyush is understanding internal controls as part of audit exercise of a company. It is a new client. He has studied controls in place in various operational areas of the company. After studying and gaining an understanding of such controls, he has decided to test few controls to actually see whether these are operating as intended by the management.

Till now, he has studied controls over inventories and bank. Few of such controls are listed below: -

Nature of Control	Control description
Control over inventories	Inventories of the company lying at each location should be insured.
Control over inventories	There should be inventory counts on a regular basis for each location of the company.
Control over Bank operations	Bank reconciliations are to be performed at regular intervals.

**Based on above, answer the following questions: -**

1. Which of the following most appropriately describes test of control regarding insurance of inventories?
  - a. Inspect insurance policies to verify that inventories at each location are insured for fire and burglary. The sum insured and period of validity of policy are not relevant.
  - b. Inspect insurance policies to verify that inventories at each location are comprehensively insured. Ensure adequacy of sum insured by comparing it with value of inventories. Also ensure policy period has not expired.
  - c. Inspect insurance policies to verify that inventories at each location are comprehensively

- insured. Ensure policy period has not expired.
- d. Inspect insurance policies to verify that inventories at each location are insured for fire and burglary. Ensure policy period has not expired.
2. Which of the following most appropriately describes test of control regarding inventory counts?
    - a. Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure.
    - b. Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure. Attend inventory count.
    - c. Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure. Attend inventory count and perform test count.
    - d. Attend inventory count and perform test count.
  3. While testing control over bank reconciliations, it has been noticed that bank reconciliations are not being performed at regular intervals. Identify the most appropriate description of “control deficiency” in this regard: -
    - a. Bank reconciliations are not being performed regularly as concerned staff is overburdened.
    - b. Bank reconciliations are not being performed regularly as concerned staff is overburdened. It could result in errors.
    - c. Bank reconciliations are not being performed regularly as concerned staff is overburdened. It could result in errors. It may result in misstatement of cash and bank balance in financial statements.
    - d. Bank reconciliations are not being performed regularly as concerned staff is overburdened. These should be performed monthly and reviewed by senior accountant.
  4. Since the company is a new client, which of the following statements is most appropriate?
    - a. There is reduced detection risk.
    - b. There is increased detection risk.
    - c. There is no effect on detection risk.
    - d. Detection risk should be increased to lower audit risk.
  5. Which of the following statements is most appropriate regarding auditor’s response to assessed risk of a new client?
    - a. More substantive procedures would require to be performed.
    - b. Less substantive procedures would require to be performed.
    - c. There is no effect on substantive procedures.
    - d. There is no effect on substantive procedures as audit risk is low.

**Answers:**

1.	(b)	2.	(c)	3.	(c)	4.	(b)	5.	(a)
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## MCQ'S FROM RTP'S, MTP'S, QP'S

1. Owing to the limitations of an audit, there is risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.

- a. Inherent, unavoidable
- b. Inherent, complete
- c. Management, unavoidable
- d. Regulatory, control

(MTP MAY'22)

Ans: (a)

2. A company is engaged in manufacturing of wooden furniture. The auditor of company notes that company has identified emerging risks pertaining to probable reduction in demand of company's products due to procurement of imported furniture from South East Asian nations. It has also estimated how significant are those risks and their possibility of happening. Besides, it has also formulated an action plan to deal with the situation, in case these risks materialize.

Which of the following options would be most appropriate to describe above situation?

- a. An example of audit risk for auditor
- b. An example of component of internal control of company
- c. An example of control risk of company
- d. An example of inherent risk for auditor

(MTP NOV'22)

Ans: (b)

3. Which of the following is incorrect-

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;
- 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. Not 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.

(MTP MAY'23)

Ans: (d)

4. To evaluate the Internal Control of Kingsway Limited, a team member of the auditors used a method according to which, number of questions relating to internal control of the company

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were required to be answered by the employees of the company. After obtaining the answers there was a discussion relating to those answers between team member of the auditor and employees of the company for a clear picture. State the method of evaluation of internal control as discussed above.

- a. Narrative record
- b. Check List
- c. Internal Control questionnaire
- d. Flow chart

(MTP NOV'23)

Ans: (c)

5. The term Internal Financial Controls (IFC) basically refers to the policies and procedures put in place by companies for ensuring:

- i. Reliability of financial reporting
- ii. Compliance with applicable laws and regulations
- iii. Safeguarding of assets.
- iv. Effectiveness and efficiency of operations
- v. Prevention and detection of frauds Which statement is correct?

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

(MTP NOV'23)

Ans: (d)

6. In designing and performing test of controls, the auditor shall perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including:

- i. How the controls were applied at relevant times during the period under audit.
- ii. The consistency with which they were applied.
- iii. By whom or by what means they were applied. Which of the following is correct?

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

(MTP MAY'22)

Ans: (c)

7. Consider the following statements pertaining to nature and meaning of “assertions”:-

**Statement I**—Assertions are representations by the management which are present in financial statements.

**Statement II** —The assertions have to be necessarily explicit. Which of the following is correct?

- a. Only Statement I is true.

- b. Only Statement II is true.
- c. Both statements I and II are true.
- d. Both statements I and II are false.

(MTP MAY'22)

Ans: (a)

**8. The concept of materiality is applied by the auditor:**

- a. in planning and performing the audit
- b. in evaluating the effect of identified misstatements on the audit
- c. both in planning and performing the audit, and in evaluating the effect of identified misstatements on the audit
- d. none of the above is correct

(MTP NOV'22,)

Ans: (c)

**9. \_\_\_\_\_ are needed to support the functioning of**

- a. General IT Controls; Application Controls
- b. Application Controls; General IT Controls
- c. IT Dependent Controls; General IT Controls
- d. Application Controls; IT Dependent Controls

(MTP MAY'23)

Ans: (a)

**10. \_\_\_\_\_ refer to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels.**

(RTP May '22)

- a. Internal control assessment procedures
- b. Risk assessment procedures
- c. substantive procedures
- d. analytical procedures

Ans: (b)

**11. A type of super user access to information systems that enforces less or no limits on using that system is known as:**

(RTP May '22)

- a. Super access.
- b. Super user access.
- c. Unlimited access.
- d. Privileged access.

Ans: (d)

**12. Tools and techniques that auditors use in applying the principles of data analytics are known as-**

- a. Computer Aided Audit Technique
- b. Computer Aided Audit Tools

c. Computer Accounting and Auditing Technique

d. Computer Assisted Audit Technique

(RTP May '23)

Ans: (d)

**13. Which of the following is a risk that arises from the use of IT systems?**

a. Direct data changes (backend changes).

b. Limited. Monitored access.

c. Adequate segregation of duties.

d. Authorized access to data.

(RTP Nov '23)

Ans: (a)

**14.** "We, the people" is an NGO working for rights of citizens. Due to nature of its activities, its volunteers take part in agitations which acquire political overtones. It also gets money from trusts based in overseas countries.

The government has tightened regulatory mechanism for NGOs receiving foreign funding. The finance and accounts department in NGO is headed by an experienced person, a former volunteer and activist himself. However, he has no professional or legal educational background. CA N is appointed as auditor of above NGO for the first time.

(MTP MAY 24)

Choose the most appropriate option regarding audit risk inferred by you from above.

(a) Audit risk in the above situation is low.

(b) The situation does not provide quantitative data. Therefore, it is not possible to make a precise measurement of audit risk.

(c) Audit risk in the above situation is high.

(d) The situation does not provide information affecting all components of audit risk.

Therefore, inference cannot be made properly.

Ans: (c)

**15.** CA J is in process of planning audit for a large company engaged in business of dealing and manufacturing of pharmaceutical products. Central Drugs Standard Control Organisation (CDSCO), National regulatory Authority under Ministry of Health & Family Welfare is responsible for approval of drugs, conduct of clinical trials and laying down Standards for drugs and control over quality of imported drugs. Auditor is also considering whether to make use of audit evidence obtained in previous audit of the same company. Besides, he is also considering volume of transactions to determine whether it is efficient to rely on internal controls. As part of planning activities, he is also considering extent of substantive audit procedures to be performed. Consider following factors stated from 1 to 5:

(MTP MAY 24)

1. Reporting requirements required by CDSCO, if any

2. Need for specialized knowledge of pharma industry

3. Expected use of audit evidence obtained in previous audit

4. Volume of transactions to consider reliance on internal control

**5. Nature and extent of substantive audit procedures**

Choose the most appropriate factor/combination of factors which could be relevant to CA J in establishing audit strategy: -

- (a) 1, 3, 4 and 5
- (b) 1 only
- (c) 1, 2, 3 and 4
- (d) 2 only

Ans: (c)

**16.** CA Prince, after developing the audit strategy for Vedika Limited, develops an audit plan but finds a need to revise the materiality levels set earlier and therefore, a deviation from the already set audit strategy is felt necessary. In this case, he should

- (e) Drop the audit and withdraw from the engagement.
- (f) Devise a new audit plan and then, change the strategy as per the Revised Plan.
- (g) First Modify the audit strategy and thereafter, prepare the audit plan according to the modified strategy.
- (h) Continue with the Audit Plan without considering the Audit Strategy. (MTP MAY 24)

Ans: (C)

# 10. AUDIT OF BANKS

## MCQS BASED QUESTIONS

1. Which of the following is included in “Interest Earned” in Profit & loss A/c of a bank?
  - a. Discount on Bills
  - b. Loan Processing fees
  - c. Commission on bills for collection
  - d. Credit Card Fees
2. While auditing advances of a bank as statutory auditor, which of the following is not a likely concern of auditor?
  - a. Appropriate documentation of advances
  - b. Ensuring budgeted targets of advances given by bank management
  - c. Compliance of sanctioned terms and conditions
  - d. Operations in advance accounts
3. Any amount due to the bank under any credit facility is ‘overdue’ if: -
  - a. it is not paid on the due date fixed by the bank
  - b. it is not paid within 30 days of due date fixed by the bank
  - c. it is not paid within 60 days of due date fixed by the bank
  - d. it is not paid within 90 days of due date fixed by the bank
4. Which of the following statement is true regarding appointment of statutory branch auditor of a nationalized bank?
  - a. The appointment is made by bank acting through its board of directors with prior approval of Central govt.
  - b. The appointment is made by bank acting through its board of directors with prior approval of RBI
  - c. The appointment is made by bank acting through its board of directors with prior approval of ICAI
  - d. The appointment is made by shareholders in AGM.
5. Identify the correct statement: -
  - a. Income from non-performing assets is recognized on accrual basis
  - b. Income from non-performing assets is never recognized.
  - c. Income from non-performing assets is recognized on basis of actual recovery
  - d. Income from non-performing assets is recognized only when such assets are upgraded to standard assets

### Answers to the MCQs based Questions

1.	a	2.	b	3.	a	4.	b	5.	c
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## **CORRECT/INCORRECT**

State with reasons (in short) whether the following statements are correct or incorrect:

1. **RBI has been entrusted with the responsibility of regulating the activities of commercial banks only.**

**Incorrect.** RBI has been entrusted with the responsibility of regulating the activities of commercial and other banks. All the Banks and even NBFC's fall under the regulatory function of RBI.

2. **In the computerised environment, the auditor need not be familiar with latest applicable RBI guidelines.**

**Incorrect.** In the Computerised environment, it is imperative that the auditor is familiar with, and is satisfied that, all the norms/parameters as per the latest applicable RBI guidelines are incorporated and built into the system that generates information/data having a bearing on the classification/ provisions and income recognition.

3. **The auditor can assume that the system generated information is correct and relied upon.**

**Incorrect.** The auditor should not go by the assumption that the system generated information is correct and can be relied upon without evidence that demonstrates that the system driven information is based on validation of the required parameters for the time being in force and applicable.

4. **Collateral security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank.**

**Incorrect.** Primary security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the principal security for an advance. Collateral security is in addition to the Primary security.

5. **Registered mortgage is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof**

**Incorrect.** Registered Mortgage can be affected by a registered instrument called the 'Mortgage Deed' signed by the mortgagor. It registers the property to the mortgagee as a security. Equitable mortgage, on the other hand, is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof.

6. **Any amount due to the bank under any credit facility is 'overdue' if it is not paid within 90 days of becoming due.**

**Incorrect.** Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank and 90 days of becoming overdue.

7. **An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.**

**Correct.** An account should be treated as 'out of order' if the outstanding balance remains

continuously in excess of the sanctioned limit/drawing power or In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet ; or credits are there but are not enough to cover the interest debited during the same period.

**8. Banks recognize income on Non-Performing Assets on accrual basis.**

**Incorrect:** Income from non-performing assets (NPA) is not recognised on accrual basis due to its uncertainty but is booked as income only when it is actually received i.e. on actual receipt basis.

**9. Auditor of a Nationalised bank is to be appointed at the annual general meeting of the shareholders.**

**Incorrect:** Auditor of a nationalized bank is to be appointed by the bank concerned acting through its Boards of Directors and approval of the Reserve bank is required before the appointment is made.

**10. Reporting of fraud of INR 150 Lakhs by auditor will be done within three days of the fraud coming to the knowledge of the auditor to the Board or the Audit Committee along with remedial action taken in case of audit of ABA Bank Ltd.**

**Incorrect:** The auditor shall report the matter to the Board or the Audit Committee, as the case may be, immediately but not later than 2 days of his knowledge of the fraud, seeking their reply or observations within 45 days. The Banking Company is bound to disclose remedial action taken in Board's report.

**11. Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets.**

**Correct:** Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets, but regarded as NPA for Income Recognition purpose.

## CASE STUDY BASED QUESTION

### CASE SCENARIO 1

CA M is conducting statutory audit of branch of MMC Bank. During the course of audit, it is noticed as under:

- i. Loans under “Kisan credit card” are given by Bank to farmers to meet their short-term credit needs for cultivation of crops.

In respect of one agricultural advance classified under “Kisan Credit Card” having an outstanding balance of Rs. 20 lacs as at year end, there is no transaction in account since last 90 days. The said loan has been granted for cultivation of paddy which is harvested in a period of 3-4 months from sowing. The branch has classified the said advance as “Standard asset”.

- ii. It is also observed that account of one borrower availing cash credit limit of Rs.50 lacs was taken over from another bank. The proposal was sanctioned by branch manager instead of immediate next higher authority as required in “Manual of Delegation of Powers” of Bank.
- iii. It is noticed that head office of bank has flagged a savings account maintained in branch in which interest was wrongly paid at higher rate due to wrong data feeding entry. Now, situation has been rectified by debiting excess interest paid in the account. Since there was little balance in savings account, a debit balance of Rs.1.50 lac was created in the said savings account due to above reversal. The matter was immediately informed to account holder. However, he has not turned up for payment since matter was informed to him about six months ago.
- iv. There are many cash credit accounts in the branch. Such borrowers are required to submit monthly stock statements to branch showing calculation of drawing power.
- v. One borrower has availed a housing loan and a car loan from the branch. Housing loan EMIs are overdue for 120 days as on date of Balance sheet. Car loan EMIs are overdue for 60 days as on date of Balance sheet.

**Based on above, answer following questions:**

1. As regards description of agricultural advance, which of the following statements is most appropriate in this regard?
- a. The branch has erred in making classification as per RBI norms. It is a “Sub-standard” asset.
  - b. The classification made by branch is proper. However, there are no transactions in account since last 90 days, it is SMA.
  - c. The classification made by branch is proper.
  - d. The branch has erred in making classification as per RBI norms. It is a “doubtful” asset.
2. Regarding taken over account from another bank, which of following statements is most appropriate?

- a. It is an internal issue of Bank and auditor is not concerned with it.
  - b. It is an internal issue of Bank. However, the auditor may, at his discretion, report it.
  - c. It is a serious violation of laid down procedures of bank for sanction of advances and should be reported by auditor without fail.
  - d. There is no issue involved as credit facility was properly sanctioned.
3. As regards debit balance of Rs. 1.50 lacs in Savings account, which of the following is correct from point of view of an auditor?
- a. The situation does not attract RBI norms on asset classification.
  - b. The debit balance of Rs.1.50 lacs should be classified as NPA.
  - c. The situation does not attract RBI norms on asset classification as no credit facility was granted.
  - d. The bank cannot demand excess interest paid to account holder.
4. Which of the following statements is not true about “drawing power” (DP)?
- a. Drawing Power refers to the amount calculated based on primary security less margin as on particular date.
  - b. It is always less than sanctioned limit.
  - c. It can be different from sanctioned limit.
  - d. Creditors for goods are reduced for purpose of calculating Drawing Power.
5. Considering housing loan and car loan availed by a borrower, which of the following statements is appropriate?
- a. Both Housing loan as well as car loan should be classified as “Non-Performing Assets” in accordance with RBI norms on asset classification.
  - b. Housing Loan should be classified as “Non-Performing Asset” in accordance with RBI norms on asset classification. However, Car loan should be classified as Standard asset.
  - c. Car Loan should be classified as “Non-Performing Asset” in accordance with RBI norms on asset classification. However, Housing Loan should be classified as Standard asset.
  - d. Both Housing as well as car loans should be classified as Standard assets.

#### Answers to Questions involving case study

1.	c	2.	c	3.	b	4.	b	5.	a
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#### CASE SCENARIO 2

(MTP MAY 24)

CA B is conducting statutory audit of branch of a nationalized bank. Saurabh, a CA student, is also part of engagement team conducting statutory branch audit. The field of bank branch audit is new to him and he is following instructions as required by engagement partner.

The engagement partner has asked him to prepare a summary of non-funded credit facilities outstanding as on balance sheet date. The following information is appearing in branch’s CBS data/records as on 31<sup>st</sup> March, 2023:

Serial number	Particulars in CBS (Core Banking solution)/records	Amount in Rs.
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		crores
1.	Agricultural term loans	15.00
2.	Staff housing loans	3.50
3.	Staff vehicle loans	0.20
4.	Housing loans-General public	10.00
5.	Letters of credit issued	2.50
6.	Education loans	1.50
7.	Guarantees issued (Fully secured by 100% margin)	1.00
8.	Bills purchased and discounted	2.00
9.	Bills for collection	0.10

On going through listing of housing loans to general public, CA B notices that branch has sanctioned many housing loans of small ticket size ranging between Rs.10.00 to Rs. 20 lakhs. Therefore, he has assessed risk of material misstatements to be high. As a consequence, he has designed procedures to perform tests of controls as well as substantive tests.

Saurabh has been further asked to go through SMA (Special Mention Accounts) jotting as on 30<sup>th</sup> November, 2022. Such reports are available from system on monthly frequency. Being new to such type of assignment, he is unable to understand relevance of above audit procedure mandated by engagement partner.

**Based on above, answer the following questions:**

**3.1** Considering table given in the case scenario, which of the following combinations is appropriate example of non- funded credit facilities provided by branch to its customers?

- (a) Bills purchased and discounted; bills for collection
- (b) Bills for collection; staff housing loans; letters of credit issued
- (c) Bills purchased and discounted; letters of credit issued; guarantees issued (fully secured by 100% margin)
- (d) Letters of credit issued, guarantees issued (fully secured by 100% margin)

**3.2** CA B's decision to perform both tests of controls as well as substantive tests was taken after he had assessed risk of material misstatement in financial statements to be high due to large number of small ticket size loans. Which Standard on Auditing deals with auditor's responsibility to design such tests?

- (a) SA 500
- (b) SA 330
- (c) SA 300
- (d) SA 315

**3.3** Saurabh is unable to understand relevance of going through SMA jotting as on 30<sup>th</sup> November, 2022. Which of following statements is most appropriate in this context?

- (a) It would necessarily help auditor in identifying accounts with significant lending exposure.
- (b) It would help auditor in identifying accounts which may involve downgrading from Sub-standard asset category to doubtful category.
- (c) It would help auditor in identifying accounts where substantial recoveries have been received during the year.
- (d) It would help auditor in identifying accounts which may involve downgrading from standard category to non-performing asset.

QuestionNo.	Answer
3.1	(d) Letters of credit issued; guarantees issued (fully secured by 100% margin)
3.2	(b) SA 330
3.3	(d) It would help auditor in identifying accounts which may involve downgrading from standard category to non-performing asset.

#### CASE SCENARIO 2

M/s Vishwacharya and Associates, a CA firm based in Orissa, is appointed as an auditor of CBF Bank for the financial year 2023-24. During the course of audit, it came to notice that CBF Bank has sanctioned an overdraft facility of Rs.75 lakh to Times Ltd. However, as per the stock statement furnished for the last quarter, the drawing power was calculated to be Rs.50 lakh. It was observed that few advances were guaranteed by the:

- (ii) Central Government as part of 'Make in India' initiative. However, the guarantee was not invoked, and the advances were overdue by 75 days. These advances were classified as standard assets and were regarded as NPA for income recognition purpose.
- (iii) State Government as part of power generation initiative. However, the guarantee was not invoked, and the advances were overdue by 80 days. These advances were also classified as standard assets and were regarded as NPA for income recognition purpose.

Additionally, XYZ Ltd., is a borrower availing cash credit facility of Rs.110 Lakh against security of paid stocks and debtors up to 90 days. Margin stipulated was 25% of stock as and 40% for debtors. Bank has calculated drawing power based on following information provided by XYZ Ltd.

Particulars	Amount (₹)
Value of Stocks (as on 31.12.2023)	130 Lakh
Value of Debtors (as on 31.12.2023)	75 Lakh
Value of stocks (Fully damaged and included in (i) above)	7 Lakh
Value of Debtors (exceeding 90 days included in (ii) above)	10 Lakh
Value of creditors for goods	60 Lakh

Also, the outstanding balance in one of the Loan accounts was Rs.25 Lakh and the realisable value of the security as assessed by the bank / approved valuers was

Rs.2.25 Lakh. Bank identified the same as erosion in the value of security. It was classified as doubtful

category and provision was made for the doubtful assets. A

discussion also took place among the team members regarding issuance of the audit reports after completion of the bank audit and annexure to the same such as Long Form Audit Report, Report on compliance with SLR Requirements, Report on Treasury Operations – as per RBI guidelines, Report on compliance as per Ghosh committee recommendations and Report on adverse credit - lending ratio in the rural areas, etc.

**Based on the above facts, answer the following: -**

1. With respect to the overdraft facility sanctioned to Times Ltd., the account would be termed as out of order if:
    - (i) The outstanding balance remains continuously in excess of Rs.75 Lakh.
    - (ii) The outstanding balance remains continuously in excess of Rs.50 Lakh.
    - (iii) The outstanding balance in the account is less than Rs.75 Lakh but there are no credits or payments deposited into the account continuously for 90 days as on balance sheet date
    - (iv) The outstanding balance is less than Rs.50 Lakh. Choose the correct option from below:
      - (a) (i), (ii) and (iii)
      - (b) (i), (iii) and (iv)
      - (c) (ii),(iii) and (iv)
      - (d) (iii) and (iv)
  
  2. Which of the treatment by the bank on the provisioning and income recognition is correct in case of bank guarantee given by the Central Government and State Government?
    - (a) Both (i) and (ii) are correct
    - (b) Only (ii) is correct
    - (c) Only (i) is correct
    - (d) Both (i) and (ii) are incorrect.
  
  3. In the given case drawing power of the borrower XYZ Limited should be:
    - (a) Rs.86.25 Lakh
    - (b) Rs.76.35 Lakh
    - (c) Rs.96.25 Lakh
    - (d) Rs.85.45 Lakh
  
  4. The Bank has identified an erosion in the value of security and made provision for doubtful assets. Whether the treatment by bank for the doubtful asset is correct?
    - (a) Yes. The security should be classified under doubtful category. It may be either written off or fully provided by the bank.
    - (b) No. The existence of such security should be ignored, and the asset should straight away be classified as loss asset. It may be either written off or fully provided by the bank.
    - (c) Yes. The security should be classified under doubtful category and provisioning should be
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made as applicable for doubtful assets.

**(d)** No. The existence of the security should be ignored, and the asset should straight away be classified as loss asset. Provisioning should be made for doubtful assets.

**5.** The Statutory Central Auditors of a bank must furnish, in addition to the main audit report, various other audit reports. From the options, choose the audit reports that M/s Vishwacharya and Associates shall furnish.

**(i)** Long Form Audit Report

**(ii)** Report on compliance with SLR Requirements

**(iii)** Report on Treasury Operations – as per RBI guidelines

**(iv)** Report on compliance as per Ghosh committee recommendations

**(v)** Report on adverse credit - lending ratio in the rural areas. Choose the correct answer:

**(a)** (i), (ii),(iii),(iv) and(v)

**(b)** Only (i),(ii),(iii) and (iv)

**(c)** Only (i),(ii) and (iii)

**(d)** Only (i),(ii) and (v)

<b>1.</b>	<b>(a)</b>	<b>2.</b>	<b>(c)</b>	<b>3.</b>	<b>(a)</b>	<b>4.</b>	<b>(b)</b>	<b>5.</b>	<b>(b)</b>
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# **11. AUDIT OF ITEMS OF FINANCIAL STATEMENTS**

## **MCQS BASED QUESTIONS**

1. An auditor is verifying purchases to ensure their genuineness. Consequently, he is also trying to verify that no fake “trade payables” are present in financial statements. Which assertions concerning purchase transactions and trade payables respectively are being verified by auditor?
  - a. Occurrence; Existence
  - b. Occurrence; Completeness
  - c. Existence; Occurrence
  - d. Completeness; Occurrence
2. Which of the following statement is most appropriate as regards to disclosure of goods in transit in financial statements of a company?
  - a. No separate disclosure of goods in transit is required.
  - b. Disclosure of total goods in transit under head of inventories is required.
  - c. Disclosure of goods in transit under each sub-head of inventories is required.
  - d. Disclosure of goods in transit for raw material and finished goods is required.
3. Sweat Equity shares are issued by a company at a discount or for consideration other than cash to its:
  - a. Directors only
  - b. Clients only
  - c. Directors or employees
  - d. Auditors only
4. Which of the following is not an element of cost of an item of machinery included under head “Property, Plant and Equipment”?
  - a. Installation costs
  - b. Freight cost of bringing the item to its location
  - c. Inaugural costs
  - d. Employee benefit cost for making such an item suitable for production
5. Which of the classification is not required by a company in respect of its “Cash and cash equivalents”?
  - a. Balance with Banks
  - b. Balance with scheduled banks
  - c. Cash on hand
  - d. Cheques on hand

### **Answers to MCQs**

1.	a	2.	c	3.	c	4.	c	5.	b
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## CORRECT/INCORRECT

State with reasons (in short) whether the following statement is correct or incorrect:

- Employee benefits expenses represent the sum an entity pays to its employees for their labour/ efforts only.**

**Incorrect:** Employee benefits expenses, commonly called payroll expenses, represent the aggregate sum an entity pays to its employees for their labour/ efforts, as well as associated expenses such as perquisites/ benefits, post-employment benefits like gratuity, superannuation, leave encashment, provident fund contribution etc. as well as towards their hiring, their welfare and training.

- Dividends are recognised in the statement of profit and loss only when the entity's right to receive payment of the dividend is established.**

**Incorrect:** Dividends are recognised in the statement of profit and loss only when:

- the entity's right to receive payment of the dividend is established;
- it is probable that the economic benefits associated with the dividend will flow to the entity; and the amount of the dividend can be measured reliably.

- "Sweat Equity Shares" means equity shares issued by the company to employees or directors at a premium or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.**

**Incorrect:** "Sweat Equity Shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

- Capital reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose.**

**Incorrect:** Revenue reserves represent profits that are available for distribution to shareholders.

- A capital reserve, generally, can be realized for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realized.**

**Correct:** A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised. But the amount of share premium or capital redemption reserve account can be utilised only for the purpose specified in Sections 52 and 55 respectively of the Companies Act, 2013.

**6. If Company X's balance sheet shows building with carrying amount of Rs.100 lakh, the auditor shall assume only one point that the management has only asserted that the building recognized in the balance sheet exists as at the period-end.**

**Incorrect:** If Company X's balance sheet shows building with carrying amount of Rs.100 lakh, the auditor shall assume that the management has claimed/ asserted that:

- The building recognized in the balance sheet exists as at the period-end (existence assertion);
- Company X owns and controls such building (Rights and obligations assertion);
- The building has been valued accurately in accordance with the measurement principles (Valuation assertion);
- All buildings owned and controlled by Company X are included within the carrying amount of Rs.100 lakh (Completeness assertion).

**7. The securities premium account may only be applied by the Company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares.**

**Incorrect:** The securities premium account may be applied by the Company:

- a. towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- b. in writing off the preliminary expenses of the Company;
- c. in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- d. in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- e. for the purchase of its own shares or other securities under section 68.

**8. Material and wages are considered to be revenue expenditure when incurred for construction of building.**

**Incorrect:** Material and Wages incurred on construction of building qualify to be capital expenditure as per AS 10 "Property, Plant and Equipment". Therefore, these have to be added to the cost of the asset i.e building and shall not be expensed off to Statement of Profit and Loss.

**9. PPE are depreciated when the asset is actually put to active use.**

**Incorrect:** Depreciation is a fall in value of asset due to obsolescence, usage and effluxion of time, Therefore, depreciation is charged when the asset is ready for use. Active use of asset is not a mandatory criteria for charge of depreciation.

**10. Increase in authorized capital of the company requires special resolution to be passed at the general meeting.**

**Incorrect:** Increase in Authorised capital requires alteration of capital clause of memorandum of Association. Therefore, ordinary resolution is passed for increase in authorised capital of the company as per the Companies Act, 2013.

**11. Capital redemption reserve can be used for distribution of dividends.**

**Incorrect:** Capital Redemption reserve is not a free reserve. It is a restrictive reserve and can be used only for purposes given in the Act. Since it is not a free reserve, it cannot be utilised for payment of dividends. CRR can be used only for the purpose of issuing fully paid up bonus shares.

**12. Dividends are recommended by the Board, and declared by the Shareholders.**

**Correct:** The dividends are recommended by the Board of Directors by passing a resolution at the board meeting. The Shareholders declare the dividends at the AGM by passing an ordinary resolution. Declaration of dividend is an item of ordinary business. However, the shareholders can decrease the amount of dividends recommended by the board but cannot increase it.

**13. In verifying Trade Receivables balance, Direct Confirmation Procedure is one of the important audit activity.**

**Correct:** While auditing trade receivable balance, direct confirmations as per SA 505, is considered to be the most important audit activity. Direct confirmation can be sought from the debtors directly confirming their balance due. The replies to the confirmation can be then matched with the records maintained by the client. Any discrepancies so revealed, can be investigated and checked in detail for possibility of any risk of material misstatement. Auditor selects few debtors' balances and ask the client to prepare the confirmations properly addressed to the debtors. Auditor maintains strict control over this process.

## CASE STUDY BASED QUESTIONS

Sunsteel Ltd. is a company engaged in the manufacture of variety of stainless steel household items ranging from hot pot, pressure cooker, cutlery set, bottles, to serving trays. The company has its corporate office in Delhi and its plant in Raigarh, a city in the state of Chhattisgarh. The company is planning to expand its manufacturing activities by setting up two new plants in the Raipur district of the state. For this purpose, the company also raised funds by making a follow-on public offer during the financial year 2022-23. R K Maheshwari & Associates are the statutory auditors of the company since the year 2020-21. The engagement team consisted of 5 members, with CA Raman as the engagement partner, CA Madhu as the senior associate and three articled trainees namely, Aman, Chetanya and Depesh.

The company raised fresh capital of Rs.5 Cr during the FY 2022-23. The shares with the nominal value of Rs.10 per share were issued at a premium of Rs.5 per share.

The company has the Reserves and Surplus totaling to Rs.2 Cr, comprising of securities premium and general reserve.

CA Raman directed CA Madhu to verify the issue of the share capital in detail giving special consideration to the utilization of the securities premium amount.

The audit engagement team discussed with the management about the performance of the company during the year under consideration. To this, the management told the engagement team that the company is performing very well and the company has doubled its revenue during the year as compared to the last year. The management of the company also told the auditors that during the year the company has made majority of its sales on credit basis to its customers.

CA Raman directed Mr. Aman to send balance confirmation requests to debtors having balance in excess of Rs.1 lakh.

During the course of audit, CA Raman, Chetanya and Depesh also visited the power plants in Raigarh to get a detailed understanding of the manufacturing process. The team performed analytical procedures to obtain audit evidence with respect to the overall reasonableness of purchase quantity and price of inventory. More specifically, Chetanya collected the reports from the management for composition of stock i.e. raw materials as a percentage of total stock and compared the same with the data of the previous year. CA Raman and Chetanya thereafter, discussed the reasons for the variations with the management.

Also, while considering the presentation and disclosure requirements as per Schedule III to the Companies Act, CA Madhu discussed with CA Raman the disclosure with respect to the following account balances:

- Current maturities to long term borrowings
- Long term maturities of finance lease obligations
- Interest accrued but not due on borrowings

- Interest accrued and due on borrowings

**Based on the above facts, answer the following questions:**

1. Which of the following is not correct with respect to shares issued at premium and securities premium account in terms of Section 52 of the Companies Act, 2013?
  - a. Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a securities premium account.
  - b. The securities premium account can be applied by the company in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares.
  - c. The securities premium account cannot be applied by the company in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company.
  - d. The securities premium account can be applied by the company for the purchase of its own shares or securities under section 68.
2. Which of the following is not an example of capital reserve?
  - a. Revaluation reserve arising from revaluation of fixed assets
  - b. Securities Premium
  - c. Capital redemption reserve
  - d. General reserve
3. **Statement 1:** Confirmations as well as undelivered letters should be given/returned to the auditor and not to the client.  
**Statement 2:** When no reply is received, the auditor should perform alternate procedures regarding the balances.
  - a. Only statement 1 is correct
  - b. Only statement 2 is correct
  - c. Both statements 1 & 2 are correct
  - d. Both statements 1 & 2 are incorrect
4. Mr. Chetanya performed which of the following analytical procedures to obtain the audit evidence with respect to the overall reasonableness of purchase quantity and price of raw material?
  - a. Consumption Analysis
  - b. Stock Composition Analysis
  - c. Reasonableness test
  - d. Ratio analysis
5. Which of the following is not correct with respect to the disclosure requirements of Schedule III to the Companies Act 2013?
  - a. Current maturities of long term borrowings is to be disclosed under the head long term

borrowings

b. Long term maturities of finance lease obligations is to be disclosed under the head long term borrowings

c. Interest accrued but not due on borrowings is to be disclosed under the head Other Current Liabilities

d. Interest accrued and due on borrowings is to be disclosed under the head Other Current Liabilities

**Answers to Questions involving case study**

1.	c	2.	d	3.	c	4.	b	5.	a
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## MCQ'S FROM RTP'S, MTP'S, QP'S

1. Obtaining trade receivables ageing report and analysis and identification of doubtful debts is performed during audit of accounts receivable balances to address the following balance sheet assertion:

- a. Valuation
- b. Rights and obligations
- c. Existence
- d. Completeness

(MTP MAY'22)

Ans: (a)

2. 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

(MTP NOV' 22)

Ans: (c)

3. Consider the following data appearing in financial statements of a firm: -

Particulars	Amount in ₹	Amount in ₹
Machinery (at cost)	XXX	10,00,000
Less: Depreciation of earlier years	6,00,000	XXX
Less: Depreciation of year	60,000	6,60,000
WDV at end of year	XXX	3,40,000

Read the following statements on basis of above: -

- (i) The firm owns machinery.
- (ii) The machinery is being utilized in business of firm productively.
- (iii) The machinery physically exists.

Which of following would be obvious assertions on the basis of above data?

- a. Only assertions (i) and (ii) can be inferred.
- b. Only assertions (ii) and (iii) can be inferred.
- c. Only assertions (i) and (iii) can be inferred.
- d. All assertions (i), (ii) and (iii) can be inferred.

(MTP NOV'22)

Ans: (d)



4. **Cut-off testing is performed during audit of sales to address the following assertion:**

- a. Occurrence
- b. Measurement
- c. Cut-off
- d. Accuracy

(MTP MAY'23)

Ans: (c)

5. **\_ are charges against profits to provide for known liabilities for which amounts cannot be determined with accuracy**

- a. Contingent Liabilities
- b. Provision
- c. Securities Premium Reserve.
- d. Liabilities

(MTP MAY'23)

Ans: (b)

6. **Financial statements of a company have been put up for audit before the auditor. On going through financial statements, he wants to verify some major bills debited in "Machinery repair" account. The purpose of it is to ensure that bills are entered correctly and their classification is proper.**

**As regards verification of bills debited in "Machinery repair" account, identify what he intends to perform?**

- a. Tests of Controls
- b. Tests of transactions
- c. Tests of balances
- d. Risk assessment procedures

(MTP NOV'23)

Ans: (b)

7. **The securities premium account may be applied by the Company for which of the following purpose:**

- a. **payment to creditors for material**
- b. purchase of fixed assets
- c. repayment of loans
- d. writing off the preliminary expenses

(MTP NOV'23)

Ans: (d)

8. **During the audit of sales, the auditor found that recorded sales represent goods which were ordered by valid customers and were dispatched and invoiced in the period. The auditor is addressing which of the following assertions:**

- a. Occurrence
- b. Measurement
- c. Cut-off

d. Accuracy

(MTP NOV'23)

Ans: (a)

**9. ABC Ltd is engaged in manufacturing of fabrics from yarn purchased from different suppliers. Occasionally, it also manufactures fabrics tailor made in accordance with requirements of certain mills from yarn received from these mills. ABC Ltd raises bills of its labour charges only on mills for converting yarn into fabrics. The auditor of ABC Ltd tries to ensure that stocks of the company as at year end do not include stocks pertaining to these mills. Which assertion auditor tries to verify in above situation:**

- a. completeness
- b. Occurrence
- c. rights and obligations
- d. cut -off

Ans: (c)

(MTP NOV'23)

**10. 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

(RTP MAY '23)

Ans: (d)

**11. ABC Limited is engaged in manufacturing of electric two-wheelers. During the year, a customer has gone to court due to incident of fire in battery-operated vehicle. The damages claimed are to tune of Rs.5 lakhs. The company insists that this incident was due to improper charging of battery and has nothing to do with manufacturing design of vehicle. The company's lawyers advise that it is probable that company is not likely to be held liable. It is likely to be reflected in financial statements of company under?**

- a. Provisions
- b. Reserves
- c. Contingent liabilities
- d. Other current Liabilities

(RTP NOV '23)

Ans: (c)

**12. CA Tarini is in process of formulating audit plan for conducting audit of a company engaged in business of dealing in commodity futures. Which of following is not likely to be an appropriate audit procedure to be included in audit plan for the abovesaid company?**

- (e) Verification of turnover of company
- (f) Verification of cost of raw material consumed
- (g) Examination of company's accounting policy for revenue recognition

(h) Verification of contract notes with brokers

(MTP MAY 24)

Ans:

13. CA Raman instructed his article Raju to verify whether employee benefit expense of Prep Limited has been fairly allocated between the operating expense incurred in production activities and general expense. Which of the following assertions is being addressed by this instruction?

(e) Completeness

(f) Presentation and Disclosure

(g) Measurement

(h) Occurrence

(MTP SEP 24)

Ans(B)

## CASE STUDY BASED QUESTIONS

### CASE SCENARIO 1

In accordance with requirements of Standards on Auditing, CA Tina (a freshly qualified professional) wants to obtain sufficient appropriate audit evidence in an audit engagement pertaining to financial statements of a partnership firm for year 2022-23. The firm is trading in FMCG goods. Appointed in May, 2023, she needs evidence to obtain information for arriving at her judgment. Clearly remembering fundamentals that an auditor has to obtain sufficient appropriate audit evidence to draw reasonable conclusions on financial statements, she proceeded in accordance with audit plan prepared by her.

During the year 2022-23, firm was maintaining a current account with a branch of a public sector bank. Her audit plan had included procedure of confirming balance of current account directly from bank. As at 28th March, 2023, the firm had an urgent need to pay its utility bill amounting to Rs.1.00 lacs. However, due to insufficiency of funds, it had requested branch manager to get cheque drawn on utility company cleared. Therefore, balance in current account of firm in books of bank branch stood at Rs.0.92 lacs (Debit). The firm had also issued cheques in evening of 31st March, 2023 in anticipation of funds on next working day i.e. 3rd April, 2023. It had also certain cheques dated 27th March, 2023 from its debtors lying with it which were deposited in afternoon of 31st March, 2023 in bank branch at request of debtors.

Her plan also included performance of certain procedures pertaining to verification of inventories. Inventories of FMCG goods were material to financial statements. Her assistant, Tisha, had her own notion about understanding of sufficient appropriate audit evidence. She further feels that when audit evidence is obtained from available records of an entity, it is known as internal evidence like purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law. She is also of the view that audit evidence

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obtained by auditor is final and conclusive.

**Based upon above, answer the following questions: -**

**3.1** As regards matter of balance in current account and related issues is concerned, which of following statements is likely to be most appropriate?

- (a) Amount of Rs. 0.92 lac is required to be classified under cash & bank balances in financial statements of firm. Procedure of confirming balance directly from the bank alone is likely to constitute sufficient appropriate audit evidence.
- (b) Amount of Rs. 0.92 lac is required to be classified under cash & bank balances in financial statements of firm. Procedure of confirming balance directly from the bank alone is not likely to constitute sufficient appropriate audit evidence.
- (c) Amount of Rs. 0.92 lac is required to be classified under current liabilities in financial statements of firm. Procedure of confirming balance directly from the bank alone is likely to constitute sufficient appropriate audit evidence.
- (d) Amount of Rs. 0.92 lac is required to be classified under current liabilities in financial statements of firm. Procedure of confirming balance directly from the bank alone is not likely to constitute sufficient appropriate audit evidence

**3.2** Considering matter of verification of inventories, which of following statements is based on facts described in the situation and also in essence of Standards on Auditing?

- (a) She should verify subsequent sale invoices of inventory items lying in stocks as at year end. Besides, she should also review stock records of year 2022-23 and subsequent period. Such evidence may constitute sufficient appropriate audit evidence.
- (b) She should verify subsequent sale invoices of inventory items lying in stocks as at year end. Besides, she should also review stock records of year 2022-23 and subsequent period. She should attend physical inventory count at year end in above situation. Such evidence may constitute sufficient appropriate audit evidence.
- (c) She should verify purchase invoices of inventory items lying in stocks as at year end. Stock records are not required to be verified. Such evidence is likely to constitute sufficient appropriate audit evidence.
- (d) She should verify purchase invoices of inventory items lying in stocks as at year end. She should attend physical inventory count at year end in above situation Such evidence may constitute sufficient appropriate audit evidence.

**3.3** Identify correct statement on the basis of description provided in case scenario: -

- (a) Purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are all examples of internal

evidence. Audit evidence obtained by auditor is final and conclusive.

- (b)** Purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are all examples of internal evidence. Audit evidence obtained by auditor is persuasive.
- (c)** Only debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are examples of internal evidence. Audit evidence obtained by auditor is persuasive.
- (d)** Only debit notes issued by firm on debtors for GST short charged earlier during the year is an example of internal evidence. Audit evidence obtained by auditor is persuasive.

**(MTP MAY 24)**

<b>Question No.</b>	<b>Answer</b>
<b>3.1</b>	(B)
<b>3.2</b>	(A)
<b>3.3</b>	(A)

# 12. CONSOLIDATED CASE STUDY

## CASE SCENARIO 1

(MTP MAY 24)

Dhanush, a CA student undergoing articles, is part of an engagement team conducting audit of Test Enterprises Private Limited. The company is engaged in business of conducting aptitude and language tests every fortnight at centres spread all over major cities of country for Indian students desirous of applying to foreign universities. It also sells books containing model test papers for the benefit of students.

The company has substantial number of computers at each centre to enable seamless experience for students appearing for standardized aptitude and language tests. The company has acquired new identifiable software involving substantial expenditure for conducting tests during the year which is expected to drive company's revenues in coming years. At the time of taking a test, a CD containing software is run in each system for enabling students to take tests. Cost of CD without software is nominal.

The revenue of the company during the year 2023-24 was Rs. 50 crores (Rs.45 crores from fees charged from students and Rs.5 crores from sale of books). Besides, company has also received Rs. 10 lacs as interest on certain investments during the year. The company has a history of profitable operations.

During the course of audit, it is noticed by Dhanush that computers form significant chunk of PPE items in financial statements of company. The company has taken useful life of computers consisting of desktops for 3 years. However, depreciation charged on computers in financial statements of the company is higher than depreciation allowable under Income tax law. It results in lower accounting income as per books of accounts of company as compared with taxable income under Income tax law.

During the course of audit, he notices that cost of CDs along with software cost is treated as an intangible asset by company. It is also part of his responsibility to verify PPE register in accordance with audit programme. On perusing details in PPE register, he finds that some computers have moved from one centre to another

centre to meet business requirements. Further, many computers were disposed or scrapped in earlier years. However, proper details in relation to movement and disposal/scrapping have not been entered in PPE register. When these items were physically verified by the management during the year, it has resulted in material discrepancies. The management has properly dealt with such discrepancies in books of accounts.

**Based on above, answer the following questions:**

1. Considering description provided in case scenario regarding accounting income as per books of accounts and taxable income under Income tax law, choose appropriate responsibility of Dhanush:
  - (a) To verify deferred tax liability likely created in financial statements in accordance with AS 22
  - (b) To verify deferred tax asset likely created in financial statements in accordance with AS 22
  - (c) To verify deferred tax asset likely created in financial statements in accordance with AS 29
  - (d) To verify deferred tax liability likely created in financial statements in accordance with AS 29

2. Keeping in view description provided in case scenario, which of following statements is likely to be correct regarding accounting treatment of cost of CDs and software acquired by company to run tests?
- (a)** The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated such costs as revenue expenditure.
  - (b)** The company's accounting treatment of treating cost of CDs with software costs as intangible assets is proper.
  - (c)** The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as intangible asset.
  - (d)** The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as revenue expenditure.
3. As regards discrepancies noticed in computer systems on physical verification by management as described in case scenario, which of following statements is most appropriate?
- (a)** The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it may result in modification of auditor's opinion.
  - (b)** The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it entails specific reporting requirement for auditor under Companies Act, 2013.
  - (c)** The management has properly dealt with such discrepancies. Therefore, Dhanush should not do anything further.
  - (d)** The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it is in nature of misstatement which needs to be communicated and documented by auditor.
4. Which of following statements meets requirements of law in respect of revenue from operations of the company?
- (a)** Revenue from operations of Rs. 50 crores should be shown in Statement of Profit and loss.
  - (b)** Revenue from operations of Rs. 50.10 crores should be shown in Statement of Profit and loss. However, revenue from sale of books, fees charged from students and interest on investments should be disclosed separately in notes.

- (c) Revenue from operations of Rs. 50.10 crores should be shown in Statement of Profit and loss.
- (d) Revenue from operations of Rs. 50 crores should be shown in Statement of Profit and loss. However, revenue from sale of books and fees charged from students should be disclosed separately in notes.
5. The company has taken useful life of desktops to be 3 years. Such a requirement is
- (a) prescribed under Schedule III to Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule III.
- (b) is not prescribed under Companies Act, 2013. It depends upon manufacturing specifications of desktops.
- (c) prescribed under Schedule II to Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule II.
- (d) is not prescribed under Companies Act, 2013. It needs to be arrived at mandatorily by a management expert.

Question No.	Answer
1	(b) To verify deferred tax asset likely created in financial statements in accordance with AS 22
2	(b) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is proper.
3	(b) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it entails specific reporting requirement for auditor under Companies Act, 2013.
4	(d) Revenue from operations of Rs. 50 crores should be shown in Statement of Profit and loss. However, revenue from sale of books and fees charged from students should be disclosed separately in notes.
5	(c) prescribed under Schedule II to Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule II.

## CASE SCENARIO 2

(MTP MAY 24)

CDL Limited, a company dealing in FMCG goods, is having 50 branches in India. SKC & Associates (referred to as company's auditor) are appointed as statutory auditors of the company for year 2023-24. Further, company has also appointed Mr. D as branch auditor for 5 of its branches. Since Mr. D is conducting audit of only 5 branches of company, he has not arrived at materiality



level in respect of auditee branches. On the same lines, identification and assessment of risk of material misstatement has not been performed. He is of the view that determination of materiality and identifying & assessing risks of material misstatement is done for financial statements of company as a whole. He has mainly performed substantive audit procedures in respect of financial statements of auditee branches like verification of PPE items, inventories, trade receivables, cash, bank balances and trade payables at auditee branches and maintained documentation of the same.

During the course of audit at two branches dealing in same kind of goods, Mr. D has performed analytical procedures pertaining to inventories. He has arrived at and compared inventory turnover ratio (Cost of goods sold/Average inventory) over a period of years of two branches. The results of analytical procedures are summarized in Table I below:

**Table 1**

Particulars	Branch	Year 2021-22	Year 2022-23	Year 2023-24
Inventory turnover ratio	I	15	14	12
Inventory turnover ratio	II	4	6	10

The company's auditor has also decided to use work of Mr. D with respect to financial information of 5 branches included in financial information of the company. During the course of audit, company's auditor has advised Mr. D by way of email certain significant accounting, auditing and reporting requirements and has asked him to provide representation as to compliance with them. Irritated and surprised, Mr. D is of the view that such an email is beyond the rights of the company's auditor.

**Based on above, answer the following questions:**

- As regards audit of a branch of CDL Limited as referred to in case scenario is concerned, which of following statements is most appropriate?
  - The accounts of a branch shall be audited either by the company's auditor or by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of the Companies Act, 2013. In case branch accounts are audited by a person other than company's auditor, branch audit report is sent by branch auditor to company's auditor.
  - The accounts of a branch shall only be audited by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of Companies Act, 2013 except company's auditor. In such a case, branch audit report is sent by branch auditor to members of company.
  - The accounts of a branch shall only be audited by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of Companies Act, 2013 except company's auditor. In such a case, branch audit report is sent by branch auditor to company's auditor.

- (d)** The accounts of a branch shall be audited either by the company's auditor or by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of Companies Act, 2013. In case branch accounts are audited by a person other than company's auditor, branch audit report is sent by branch auditor to members of company.
2. After reading methodology for carrying out branch audits by Mr. D, which of following statements is likely to be most appropriate?
- (a)** Separate determination of materiality and identifying & assessing risk of material misstatement is not required in respect of each of the branches. He is required to perform only substantive procedures as described in the case scenario in respect of auditee branches and maintain documentation of the same.
- (b)** Separate determination of materiality and identifying & assessing risk of material misstatement is required in respect of each of branches. However, documentation for these matters regarding branches is not required. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.
- (c)** Separate determination of materiality and identifying & assessing risk of material misstatement is required along with documentation thereof in respect of each of branches. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.
- (d)** Identifying & assessing risk of material misstatement is required along with documentation in respect of each of branches. However, materiality is required to be arrived at for financial statements of company as a whole. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.
3. Choose the correct statement regarding results of analytical procedures performed by Mr. D summarized in Table 1 in case scenario.
- (e)** During year 2023-24, inventories of Branch I have moved faster in comparison to Branch II.
- (f)** During year 2023-24, inventories of Branch II have moved faster in comparison to Branch I.
- (g)** Comparison of inventory turnover ratio of Branch II over a period of years may indicate that branch's sales have likely been weak with higher inventory holdings in year 2023-24 as compared to previous years.
- (h)** Comparison of inventory turnover ratio of Branch I over a period of years may indicate that branch's sales have likely been strong with lower inventory holdings in year 2023-24 as compared to previous years.

4. Considering contents of email sent by company's auditor to Mr. D, which of following statements is likely to be in accordance with Standards on Auditing?
- (i) Company's auditor can advise Mr. D regarding certain significant accounting, auditing and reporting requirements and ask him to provide representation as to compliance with them.
  - (j) Company's auditor can advise Mr. D certain significant accounting, auditing and reporting requirements. However, asking him to provide representation as to compliance with them is breach of Mr. D's independence.
  - (k) Company's auditor cannot advise Mr. D certain significant accounting, auditing and reporting requirements. It is breach of Mr. D's independence.
  - (l) Company's auditor can advise Mr. D regarding certain significant accounting, auditing and reporting requirements only when Mr. D makes such a request.

Question No.	Answer
2	(a) The accounts of a branch shall be audited either by the company's auditor or by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of Companies Act, 2013. In case branch accounts are audited by a person other than company's auditor, branch audit report is sent by branch auditor to company's auditor.
3	(c) Separate determination of materiality and identifying & assessing risk of material misstatement is required along with documentation thereof in respect of each of branches. He is required to perform substantive procedures as described in case study in respect of auditee branches and also maintain documentation of same.
4	(a) During year 2023-24, inventories of Branch I have moved faster in comparison to Branch II.
5	(a) Company's auditor can advise Mr. D regarding certain significant accounting, auditing and reporting requirements and ask him to provide representation as to compliance with them.

### CASE SCENARIO 3

**(MTP MAY 24)**

Pluto Limited is engaged in manufacturing and distribution of ergonomic furniture. Such kind of customisable range home office furniture has gained lot of importance in past few years. The company was able to perform well over the years and the same is reflected in their financials. During year 2023-24, audit firm of S.J. and Associates was reappointed as their auditor. The engagement team consisted of CA Sneha (partner) and five articled assistants. One of the assistants was new to this engagement. Considering huge volume of transactions, the partner asked him to go

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through files of last year and auditor's report to gain an understanding of issues which arose in last year i.e. 2022-23.

While going through summary page of file of last year, he noticed that below points were under discussion with the partner before audit finalisation:

**Point 1:** For employee benefit expenses, following points were verified by the team:

- The employee benefit expenses shown in the books were actually incurred during the relevant period.
- The expenses in respect of all personnel were accounted for.
- The expense recognised during year 2022-23 related to this year only.

**Point 2:** It was noted that dividend to equity shareholders for the year 2022-23, was declared on 15.04.2023. As the dividend related to the year 2022-23, the same was recognised as liability in the same year.

**Point 3:** Debtors constitute one of the major components of company's financials. As part of audit procedures, verification was made whether company had made allowance for those debtors which were doubtful. In this regard, list of debtors under litigation was also obtained and scrutinized.

**Point 4:** Asset additions during the year amounted to Rs. 50 lakhs. The payment in respect of these assets were made through bank account of the company. However, on scrutiny, it was found that some of invoices were not in the name of the company but in name of one of directors.

**Point 5:** The company was maintaining few bank accounts including one foreign currency account. There was included in previous year file a paper converting foreign currency amount held in a bank account to Indian Rupees at closing exchange rate.

**Based on above, answer the following questions:**

1. In point 1 relating to Employee benefits, which among the following assertions are discussed respectively (in same order as described in point 1)?
  - (i) Valuation
  - (ii) Occurrence
  - (iii) Cut-off
  - (iv) CompletenessChoose the correct combination from below: -
  - (a) (i),(ii) and (iv)
  - (b) (ii), (iv) and (iii)
  - (c) (ii), (iii) and (iv)
  - (d) (i),(ii) and (iii)

2. Do you think the amount of dividend recognised as liability in the year 2022 - 23 as given in point 2 appropriate?
- (a) Yes. As the amount of dividend related to year 2022-23, it should be recognised in the same year irrespective of the year of declaration.
- (b) No. The amount should be recognised equally between two financial years.
- (c) No. The amount should not be recognised as liability in year 2022-23. But it needed to be disclosed in the notes to accounts of that year.
- (d) No. The amount should not be recognised as liability. Further, no disclosure was needed in the financials of that year.
3. In relation to matter described in para 3 pertaining to debtors, which of the following assertions was verified by auditors?
- (a) Valuation
- (b) Rights and obligations
- (c) Existence
- (d) Completeness
4. Read Point 4 and choose which assertion is not proved in this case.
- (a) Existence
- (b) Rights and obligation
- (c) Completeness
- (d) Measurement/Valuation
5. Choose the correct statement from below pertaining to matter described in Point 5.
- (a) The company was required to restate said amount in accordance with requirements of AS 1. By verifying it, auditor had verified existence assertion.
- (b) The company was required to restate said amount in accordance with requirements of AS 11. By verifying it, auditor had verified completeness assertion.
- (c) There was no responsibility of company to restate said amount. It was auditor's responsibility to restate said amount in accordance with requirements of AS 11. No assertion was, therefore, verified by auditor.
- (d) The company was required to restate said amount in accordance with requirements of AS 11. By verifying it, auditor had verified valuation assertion.

Question No.	Answer
1	(B)
2	(c)

<b>3</b>	(C)
<b>4</b>	(D)
<b>5</b>	(C)