

MCQ's

1. NATURE, OBJECTIVE & SCOPE OF AUDIT AND ETHICS

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

CASE STUDY – 2:

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.

Answers: 1. c 2. d 3. b 4. d 5. a

GENERAL MCQ's:

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. 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.

4. 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.

5. 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
6. 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.
7. 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: 1. C 2. A 3. C 4. D 5. D 6. B 7. A

2. AUDIT REPORTING

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/s Honest & 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: 1. (b) 2. (c) 3. (c) 4. (b) 5. (d)

GENERAL MCQ's:

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) None 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

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

3. AUDIT DOCUMENTATION AND EVIDENCE

CASE STUDY – 1:

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.

(A) 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.

(B) She plans to verify that all balances appearing under trade payables are genuine and not fake.

(C) 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.

(D) She is of the view that it is necessary to examine title deeds of “land” appearing in financial statements of the firm.

(E) 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?
- (a) Observation
 - (b) Inspection
 - (c) External confirmation
 - (d) 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?
- (a) Reperformance
 - (b) Recalculation
 - (c) Observation
 - (d) Inspection

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

CASE STUDY - 2:

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.

(C) The team has assessed risks of material misstatements to be low.

(D) CA Shobhit is responsible for attending inventory count process and putting down its documentation part.

(E) 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 date showing 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: 1. c 2. c 3. d 4. d 5. d

GENERAL MCQ's:

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.

Answer: 1. a 2. b 3. c 4. d

4. RISK ASSESSMENT AND INTERNAL CONTROL

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 ₹ 50 crore in last year to ₹ 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 ₹ 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)

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. Nature of Control 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.

6. Who is responsible for maintaining effective internal financial controls?
 - (a) Statutory auditor
 - (b) Audit Committee
 - (c) Management
 - (d) Shareholders

7. 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

8. 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

Answer: 1. (b) 2. (c) 3. (c) 4. (b) 5. (a) 6. (c) 7. (d) 8. (d)

5. STANDARDS ON AUDITING

CASE STUDY – 1:

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 ₹ 100 crore for the next year, ₹150 crore & ₹200 crore for following years respectively as compared to present turnover of ₹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: 1. C 2. C 3. C 4. D 5. D

CASE STUDY – 2:

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: 1. (a) 2. (b) 3. (d) 4. (d) 5. (d)

CASE STUDY – 3:

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: 1. c 2. c 3. d 4. a 5. a

GENERAL MCQ's:

1. 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.
2. 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.
3. 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.
4. 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.

- a. The risk that management may override controls in respect of related party transactions is higher.
 - (b) There is no effect on the risk that management may override controls in respect of related party transactions.
 - (c) Risk of overriding of controls by management has no relationship at all with related party transactions.
- 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.
- 6. 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.
- 7. 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
- 8. 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.
- 9. 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.

10. 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: 1. (c) 2. (d) 3. (b) 4. (b) 5. (b) 6. (c) 7. (a) 8. (b) 9. (b) 10. (b)

6. AUDIT IN AN AUTOMATED ENVIRONMENT

GENERAL MCQ's:

1. 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.

2. 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

3. 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: 1. **(a)** 2. **(d)** 3. **(d)**

7. AUDIT STRATEGY, PLANNING AND PROGRAMME

CASE STUDY – 1:

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.

Answer: 1. (b) 2. (b) 3. (b) 4. (c) 5. (b)

GENERAL MCQ's:

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

6. 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.

Answers: 1. (c) 2. (d) 3. (d) 4. (c) 5. (b) 6. (d)

8. AUDIT SAMPLING

GENERAL MCQ's:

1. 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.

Answers: 1. (d)

9. AUDIT OF BANKS

CASE STUDY – 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 ₹ 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 ₹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 ₹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 ₹ 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 ₹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: 1. c 2. c 3. b 4. b 5. A

GENERAL MCQ's:

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: 1. a 2. b 3. a 4. b 5. c

10. AUDIT OF ITEMS OF FINANCIAL STATEMENTS

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 ₹ 5 Cr during the FY 2022-23. The shares with the nominal value of ₹ 10 per share were issued at a premium of ₹ 5 per share. The company has the Reserves and Surplus totaling to ₹ 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 ₹ 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: 1. (c) 2. (d) 3. (c) 4. (b) 5. (a)

GENERAL MCQ's:

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: 1. a 2. c 3. c 4. c 5. b

11. GOVERNMENT AUDIT

CASE STUDY – 1:

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. “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: 1. **c** 2. **d** 3. **a** 4. **c** 5. **b**

12. AUDIT OF VARIOUS ENTITIES

GENERAL MCQ's:

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.
 - (P) Revenues from direct taxes
 - (Q) Revenues from Goods and Services Tax
 - (R) Revenues from Custom Duties
 - (S) 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: 1. d 2. b 3. b 4. b 5. c

TRUE OR FALSE STATEMENTS

1. NATURE, OBJECTIVE & SCOPE OF AUDIT AND ETHICS

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.

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.

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.

4. 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.

5. 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.

2. AUDIT REPORTING

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:

- (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
- (b) 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.

3. AUDIT DOCUMENTATION AND EVIDENCE

1. Purchase invoice is an example of internal evidence.

Incorrect: Internal evidence is the evidence that originates within the client's organization. Since purchase invoice originates outside the client's organization, 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. 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.

7. 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.

4. RISK ASSESSMENT AND INTERNAL CONTROL

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.

5. AUDIT STRATEGY, PLANNING AND PROGRAMME

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 begin 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.

6. AUDIT SAMPLING

1. **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.

2. **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.

3. **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.

4. **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.

5. **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.

6. **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.

7. **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.

8. **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.

9. 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

10. 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.

11. 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.

7. ANALYTICAL PROCEDURES

1. **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.

2. **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.

3. **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.

4. **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.

5. **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.

6. **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

7. **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.

8. **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.

8. AUDIT OF BANKS

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.

9. AUDIT OF ITEMS OF FINANCIAL STATEMENTS

1. **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, postemployment benefits like gratuity, superannuation, leave encashment, provident fund contribution etc. as well as towards their hiring, their welfare and training.

2. **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:

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

3. **"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.

4. **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.

5. **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.**

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 ` 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 ` 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 ₹ 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:

- towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- in writing off the preliminary expenses of the Company;
- in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- 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 authorised 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.

10. GOVERNMENT AUDIT

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.

11. AUDIT OF VARIOUS ENTITIES

1. **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.

2. **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.

3. **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.

4. **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.

5. **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.

6. **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.

7. 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.

8. 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.

9. 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.

10. 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.