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Foundation → Intermediate → Final CA ↗

CA INTER

AUDITING AND ETHICS

Objectives Guide

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CA INTER - AUDITING AND ETHICS

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1

NATURE, OBJECTIVE AND SCOPE OF AUDIT



MCQs BASED QUESTIONS

1. Which of the following is not an advantage of audit?
 - (a) It provides high quality financial information.
 - (b) It acts as a moral check on employees.
 - (c) It enhances risk of management bias.
 - (d) It helps in safeguarding interests of shareholders.

2. Which of the following is NOT TRUE about an assurance engagement?
 - (a) It relates to providing assurance about historical financial information only.
 - (b) The practitioner obtains sufficient appropriate evidence.
 - (c) There is some information to be examined by practitioner.
 - (d) A written assurance report in appropriate form is issued by practitioner.

3. Which of the following is TRUE about Engagement Standards?
 - (a) Engagement standards ensure proper rights to practitioners in course of performance of their duties.
 - (b) Engagement standards ensure preparation and presentation of financial statements in a standardized manner.
 - (c) Engagement standards ensure uniformity by practitioners in course of performance of their duties.
 - (d) Engagement standards ensure savings in resources of clients.

4. Consider following statements in relation to “Limited assurance engagement”:-
Statement I - It involves obtaining sufficient appropriate evidence to draw reasonable conclusions.
Statement II - Review of interim financial information of a company is an example of limited assurance engagement.

- (a) Statement I is correct. Statement II is incorrect.
- (b) Both Statements I and II are correct.
- (c) Both Statements I and II are incorrect.
- (d) Statement I is incorrect. Statement II is correct.

5. Which of the following is TRUE about Standards on auditing?

- (a) These deal mainly with voluntary responsibilities of auditors.
- (b) These deal mainly with mandatory responsibilities of auditors.
- (c) Their sole purpose is to help government authorities in augmenting revenues.
- (d) These deal mainly in carrying out audit according to legal provisions.

6. _____ along with other disciplines such as accounting and law, equips you with all the knowledge that is required to enter into auditing as a profession.

- (a) Auditing (b) Taxation (c) Finance (d) Law

7. No business or institution can effectively carry on its activities without the help of proper.....:

- (a) Audit
- (b) Record and accounts
- (c) neither (a) nor
- (d) both (a) and (b)

8. As per SA-200 “Overall Objectives of the Independent Auditor”, in conducting an audit of financial statements, the overall objectives of the auditor are:

- (a) To obtain reasonable assurance
- (b) To report on the financial statements
- (c) Both (a) and (b) above
- (d) to obtain absolute assurance.

9. Which of the following is the responsibility of the auditor:

- (a) Preparation and presentation of the financial statements in accordance with applicable financial reporting
- (b) Design, implementation and maintenance of internal controls
- (c) Express an opinion on the Financial Statements
- (d) To obtain limited assurance.

10. An employee of Fruits and Vegetables Limited was of the opinion that auditor of a company is required to express an opinion. On which one of the following the auditor of a company is required to express an opinion:
- (a) Only Balance Sheet of the Company.
 - (b) Financial Statements of the Company.
 - (c) Only Profit and Loss Account of the Company.
 - (d) Only Cash Flow Statement of the Company.
11. As explained in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", _____ is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.
- (a) absolute assurance
 - (b) limited assurance
 - (c) reasonable assurance
 - (d) reasonable or absolute assurance
12. The basic requirement which is absent in auditing is
- (a) Exact accounts
 - (b) Certainty in financial statements
 - (c) Conclusive evidence
 - (d) All of the above
13. Pick the odd one
- (a) Preparation of financial statements
 - (b) Designing, implementation and maintenance of internal control system
 - (c) Reporting on true and fair view of financial statements
 - (d) Compliance with the applicable law and regulation
14. In which of the following engagement an opinion is expressed on a subject matter other than the historical financial information
- (a) Auditing Engagement
 - (b) Review Engagement
 - (c) Assurance Engagement
 - (d) Related Services Engagement
15. Standards on Auditing are _____
- (a) Mandatory
 - (b) Optional
 - (c) Discretionary
 - (d) All of these

16. If in exceptional circumstances the auditor departs from Standards on Auditing, he shall _____
- (a) Document the reason for departure
 - (b) Perform alternative procedures
 - (c) Both (a) and (b)
 - (d) Auditor is not allowed to depart from SAs.
17. The primary objective of the ordinary examination of financial statement by an auditor is the expression of an opinion on
- (a) The competence of management in accounting matters which is implied by whether the opinion is qualified or not
 - (b) The conformity of the statements with the book of account
 - (c) The conformity of the financial statements with generally accepted auditing standards applied on a basis consistent with that of the prior year
 - (d) The fairness with which the financial statements present cash flows and results of operations
18. Which of the following is not type of engagement standard
- (a) Standards on Auditing
 - (b) Standard on Quality Control
 - (c) Standards on Review Engagement
 - (d) Standards on Assurance Engagement
19. Reasonable assurance is _____ level of assurance but it is not _____ assurance.
- (a) High, Absolute
 - (b) Absolute, Guaranteed
 - (c) Moderate, Absolute
 - (d) None of these

ANSWERS

1	(c)	2	(a)	3	(c)	4	(d)	5	(b)	6	(a)	7	(b)
8	(c)	9	(c)	10	(b)	11	(c)	12	(d)	13	(c)	14	(c)
15	(a)	16	(c)	17	(d)	18	(b)	19	(a)				



CASE STUDY MCQs

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. Goretí 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 Goretí is correct.
 - (c) Views of both Ali and Goretí are correct.
 - (d) Views of both Ali and Goretí 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. Goretí told her friends that she had read a news report about how a company had misled its auditors by producing some fabricated documents. Which of following statements seems to be appropriate in this regard?
- (a) It was wrong on the part of auditor to rely upon fabricated documents. He must have discovered it as the same falls within the scope of his duties.
 - (b) Although it was wrong on the part of auditor to rely upon fabricated documents, he cannot do anything in the matter. He has to report on the basis of documents provided to him. He has no duty in this regard.
 - (c) Auditor has to conduct audit by exercising professional skill. But he is not an expert in discovering genuineness of documents. Hence, management consisting of dishonest persons may have led him to rely upon fabricated documents deliberately.
 - (d) Management cannot mislead auditor due to high level of knowledge and expertise possessed by him. The above is an outlier case-one of the rare odd cases.

Answer to Questions involving Case Studies 1

1	(c)	2	(c)	3	(d)	4	(a)	5	(c)
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Case Study 2

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

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

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

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

Based on above, answer the following questions: -

1. The management of company has engaged CA P to issue a duly signed report for half year. Which of the following standards, if any, issued by ICAI are relevant for CA P?
 - (a) Standards on Review Engagements
 - (b) Standards on Auditing
 - (c) Standards on Related Services
 - (d) There are no standards for issuing report in such situation.
2. Which of the following statements is MOST APPROPRIATE in given case situation?
 - (a) CA P can assist management in preparation of financial statements of the company. However, issue of a report in such a case is outside the scope of work.
 - (b) CA P can assist management in preparation of financial statements of the company and he can issue an audit report.
 - (c) CA P can assist management in preparation of financial statements of the company and he can issue a compilation report in this respect.
 - (d) The responsibility of preparation of financial statement is of company's management. CA P cannot assist management in preparation of financial statements of the company. However, he can issue a review report.
3. In the above said scenario for issuance of signed financial statements for half year by CA P, as discussed in last para of Case Study, identify the MOST APPROPRIATE statement: -
 - (a) Standard on Quality control (SQC 1) is not applicable as CA P cannot issue audit report.

- (b) Standard on Quality Control (SQC 1) is not applicable as CA P cannot issue review report.
 - (c) Standard on Quality Control (SQC 1) is applicable in such type of engagement.
 - (d) Standard on Quality Control (SQC 1) is not applicable as CA P is barred from issuing any report in such type of engagement.
4. The banker of company has also requested for projected financial statements for coming years along with a report from CA regarding these projections to consider request of management. Which of the following standards issued by ICAI are relevant for CA P in such a situation, if any?
- (a) Standards on Review Engagements
 - (b) There are no standards for issuing such type of reports.
 - (c) Standards on Related Services
 - (d) Standards on Assurance Engagements
5. Suppose CA P also accepts work of issuing projected financial statements with a report to be signed by him. The management has projected turnover of `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 to Questions involving Case Studies 2

1	(c)	2	(c)	3	(c)	4	(d)	5	(d)
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CORRECT / INCORRECT

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

- (i) The basic objective of audit does not change with reference to nature, size or form of an entity.
- (ii) The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.
- (iii) 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.

Answers to Correct/Incorrect

- (i) **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.
- (ii) **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.
- (iii) **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.

2

**AUDIT STRATEGY, AUDIT
PLANNING AND AUDIT PROGRAMME**



**MCQs
BASED QUESTIONS**

1. Which of the following is not considered in planning an audit generally?
 - (a) Understanding of legal and regulatory framework of an entity
 - (b) Need to consider determination of materiality
 - (c) Evaluating audit evidence
 - (d) Need to consider involvement of expert

2. Which of the following is true about audit plan?
 - (a) Once an audit plan has been finalized for an engagement, changes cannot be made to it.
 - (b) Audit plan includes scope, timing and direction of planned risk assessment procedures.
 - (c) Changes in audit plan cannot lead to change in audit strategy.
 - (d) Audit plan has to be documented by auditor.

3. Which of the following is not included in an audit programme normally?
 - (a) Extent of checking
 - (b) Date of checking
 - (c) Nature or type of procedure
 - (d) Planning of risk assessment procedures

4. Which of the following is not an advantage of an audit programme?
 - (a) It acts as a guide for audit of coming years.
 - (b) It fixes responsibility of assistants.
 - (c) It serves as a shelter for assistants.
 - (d) It serves a proof of work done by auditor.

5. Which of the following is most important principle for formulating an audit plan?
- (a) Gaining knowledge of client's workforce
 - (b) Gaining knowledge of client's business
 - (c) Gaining knowledge of client's vendors
 - (d) Gaining knowledge of tax laws applicable to client
6. sets the scope, timing & direction of the audit and guides the development of the more detailed plan.
- (a) Audit Programme
 - (b) Overall Audit Strategy
 - (c) Completion Memorandum
 - (d) Audit Plan
7. Planning is _____ process of an audit that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement:
- (a) continuous
 - (b) discrete
 - (c) neither continuous nor discreet
 - (d) strategic
8. Statement 1: The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential process but are closely inter-related. Statement 2: The auditor shall establish an overall audit strategy that guides the development of audit plan.
- (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
9. Which of the following is not addressed by the overall audit strategy :
- (a) scope of the audit
 - (b) timing of the audit
 - (c) direction of the audit
 - (d) monitoring of the audit
10. The overall audit strategy and the audit plan remain the _____ responsibility
- (a) auditor's
 - (b) management's
 - (c) those charged with governance.
 - (d) both management and those charged with governance.

11. Which of the following is correct :

- (a) The auditor shall establish an audit plan that sets the scope, timing & direction of the audit, and that guides the development of the overall audit strategy.
- (b) The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and there is no need to guide the development of the audit plan.
- (c) 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.
- (d) The auditor shall establish an audit plan that sets the scope, timing and direction of the audit, and that there is no need to guide the development of the overall audit strategy.

12. Planning an audit involves

- (a) establishing the overall audit strategy for the engagement and developing an audit plan.
- (b) establishing the overall audit plan for the engagement and developing an audit strategy.
- (c) establishing the overall audit plan for the engagement
- (d) developing an audit strategy.

13. When planning the audit,

- (a) the auditor considers what would make the financial information materially misstated.
- (b) the auditor need not consider what would make the financial information materially misstated.
- (c) the auditor need not consider what would make the financial information materially misstated at planning stage
- (d) the auditor needs to consider what would make the financial information materially misstated while conducting audit only

14. Once the overall audit strategy has been established, _____ can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources.

- | | |
|-----------------------------------|---------------------|
| (a) audit strategy | (b) audit plan |
| (c) audit plan and audit strategy | (d) audit note book |

15. The auditor shall develop an audit plan that shall include a description of:

- (a) The nature, timing and extent of planned risk assessment procedures
- (b) The nature, timing and extent of planned further audit procedures at the assertion level.
- (c) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.
- (d) All of the above

16. Benefit(s) of audit planning is

- (a) Helping auditor to devote appropriate attention on important areas of the audit
- (b) Better preparation of engagement letter
- (c) Effective communication with retiring auditor
- (d) It ensure compliance with applicable law and regulation

17. Which of the following is incorrect

- (a) In establishing the audit strategy the auditor shall identify characteristics of the engagement that define its scope.
- (b) The auditor shall develop an audit plan that shall include a description of the nature, timing and extent of risk assessment procedures and further audit procedures which are proposed to be performed.
- (c) The auditor shall establish audit strategy on the basis of overall audit plan.
- (d) The auditor shall update and change the audit strategy and audit plan as necessary during course of the audit.

18. Which of the following is incorrect w.r.t audit programme

- (a) An audit programme consists of a series of verification procedures to be applied.
- (b) It is desirable in respect of each audit and more particularly for bigger audits an audit programme should be drawn up.
- (c) An audit programme is a summarized plan
- (d) There should be periodic review of the audit programme to assess whether the same continues

19. With reference to SA 300, the auditor shall document:

- (a) The overall audit strategy
- (b) The audit plan
- (c) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.
- (d) All of the above

ANSWERS

1	(c)	2	(d)	3	(d)	4	(c)	5	(b)	6	(b)	7	(a)
8	(c)	9	(d)	10	(a)	11	(c)	12	(a)	13	(a)	14	(b)
15	(d)	16	(a)	17	(c)	18	(c)	19	(d)				

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CASE STUDY MCQs

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 the following questions: -

- 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?**
 - She is establishing audit strategy.
 - She is conducting preliminary engagement activities.
 - She is designing audit plan.
 - 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 to Questions involving Case Studies 1

1	(b)	2	(b)	3	(b)	4	(c)	5	(b)
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CORRECT / INCORRECT

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

1. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.
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.
3. Planning is a discrete phase of an audit.
4. A detailed Audit Programme once prepared for a business can be used for all business under all circumstances.
5. The audit plan is more detailed than the overall audit strategy.

Answers to Correct/Incorrect

1. **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. **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. **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. **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. **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.

3

RISK ASSESSMENT AND INTERNAL CONTROL



**MCQs
BASED QUESTIONS**

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

5. Which of the following is not an example of “General IT controls”?
- (a) Controls pertaining to Disaster recovery plan
 - (b) Controls pertaining to batch preparation
 - (c) Controls pertaining to data security
 - (d) Controls pertaining to validation of input data in an application
6. Determining a percentage to be applied to a chosen benchmark (in relation to materiality) involves the exercise of _____
- (a) Independence (b) Professional judgement
 - (c) Professional skepticism (d) Professional behaviour.
7. Which of the following is not an example of benchmarks in determining materiality for the Financial Statements as whole:
- (a) Profit before tax (b) total revenue
 - (c) audit programme (d) total equity
8. SA 320 on “Materiality in Planning and Performing an Audit” requires that an auditor
- (a) should not consider materiality and its relationship with audit risk while conducting an audit.
 - (b) should consider materiality and its relationship with audit risk while conducting an audit.
 - (c) should not consider materiality but should consider its relationship with audit risk while conducting an audit.
 - (d) should consider materiality but need not consider its relationship with audit risk while conducting an audit.
9. When deviations from controls upon which the auditor intends to rely are detected,
- (a) the auditor shall not make any inquiries to understand these matters and their potential consequences
 - (b) the auditor shall make specific inquiries to understand these matters and their potential consequences
 - (c) the auditor shall make general inquiries to understand these matters and their potential consequences
 - (d) the auditor shall make both general as well as specific inquiries to understand these matters and their potential consequences

10. Because the assessment of the risk of material misstatement takes account of internal control,
- (a) the extent of substantive procedures may need to be increased irrespective of the results from tests of controls.
 - (b) the extent of substantive procedures may need to be increased when the results from tests of controls are satisfactory.
 - (c) the extent of substantive procedures may need to be decreased when the results from tests of controls are unsatisfactory.
 - (d) the extent of substantive procedures may need to be increased when the results from tests of controls are unsatisfactory
11. In determining the level of materiality for an audit, what should not be considered?
- (a) Prior year's errors
 - (b) The auditor's remuneration
 - (c) Adjusted interim financial statements
 - (d) Prior year's financial statements
12. When more persuasive audit evidence is needed regarding the effectiveness of a control,
- (a) it may be appropriate to increase the extent of testing of the control and reduce the extent of the degree of reliance on controls.
 - (b) it may be appropriate to decrease the extent of testing of the control as well as the degree of reliance on controls.
 - (c) it may be appropriate to decrease the extent of testing of the control and increase the extent of the degree of reliance on controls.
 - (d) it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls.
13. _____ refers to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control to identify and assess the risk of material misstatement.
- (a) Risk Assessment procedures
 - (b) Test of controls
 - (c) Substantive Analytical Procedures
 - (d) Observation

14. Audit risk is a function of the risks of material misstatement and _____
- (a) detection risk (b) inherent risk
(c) control risk (d) business risk
15. For a given level of audit risk, the acceptable level of detection risk bears _____ relationship to the assessed risks of material misstatement at the assertion level.
- (a) direct (b) Inverse
(c) no relationship (d) either (a) or (c)
16. Risk of material misstatement has _____ components
- (a) one (b) two (c) three (d) four
17. Controls can be related to an assertion.
- (a) directly (b) indirectly
(c) directly or indirectly (d) no relationship between controls and assertion.
18. Which of the following is incorrect
For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall :
- (a) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
- (b) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
- (c) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and
- (d) Not consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.
19. Components of risk of material misstatement at the assertion level are:
- (a) Inherent risk and detection risk
(b) inherent risk and control risk
(c) control risk and detection risk
(d) inherent risk, control risk and detection risk

20. Risk of material misstatement may be defined as the risk
- (a) that the financial statements are materially misstated after audit.
 - (b) that the financial statements are materially misstated during audit.
 - (c) that the financial statements are materially misstated prior to audit.
 - (d) All of the above
21. The susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements, before consideration of any related controls is-
- (a) Control Risk
 - (b) Inherent Risk
 - (c) Detection Risk
 - (d) Audit Risk
22. The assessment of risks is a
- (a) matter capable of precise measurement rather than matter of professional judgment
 - (b) matter of professional judgment, rather than a matter capable of precise measurement.
 - (c) matter of professional judgement as well as capable of precise measurement sometimes.
 - (d) None of the above
23. SA 315 establishes requirements and provides guidance on identifying and assessing the risks of material misstatement
- (a) at the financial statement levels only.
 - (b) at the assertion levels only.
 - (c) at the financial statement and assertion levels.
 - (d) at the financial statement or assertion levels.
24. Who is mainly responsible for implementation of internal financial controls in a company?
- (a) Auditors
 - (b) Directors
 - (c) Employees
 - (d) Regulators

25. Who among the following is required to comply with Section 149(8) read with Schedule IV to the companies Act, 2013 ?

- (a) Board of Directors
- (b) Audit Committee
- (c) Statutory Auditor
- (d) Independent Directors

26. Risk assessment procedures are performed by auditor

- (a) To detect material misstatements in the financial statements
- (b) To identify and assess material misstatements in the financial statements
- (c) To identify and assess operational risk in the operations of the entity
- (d) All of these

27. If before considering the internal controls at the audited entity, there is a high probability of certain errors in the financial statements, we particularly speak of

- (a) a high sampling risk
- (b) a high inherent risk
- (c) a high control risk
- (d) a high detection risk

28. There is inverse relationship between

- (a) Inherent risk and control risk
- (b) Combined risk of inherent and control risk with risk of material misstatements
- (c) Materiality and Audit Risk
- (d) Detection Risk and Audit Risk

29. Significant risk refers to

- (a) Audit Risk
- (b) Sampling Risk
- (c) Risk of material misstatements
- (d) Risk of material misstatements requiring special audit considerations

30. For better assessing the audit risk, auditor inquires different groups in the organizations EXCEPT:

- (a) Board of governance and top level management
- (b) Legal counsel
- (c) Middle level management
- (d) Shareholders

31. The nature, timing and extent of substantive procedures is related to assessed level of control risk
- (a) randomly
 - (b) disproportionately
 - (c) directly
 - (d) inversely
32. The sequence of steps in the auditor's consideration of internal control is as follows –
- (a) Obtain an understanding, design substantive test, perform tests of control, make a preliminary assessment of control risk
 - (b) Design substantive tests, obtain an understanding, perform tests of control, make a preliminary assessment of control risk
 - (c) Obtain an understanding, make a preliminary assessment of control risk, perform tests of control, design substantive procedures.
 - (d) Perform tests of control, obtain an understanding, make a preliminary assessment of control risk, design
33. Which of the following is not an inherent limitation of internal control system?
- (a) Management override
 - (b) Collusion among employees
 - (c) Inefficiency of internal auditor
 - (d) Abuse of authority
34. The primary purpose of performing tests of control is to provide reasonable assurance that_
- (a) there are no material misstatements due to fraud or error in financial statement
 - (b) accounting system is well documented
 - (c) Written evidence is there to support transactions
 - (d) if internal control is effective
35. The overall attitude and awareness of an entity's board of directors concerning the importance of internal control is reflected in
- (a) accounting controls
 - (b) control environment
 - (c) control procedures
 - (d) supervision

36. A flow chart, made by the auditor, of an entity's internal control system is a graphic representation that depicts the auditor's.
- (a) understanding of the system
 - (b) understanding of fraud risk factors
 - (c) documentation of assessment of control risk
 - (d) Both (a) and (c)
37. The performance of tests of control is documented in
- (a) audit programme
 - (b) flow charts
 - (c) working papers
 - (d) any of the above
38. Which of the following statements is not correct?
- (a) Inherent risk and control risk cannot be controlled by the management i.e are uncontrollable
 - (b) Detection risk is related directly to they effectiveness of the auditor's procedure
 - (c) Detection risk related inversely to control risk
 - (d) Inherent risk and control risk are highly interrelated
39. After testing a client's internal control activities, an auditor discovers a number of significant deficiencies in the operation of a client's internal controls. Under these circumstances the auditor most likely would
- (a) Issue a disclaimer of opinion about the internal controls as part of the auditor's report
 - (b) Increase the assessment of control risk and increase the extent of substantive tests
 - (c) Issue a qualified opinion of this finding as part of the auditor's report
 - (d) Withdraw from the audit because the internal controls are ineffective
40. _____ is a complete and exhausted description of the system as found in operation by the auditors.
- (a) Check List
 - (b) Flow Chart
 - (c) Narrative Records
 - (d) Internal Control Questionnaire
41. _____ gives a bird's eye view of the system and flow of transactions.
- (a) Narrative Records
 - (b) Check List
 - (c) Internal Control Questionnaire
 - (d) Flow Chart

42. Internal control system provides reasonable assurance about the achievements of entity's objectives, except

- (a) Reliability of financial reporting
- (b) Safeguarding of assets
- (c) Both (a) and (b)
- (d) None of these

43. Examination in depth refers to

- (a) Examining 100% items of a population
- (b) Examining all the assets and liabilities
- (c) Examination of a few selected transactions from the beginning to the end through the entire flow of transaction
- (d) None of these

44. Prakash & Co. Chartered Accountants are the internal auditor of Textbook Private Limited, for the year 2016-17. You have been instructed by your senior to check the internal controls for the investments done by the company during the year.

While verifying the same you noticed that the property documents, share certificates and other investment documents have been kept in a safe custody locker, whose keys are kept with an authorised official of Accounts Department of the company and none other than that official has access to locker. As an internal auditor do you consider as material weakness in internal controls? If yes, how will you report the matter?

- (a) It cannot be considered as material weakness in internal control as the company might not have any other reliable employee within in its staff members.
- (b) The safe custody locker should always be under the control of two authorised officials. Therefore, the auditor should communicate such material weakness to the management or audit committee.
- (c) It is not material weakness to be reported as giving the keys to two or more persons can lead a situation of confusion only.
- (d) The auditor should discuss the observation with the management and there is no need of any written communication.

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

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

46. Which of the following is a General IT control?
- (a) IT Environment (b) Application Control
(c) Access Security (d) IT Dependent Control
47. In WH Limited every business activity was being carried out manually. The top management of WH Limited decided to change the business environment of WH Limited by using computer systems and computer systems related technology to carry out all the major business activities of WH Limited.
This business environment of WH Limited, where all the major business activities are done using computer systems and computers related technology is an example of:
- (a) Operational Environment (b) Computational Environment.
(c) Control Environment (d) Automated Environment
48. _____ are also known as pervasive or indirect controls:
- (a) General IT Controls (b) Application Controls
(c) IT dependent Controls (d) None of the above
49. _____ is the combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information:-
- (a) Computer Assisted Audit Techniques
(b) Automated Controls
(c) Data Analytics
(d) Combination Controls
50. _____ are manual or automated procedures that typically operate at a business process level and apply to the processing of individual applications.
- (a) Application controls (b) General IT controls
(c) Process controls (d) All of these
51. _____ are the manual controls that make use of some form of data or information or report produced from the IT systems and applications.
- (a) Application
(b) IT dependent Controls
(c) Automated Controls
(d) General IT Controls

52. _____ is a logical subsystem within a larger information system where electronic data is stored in a predefined form and retrieved for use.
- (a) Data Mining (b) Data warehouse
(c) Database (d) Data Analytics
53. Which of the following Audit testing methods is most effective as an audit test and gives the best audit evidence ?
- (a) Inquiry (b) Observation
(c) Inspection (d) Reperformance
54. The Objective of establishing Security Policies and Procedures is to
- (a) To ensure that production systems are processed to meet financial reporting objectives.
(b) To ensure that modified systems continue to meet financial reporting objectives
(c) To ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives.
(d) To ensure that systems are developed, configured and implemented to meet financial reporting objectives.
55. IT related risks, if not mitigated, may put an impact on
- (a) Substantive Audit (b) Controls
(c) Reporting (d) All of above
(a) Inquiry (b) Inspection
(c) Observation (d) Reperformance
56. Applying _____ gives the most effective and efficient audit evidence while using Audit testing methods.
- (a) Inquiry in combination with Inspection
(b) Inspection in combination with Observation
(c) Observation in combination with reperformance
(d) Reperformance in combination with Inquiry
57. _____ are needed to support the functioning of _____
- (a) General IT Controls ; Application Controls
(b) Application Controls ; General IT Controls
(c) IT Dependent Controls ; General IT Controls
(d) Application Controls ; IT Dependent Controls

58. The concept of materiality is applied by the auditor:

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

ANSWERS

1	(d)	2	(a)	3	(c)	4	(d)	5	(d)	6	(b)	7	(c)
8	(b)	9	(b)	10	(d)	11	(b)	12	(d)	13	(a)	14	(a)
15	(b)	16	(b)	17	(c)	18	(d)	19	(b)	20	(c)	21	(l)
22	(b)	23	(c)	24	(b)	25	(d)	26	(d)	27	(b)	28	(c)
29	(d)	30	(d)	31	(c)	32	(c)	33	(c)	34	(d)	35	(b)
36	(a)	37	(c)	38	(a)	39	(b)	40	(c)	41	(d)	42	(d)
43	(c)	44	(b)	45	(d)	46	(c)	47	(d)	48	(a)	49	(c)
50	(a)	51	(b)	52	(c)	53	(d)	54	(c)	55	(d)	56	(a)
57	(a)	58	(c)										

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CASE STUDY MCQs

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.

Answer to Questions involving Case Studies 1

1	(b)	2	(c)	3	(b)	4	(a)	5	(c)
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Case Study 2

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

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

Based on above, answer the following questions:

- Which of the following most appropriately describes test of control regarding insurance of inventories?
 - 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.
 - 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.
 - Inspect insurance policies to verify that inventories at each location are comprehensively insured. Ensure policy period has not expired.
 - Inspect insurance policies to verify that inventories at each location are insured for fire and burglary. Ensure policy period has not expired.
- Which of the following most appropriately describes test of control regarding inventory counts?
 - Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure.
 - Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure. Attend inventory count.
 - 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.
 - Attend inventory count and perform test count.
- 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.

Answer to Questions involving Case Studies 2

1	(b)	2	(c)	3	(c)	4	(b)	5	(a)
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Case Study 3

- M/s PQR & Associates are appointed as auditors of Jupiter Ltd. for the Financial Year 2019-20.
- The team consisted of Mr. P, Mr. Q, Mr. R all Chartered Accountants and three article assistants.
- Mr. P, one of the engagement partners, briefed the audit staff about various items of financial statement to be checked in detail in case of Jupiter Ltd and about various aspects to be covered in the audit of the company.

- Mr. P told the audit staff about audit documentation, audit evidence, audit file, completion memorandum and many other things along with relevant Standards of Auditing applicable.
- Mr. P also told the staff about the risk of material misstatement that the financial statements are prone to and how it affects the sufficiency and appropriateness of audit evidence.
- The audit staff was also apprised about the various audit procedures to be adopted while conducting the audit of Jupiter Ltd.
- Further discussions were done about various types of risks related to financial statement and the audit work, the related audit procedures, and the risk assessment procedures.
- The engagement partners are also very particular about the application of various Standards on Auditing applicable in case of Jupiter Ltd.

Based on the above facts, answer the following:

1. _____ is the summary of significant matters identified during audit and way they are addressed :-
 - (a) Audit File
 - (b) Audit Programme
 - (c) Completion memorandum
 - (d) Checklists
2. The susceptibility of an assertion to a misstatement that could be material before consideration of any related control is _____:
 - (a) Control Risk
 - (b) Inherent Risk
 - (c) Audit Risk
 - (d) Significant Risk
3. Statement 1: Audit procedures consist of Risk Assessments Procedures and other procedures.
Statement 2: Substantive procedures consist of test of details and analytical procedures.
 - (a) Only Statement 1 is correct
 - (b) Only Statement 2 is correct
 - (c) Both 1 & 2 are correct
 - (d) Both 1 & 2 are incorrect

4. _____ refers to the audit procedures performed to obtain an understanding of the entity and its environment, including the entity’s internal control, to identify and assess the risks of material misstatement, whether due to fraud or error at the financial statement and assertion levels:-

- (a) Analytical Procedures
- (b) Risk Assessment Procedures
- (c) Audit Procedures
- (d) Substantive Analytical Procedures

5. Statement 1:- Substantive Procedures alone can provide sufficient and appropriate audit evidence at the assertion level.

Statement 2:- Test of Controls is audit procedure designed to evaluate the operating effectiveness of controls in prevention, detection and correcting material misstatement at the assertion level.

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

Answer to Questions involving Case Studies 3

1	(c)	2	(b)	3	(c)	4	(b)	5	(b)
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Case Study 4

Cheenu & Co are the auditors of a manufacturing industry. During the course of the audit, the following are the observations:

- (a) Due to paucity of time, one of the partners of Cheenu & Co. suggests that the team may complete the audit procedures and issue the audit report. They may carry out the audit documentation at a later stage.
- (b) Cheenu & Co. has identified the benchmark for the materiality level. However, there is a difference of opinion in documenting materiality for the financial statements. One of the partners is of the opinion that there is no need to document the same as per SA 230.
- (c) During the course of the audit, Cheenu & Co. wants to verify the inventory of the company held under the custody and control of the third party. The management refuses the same as it is not practicable.
- (d) There exists a litigation matter in which the auditor assesses a risk of material misstatement and wants to directly communicate with the entity’s external legal counsel. The management however refuses to give the auditor permission to communicate or meet the entity’s external legal counsel. Further, the auditor is unable to obtain sufficient appropriate audit evidence by performing alternate procedures.

From the above information, answer the following by choosing the correct option:

1. As per SQC1, what is the retention period of the audit documentation?
 - (a) It should be no shorter than seven years from the date of the auditor's report.
 - (b) It should be no shorter than eight years from the date of the auditor's report
 - (c) There is no such retention period; audit documentation must be there permanently as a defense in favor of the auditor in any litigation
 - (d) It should be no shorter than eight years from the date of entering into the audit agreement with client

2. As part of the audit documentation, the auditor may consider it helpful to prepare and retain a summary that describes significant matters identified during the audit and how they were addressed. What is this summary known as?
 - (a) Audit File
 - (b) Completion Memorandum
 - (c) Evidence summary
 - (d) Control Memorandum

3. How should the auditor verify the inventory held in custody with the third party?
 - (a) SA 501 mandates auditor to verify the same physically, hence management refusal will lead to a disclaimer of opinion
 - (b) The auditor should perform other procedures like requesting confirmation from third party or inspecting documentation like warehouse receipts to confirm existence of the inventory
 - (c) The auditor should obtain written representation from management on the inventory held in custody with third party (d) Inventory of client held with third party is outside the scope of audit; hence auditor need not verify the same for his audit opinion on the financial statements.

4. Is the opinion of the auditor on not to document the materiality level correct?
 - (a) Yes, SA 230 does not prescribe any documentation of materiality level as it is derived out of auditor's professional judgment.
 - (b) Yes, none of the auditing standards prescribe documentation of materiality level.
 - (c) No, though SA 230 does not prescribe any documentation, it should be documented as per SA 320.
 - (d) No, SA 230 explicitly states that materiality level should be documented.

- 5 Which among the following is not a factor for identification of an appropriate benchmark?
- (a) The elements of the financial statements
 - (b) The relative volatility of the benchmark
 - (c) The entity's ownership structure and the way it is financed.
 - (d) Previous experience of audit with the entity

Answer to Questions involving Case Studies 4

1	(a)	2	(b)	3	(b)	4	(c)	5	(d)
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Case Study 5

Roop & Co. are the auditors of Onda group of Hotels. This is the first time the firm is auditing an industry in food and beverage and it is day one of the audit. The engagement partner along with his team wants to make a thorough understanding of the entity and its environment in order to identify and assess the risks of material misstatements, whether due to fraud or error. The following are some of the points identified by them on Day 1.

- The hotel has two banquet halls. The documentation available for verification of banquet hall revenue is only the invoice raised by the hotel and some mail conversations on customer enquiry and finalization of price. On audit trial, it is found that finance approval of the transaction is only after invoice is sent to them for accounting at final settlement. Advance paid by the clients are not vetted through finance team. The auditor suspects a weakness in this system.
- The auditor also finds a control deficiency in the process of procurement of stores. A goods receipt note is not prepared at the time of receipt of goods. On enquiry with management, the auditor finds that there exists a system control wherein goods receipt note is automatically prepared and approved in the system once the quantity and price of goods is entered against specific vendor. This entry is on realtime basis and system does not allow back dated entries.
- The auditor enquires of the management as to what is risk assessment process followed by the entity for prevention and detection of risk of material misstatement due to fraud and error.

The auditor finds there is no documented risk assessment process.

With the help of the above facts, answer the following questions by choosing the correct option

1. What kind of a risk is portrayed in the booking of revenue with respect to Banquet halls?
 - (a) Inherent risk in the class of transaction
 - (b) Control risk in the class of transaction
 - (c) Detection risk in the audit procedures
 - (d) Audit risk in the opinion on the financial statements.

2. Which among the following statement is incorrect in the context of Audit Risk?
 - (a) The more extensive the audit procedures performed, the lower is the detection risk
 - (b) Greater the risk of material misstatement the auditor believes exist, less is the detection risk that can be accepted and accordingly more persuasive evidence is required by the auditor.
 - (c) Audit risk also includes the risk that the auditor may express an opinion that the financial statements are materially misstated when they are actually not.
 - (d) Risk of material misstatement at the assertion level is of two kinds – control risk and inherent risk.

3. In the case of procurement of stores, the auditor has tested more than one control for the same assertion. In that given case, what should be his reliance on the control?
 - (a) Since compensating controls are identified, if tested and evaluated to be effective, the auditor can rely on the control.
 - (b) Even though compensating controls are there, since one control is ineffective, the auditor should not rely on control for this assertion and should perform extensive procedures.
 - (c) Documentation in electronic medium cannot be accepted, hence, he cannot rely only on system control.
 - (d) Even though compensating controls are there, since one control is ineffective, the auditor should not rely on control for this assertion as well as associated assertions.

4. In the context of SA 315, which among the following is NOT a risk assessment procedure?
 - (a) Inquiries of management, of appropriate individuals within internal audit function and of others within the entity
 - (b) Analytical Procedures
 - (c) Observation and Inspection
 - (d) External Confirmation

5. What should be the course of action of the auditor for the entity not having a documented risk assessment process?
- (a) The auditor should obtain management written representations on how risks are identified
 - (b) The auditor shall discuss with management on how risks are identified, addressed and determine whether the absence is appropriate in the circumstances or whether it represents a significant deficiency in internal control.
 - (c) The auditor should advise the management to document the same immediately and accordingly opine on the same in his audit report too.
 - (d) The auditor shall discuss with management on how risks are identified by system and place reliance on the same as documentation in this context is immaterial

Answer to Questions involving Case Studies 5

1	(b)	2	(c)	3	(a)	4	(d)	5	(b)
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Case Study 6

A Partnership Firm of Chartered Accountants by the name of WN and Associates was appointed to audit books of accounts of Healthy and Talented Private Limited for the financial year 2020-21. WN and Associates consisted of two partners, Mr. W and Mr. N. The main responsibility to audit books of accounts of Healthy and Talented Private Limited for the financial year 2020-21 was given to Mr. W by WN and Associates. A team of seven members was provided to Mr. W for the purpose of helping him in conducting the audit of Healthy and Talented Private Limited for the financial year 2020-21. In the initial stages of conducting audit of Healthy and Talented Private Limited, Mr. W decided to evaluate internal control operating in the company. To gather information required for evaluation of internal control, Mr. W asked his team members to suggest a method which would help in gathering information so that internal control of the company can be evaluated.

First team member of team helping Mr. W suggested that they should follow a method, according to which number of instructions were required to be followed to collect information about internal control.

The second team member of team helping Mr. W suggested a method in which complete description of internal control in operation is recorded.

The third team member of team helping Mr. W suggested a method in which internal control of a company is presented in graphic form. The fourth team member of team helping Mr. W suggested a method in which a series of questions were required to be answered which would provide information for internal control. After analyzing all the suggestions Mr. W was satisfied with the suggestion of the third team member because according to Mr. W the suggestion of third team member was suitable from WN and Associates point of view and also from the point of view of Healthy and Talented Private Limited. Keeping the basic concepts of Internal Control in mind, answer the following multiple choice questions:

- In initial stage of conducting audit of Healthy and Talented Private Limited, Mr. W decided to evaluate internal control of the company. Evaluation of internal control is very important part of:

(a) Audit Report.	(b) Audit Evidence.
(c) Audit Documentation.	(d) Audit Programme.
- The first team member of team helping Mr. W suggested a method according to which, number of instructions were required to be followed to collect information about internal control. This method is called as :

(a) Flow Chart.	(b) Check List.
(c) Narrative Record.	(d) Questionnaire.
- The second team member of team helping Mr. W suggested a method in which complete description of internal control in operation is recorded. This method is known as :

(a) Narrative Record.	(b) Flow Chart.
(c) Questionnaire.	(d) Check List.
- The third team member of team helping Mr. W suggested a method in which internal control of company is presented in graphic form. This method of gathering information so that internal control can be evaluated is known as :

(a) Check List.	(b) Questionnaire.
(c) Flow Chart.	(d) Narrative Record.

5. The fourth team member of team helping Mr. W suggested a method in which a series of questions were required to be answered to gather information for internal control. This method of gathering information so that internal control can be evaluated is called as :

- (a) Questionnaire. (b) Flow Chart.
(c) Narrative Record. (d) Check List.

Answer to Questions involving Case Studies 6

1	(d)	2	(b)	3	(a)	4	(c)	5	(a)
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Case Study 7

M/s NSG & Associates have been appointed as auditors of Viaan Ltd. for the financial year 2019-20.

- The processes, operations, accounting and decisions are carried out by using computers in Viaan Ltd.
- The auditors understand that there are several aspects that they should consider to determine the level of automation and complexity in the business environment of Viaan Ltd.
- While planning the audit work, the engagement partners discussed with the audit staff about the various types of controls in the automated environment.
- The different types of audit tests that can be used in audit of an automated business environment were also discussed within the engagement team.
- The responsibility regarding the Internal Financial Controls was also discussed in detail.
- Further the tools and techniques that can be used to deal with the enormous data and information of Viaan Ltd. were briefed to the audit staff by the engagement partners.

Based on the above facts, answer the following:-

1. _____ are the manual controls that make use of some form of data or information or report produced from the IT systems and applications.

- (a) Application Controls (b) IT dependent Controls
(c) Automated Controls (d) General IT Controls

2. Statement 1: Application controls include both manual and automated controls that operate at a business process level.
Statement 2: General IT Controls apply to mainframe, miniframe as well as end user environment.
- (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
3. _____ are also known as pervasive or indirect controls:
- (a) General IT Controls (b) Application Controls
(c) IT dependent Controls (d) None of the above
4. _____ is the combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information:
- (a) Computer Assisted Audit Techniques (b) Automated Controls
(c) Data Analytics (d) None of the above
5. Which of the following is not a correct statement:
- (a) Inquiry should always be used in combination with any of the audit testing methods.
(b) Re performance is the most effective but is very time consuming and least efficient most of the times.
(c) Applying inquiry in combination with inspection gives the least effective and least efficient audit evidence.
(d) Use of audit tests is a matter of professional judgment of auditor

Answer to Questions involving Case Studies 7

1	(b)	2	(c)	3	(a)	4	(c)	5	(c)
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Case Study 8

Zenith Software Ltd has appointed Ram Laxman & Associates as its auditors for financial year 2019-2020.

The audit would cover all the usual aspects of financial auditing but would be more focused on Systems Audit as Zenith Software is a company which maintains its financial records extensively on digital platform.

The processes, operations, accounting and decisions are carried out by using computers in Zenith Software Ltd.

Standards on Auditing SA 315 and SA 330 require auditors to understand, assess and respond to risks that arise from the use of IT systems.

Ram Laxman & Associates have been seasoned auditors but have not carried out Systems audit in detail.

The tools and techniques that can be used to deal with the enormous data and information of Zenith Software Ltd. were briefed to the audit staff by the engagement partners but they still have some queries and doubts and seek your assistance for conducting this special assignment.

Based on below queries/cases, you are required to answer on specific areas which require special attention while conducting audit in an automated environment.

1. _____ are policies and procedures that relate to many applications and support the effective functioning of application controls
 - (a) General IT Controls
 - (b) IT Dependent Manual Controls
 - (c) Both (a) and (b)
 - (d) None of these

2. The objective of which of the following is to ensure that access to programs and data is authenticated and authorized to meet financial reporting objectives
 - (a) Data Centre and Network Operations
 - (b) Program Change
 - (c) Access Security
 - (d) Application system, acquisition, development and maintenance

3. Tools and techniques that auditors use in applying the principles of data analytics are known as-
 - (a) Computer Aided Audit Technique
 - (b) Computer Aided Audit Tools
 - (c) Computer Accounting and Auditing Technique
 - (d) Computer Assisted Audit Technique

4. _____ is a term that is used to describe a very large computer with high computing power, memory and storage that are required for running large business operations.

- (a) Application
- (b) Read Access Memory
- (c) Automated
- (d) Mainframe

5. _____ are needed to support the functioning of _____ and both are needed to ensure complete and accurate information processing through IT systems.

- (a) Internal controls, Automated controls
- (b) IT- Dependent controls, General IT controls
- (c) Application controls, IT- Dependent controls
- (d) General IT controls, Application controls

Answer to Questions involving Case Studies 8

1	(a)	2	(c)	3	(d)	4	(d)	5	(d)
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Case Study 9

M/s CA & Co is a firm of Chartered Accountants based at Mumbai, Mr C and Mr A being the Partners of the Firm. They are engaged, inter alia, in the Statutory Audit of Great Trading Company who is dealing in FMCG Products and sells its products to Wholesalers and Retailers. During the course of their primary discussion with the Accounting Personnel of the Company, Mr C found out that the number of Transactions are very high and the value of Transactions also vary a great length especially in the case of Sales Transactions - as their base is very large and number of sales transactions run into Hundreds of Invoices per month. Mr C and Mr A are thinking about checking the Sales Transactions and Balances of Account Receivables on a Sampling basis and for that they are discussing about which of the main two approaches to sampling would be appropriate in this case. They mostly are satisfied with the Internal Control Procedures as far as Sales Order Processing is concerned. After discussion, they have decided that they would divide the Sales Transactions into Value Buckets viz. Less than 1 Lakh, 1 Lakh to 5 Lakh, 5 Lakh and above. For Accounts Receivables they would go for Age-wise Receivables viz. up to 45 Days, 45 to 90 Days, 90 to 180 Days and Above 180 Days.

Checking of Sales and Receipts Transactions on the above basis was carried out and though the Auditors didn't find any major irregularity in the Sales, it was observed that most of the Receivables in Above 180 Days category were from individual Sales Bill of 1

Lakh or less and most of the parties were local ones. So it was decided to follow-up this matter by asking for Balance confirmation from those Debtors whose balance remained outstanding for more than 180 Days.

1. Which of the following Statement is correct?

- (a) Hundred Percent Checking will give absolute satisfaction to the Auditor about correctness of transactions.
- (b) Sampling Methods cannot be relied upon to reveal the true feature and characteristics of the population.
- (c) If drawn properly, a sample would give reasonable basis to an Auditor to draw conclusions about the entire population
- (d) Sampling should be done only when Hundred Percent Checking is not possible

2. Mr C and Mr A are discussing different approaches to Sampling, which are they?

- (a) Statistical Sampling and Non-statistical Sampling
- (b) Large Sample and Small Sample
- (c) Random Sampling and Systematic Sampling
- (d) Scientific Sampling and Non-Scientific Sampling

3. Which of the following method is used by the Auditor for Drawing of the Samples?

- (a) Simple Random Sampling
- (b) Haphazard Sampling
- (c) Systematic Sampling
- (d) Stratified Sampling

4. What is the initial perception of control risk as far as Sales Transactions are concerned?

- (a) High (b) Medium (c) Low (d) Non-existent

5. To satisfy about the genuineness of Balances of Debtors outstanding for more than 180 Days, M/s CA & Co would have to lower which risk?

- (a) Inherent Risk (b) Detection Risk
- (c) Control Risk (d) All of the above

Answer to Questions involving Case Studies 9

1	(c)	2	(a)	3	(d)	4	(a)	5	(b)
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Case Study 10

Sun Private Limited is a newly formed private limited company, engaged in the manufacturing of solar panels. Company has appointed M/s M&S Associates, a Partnership Firm of Mr Meticulous and Mr Sincere - as their First Auditors. M/s M&S Associates accepted the assignment and Mr Meticulous being the engagement Partner, started their Audit. During the course of Audit, Mr Meticulous asked the Management for name of the companies operating in similar business so that they can compare the Company's Figures. During this procedure, Mr Meticulous found that the Gross Margin of the Company is lower than the Industry Standard / Fellow Companies. He prepared an Interim Report dealing with this matter and asked the Management about the reasons for this deviation. Management asked him to give all the working along with the Working Papers as they believed it is the Company's Property. Mr Meticulous advised them that he can provide working but cannot give them the working papers as they are the property of the Firm. Management agreed to that and asked Mr Meticulous to go into detail and tell him the reasons for lower Gross Margin to which he agreed.

During the detailed audit, Mr Meticulous came to know about the fact that the company dispatched its solar panels to its Distributors on Delivery Challans and once the goods were accepted, Sales bills were raised. Checking each Challan against Sales Invoices, Mr Meticulous found that there were many challans for which no Invoices were raised and thus Sales was grossly understated and there was no mechanism where unbilled Challans were recorded or tracked. Company employed a person to reconcile all the Challans and prepared a list where Bills are yet to be sent to the Customers. In addition, Company was also asked to seek Confirmation of Balances from all its Customers. The Management assured Mr Meticulous that Inventories are physically verified and hence there will be no impact on them.

1. Mr Meticulous asked about other Companies, he was intending to perform which audit procedure?
 - (a) Analytical Procedures
 - (b) Substantive Procedures
 - (c) Random Sampling
 - (d) Statistical Sampling
2. What was the initial procedure carried on by Mr Meticulous?
 - (a) Trend Analysis
 - (b) Ratio Analysis
 - (c) Statistical Modelling
 - (d) Random Sampling

3. Who has the right to retain the audit working papers of the Company in current case?
- (a) Audit Committee (b) Board of Directors
(c) Auditor (d) Chairman of the Audit Committee
4. When Mr Meticulous decided to go in detail checking of Sales, which Audit Procedure he applied to obtain the evidence?
- (a) Test of Transactions (b) Test of Balances
(c) Both (a) and (b) (d) Analytical Procedures
5. The impact of the exercise carried on by the Company for unbilled challans will have an impact on
- (a) Gross Receipts and Debtors (b) Gross Receipts and Inventory
(c) Debtors (d) Inventory

Answer to Questions involving Case Studies 10

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

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

- (i) There is direct relationship between materiality and the degree of audit risk.
- (ii) 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.
- (iii) Tests of control are performed to obtain audit evidence about the effectiveness of Internal Controls Systems.
- (iv) Maintenance of Internal Control System is the responsibility of the Statutory Auditor.

Answers to Correct/Incorrect

- (i) **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.
- (ii) **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.
- (iii) **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.

- (iv) **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.

4

AUDIT EVIDENCE



MCQs BASED QUESTIONS

- Which of the following is not one of functions of internal auditor of an organization?
 - Performing assurance activities
 - Performing consulting activities to improve governance of organization
 - Performing risk management activities
 - Expressing independent opinion on financial statements of organization
- 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?
 - The risk that management may override controls in respect of related party transactions is lower.
 - The risk that management may override controls in respect of related party transactions is higher.
 - There is no effect on the risk that management may override controls in respect of related party transactions.
 - Risk of overriding of controls by management has no relationship at all with related party transactions.
- Which of the following is not an objective of a company's policies for ensuring "internal financial controls"?
 - Efficient conduct of business
 - Safeguarding of assets
 - Prevention and detection of frauds and errors
 - Assessing audit risk

4. Which of the following is not an advantage of statistical sampling?
- (a) Sample size does not increase in proportion to size of area tested.
 - (b) Sample selection is more objective.
 - (c) It provides a means of deriving a calculated risk and corresponding precision.
 - (d) In case of verifying compliance with specific legal requirements, it is suitable.
5. A company auditor receives external confirmation from an entity to whom company has sold goods. The said amount is properly classified in financial statements of company. Which of the following statements is not true in this regard?
- (a) It shows that said trade receivable exists.
 - (b) It shows that said trade receivable is properly valued.
 - (c) It shows that company has a right to said trade receivable.
 - (d) It shows that amount of said trade receivable has been recorded in proper account
6. Statement 1: A response that indicates a difference between information requested to be confirmed and information provided by confirming party is Negative Confirmation. Statement 2: A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered is exception.
- (a) Statement 1 is correct
 - (b) Statement 2 is correct
 - (c) Both 1 & 2 are incorrect
 - (d) Both 1 & 2 are correct
7. Audit evidence includes
- (a) information contained in the accounting records underlying the financial statements
 - (b) both information contained in the accounting records underlying the financial statements and other information.
 - (c) other information.
 - (d) information contained in the accounting records underlying the financial statements or other information.

8. The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:
- (a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel.
 - (b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel.
 - (c) Reviewing legal expense accounts.
 - (d) All of the above
9. If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express :
- (a) a disclaimer opinion
 - (b) a qualified opinion
 - (c) a qualified opinion or a disclaimer of opinion, as appropriate
 - (d) unmodified opinion
10. Auditor's judgment as to sufficiency may be affected by the factors such as:
- (a) Materiality
 - (b) Risk of material misstatement
 - (c) Size and characteristics of the population
 - (d) All of the above
11. A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.
- (a) Positive confirmation request
 - (b) Non Response
 - (c) Negative Confirmation request
 - (d) Exception
12. Which of the following is not an Audit procedure to obtain audit evidence:
- (a) Inspection
 - (b) Observation
 - (c) External Confirmation
 - (d) Internal Contro

13. Which of following SA deals with auditor's responsibility to design and perform audit procedures in such a way to enable the auditor to obtain sufficient and appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion
- (a) SA 500 (b) SA 501 (c) SA 330 (d) SA 315
14. Which of the following is the least persuasive type of audit evidence?
- (a) Bank statements obtained from the client
(b) Documents obtained by auditor from third parties directly
(c) Carbon copies of sales invoices inspected by the auditor
(d) Computations made by the auditor.
15. Observation consists
- (a) Review of financial statements
(b) Looking at a process, procedure being performed by others
(c) Independent execution of procedure or controls that were originally performed as part of entity's internal control.
(d) All of these
16. A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information, is
- (a) Negative Confirmation Request (b) Exception
(c) Positive Confirmation Request (d) Non-Response
17. In case any exception is identified by auditor by conducting external confirmation, he shall perform
- (a) Alternative audit procedures (b) Additional audit procedures
(c) Test of Controls (d) Both (a) and (b)
18. A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered is called-
- (a) Negative confirmation request
(b) Non-response
(c) Exception
(d) Positive confirmation request

19. If auditor is unable to attend physical inventory counting due to unforeseen circumstances the auditor shall
- (a) Obtain a written representation from management of entity
 - (b) Conduct external confirmation form third party
 - (c) Make or observe some physical count on an alternative date, and perform audit procedures on intervening transactions
 - (d) All of these.
20. An initial audit engagement in engagement in which :
- (a) The financial statements for the prior period were not audited
 - (b) The financial statements for the prior period were audited by a predecessor auditor
 - (c) Either (a) or (b)
 - (d) None of (a) or (b)
21. Which of the following is not a record or document that may provide information about related party relationships and transactions:
- (a) Entity income tax return
 - (b) Internal auditor's report
 - (c) Memorandum of Association
 - (d) Life insurance policies acquired by the entity.
22. If auditor identifies significant related party transactions, not conducted on the terms and conditions like normal rate and market conditions then, he should evaluate
- (a) Business rationale behind these transactions
 - (b) Consistency of terms with management's explanation
 - (c) Accounting and disclosure of such transactions in financial statements
 - (d) All of these
23. Statement(1)
Regarding related party relationships and transactions with them, auditor shall not obtain any written representation; rather obtain extra evidences independently as he cannot rely on written representations when it comes to related party transactions.
Statement (2)
As per SA-550, he should maintain documentation regarding name and nature of related party relationships.

- | | |
|----------------------------------|------------------------------------|
| (a) Only Statement (1) is true | (b) Only Statement (2) is true |
| (c) Both the statements are true | (d) None of the Statements is true |

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

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

25. Which of the following is the most appropriate potential reaction of the auditor to his assessment that the risk of material misstatement due to fraud is high in relation to existence of inventory?

- (a) Visit location on surprise basis to observe test counts
- (b) Request inventory count at a date close to year end
- (c) Vouch goods sent on approval very carefully
- (d) Perform analytical procedures.

26. Reliability of data is influenced by

- | | |
|--|------------------|
| (a) Its source | (b) Its nature |
| (c) Circumstances under which it is obtained | (d) All of these |

27. Your firm has been appointed as the statutory auditors of GBM Private Limited for the financial year 2017-18. While verification of company's inventories as on 31st March 2018 you found that the significant amount of inventories belonging to the company are held by other parties. However, the company has kept all the records of the inventories maintained by other parties, what is your duty as an auditor in order to ensure that third parties are not such with whom the stock should not be

held and the stock as disclosed in company's records actually belongs to them?

- (a) Ensure that the total stock including the stock with third party tally with the stock register maintained by the company.
- (b) Obtain confirmation from the third party/s with whom the inventories of the company are held and reconcile the same with stock register.
- (c) Conduct a physical verification of stock maintained with third party/s.
- (d) Obtain a written confirmation from the departmental head of the company for the inventories maintained at other places as audit evidence.

28. Coyote Ltd. is dealing in trading of electronic goods. Huge inventory (60% approximately) of the company is lying on consignment (i.e. under the custody of third party). CA. Star, the auditor of the company, wants to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory lying on consignment. Thus, he requested & obtained confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity, however, it raised doubts about the integrity and objectivity of the third party. Which of the following other audit procedures may be performed by CA. Star to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory under the custody of third party?

- (a) Attend third party's physical counting of inventory.
- (b) Arrange for another auditor to attend third party's physical counting of inventory.
- (c) Inspect warehouse receipts regarding inventory held by third parties.
- (d) All of the above

29. Audit evidence is necessary to support the auditor's opinion and report. It is _____ in nature and is primarily obtained from audit procedures performed during the course of the audit.

- (a) cumulative
- (b) regressive
- (c) selective
- (d) objective

30. Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence.

- (a) obtaining audit evidence
- (b) evaluating audit evidence
- (c) obtaining or evaluating audit evidence.
- (d) obtaining and evaluating audit evidence.

31. Audit procedures to obtain audit evidence can include

- (a) inspection, observation, confirmation, recalculation, re-performance and analytical procedures
- (b) inspection, observation, confirmation, recalculation and re-performance
- (c) inspection, observation, confirmation and analytical procedures
- (d) inspection, observation, recalculation, re-performance and analytical procedures

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

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

33. Statement 1: Audit procedures consist of Risk Assessments Procedures and other procedures.

Statement 2: Substantive procedures consist of test of details and analytical procedures.

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

34. Statement I As per the Standard on Auditing (SA) 520 “Analytical Procedures”, the term “analytical procedures” means evaluations of financial information through analysis of plausible relationships among financial data.

Statement II Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

- (a) Only Statement I is correct
- (b) Only Statement II is correct
- (c) Both statements are correct
- (d) Both Statements are incorrect

35. Which of the following is incorrect

- (a) The external auditor may use internal auditor to provide direct assistance w.r.t. area that involve significant judgements in audit
- (b) The external auditor shall not use internal auditor to provide direct assistance w.r.t. area where risk of material misstatements is highly assessed by auditor
- (c) Both (a) and (b)
- (d) None of these

36. The main advantage of using statistical sampling techniques is that such techniques:
- (a) Mathematically measure risk
 - (b) Eliminate the need for judgmental sampling
 - (c) Defines the values of tolerable error
 - (d) All of the them.
37. Which of the following factors is (are) considered in determining the sample size for tests of control?
- (a) Projected error
 - (b) tolerable error
 - (c) Expected error
 - (d) Both (b) and (c)
38. Which of the following is more scientific :
- (a) Statistical
 - (b) Non- statistical
 - (c) both (a) and (b)
 - (d) none of the above
39. As the number of transactions of WY Limited for the financial year 2018-19 were in very large number, the auditor of WY Limited decided to use the technique of Audit Sampling. Before selecting the sample from Repair and Maintenance Expenses, the auditor of WY Limited wished that entire data of Repair and Maintenance Expenses of WY Limited for financial year 2018-19 should have three characteristics. These three characteristics are:
- (a) Simple, Completeness, Relevant.
 - (b) Appropriateness, Simple, Relevant.
 - (c) Reliable, Simple, Relevant.
 - (d) Appropriateness, Completeness, Reliable
40. In random Sample, each item of population has
- (a) equal chance of selection
 - (b) has varying chance of selection depending upon placing of items.
 - (c) may have a chance of selection based on auditors professional judgement
 - (d) All of these
41. The relationship between tolerable error and sample size is
- (a) Inverse
 - (b) Direct
 - (c) Close
 - (d) There is no relationship.

42. Statistical sampling has the following characteristics

- (a) Random selection
- (b) Use of Probability theory
- (c) both (a) and (b)
- (d) Judgmental approach

43. Which of the following statements is correct?

- (a) Lower the sampling risk greater the sample size
- (b) Smaller the tolerable error, greater the sample size
- (c) Lower the expected error, smaller the sample size
- (d) All are correct

44. In non-statistical sampling, the sample size and its composition are determined on the basis of

- (a) Personal experience of auditor
- (b) Knowledge of auditor
- (c) Judgement of auditor
- (d) All of above

45. In which of the following sampling, sampling units are selected from population at fixed intervals

- (a) Random Sampling
- (b) Systematic Sampling
- (c) Block Sampling
- (d) Cluster Sampling

46. In stratified random sampling

- (a) Sample is taken from whole of the population
- (b) It requires special attention to judge contents of stratum
- (c) There is application of different concept and not an extension of simple random sampling
- (d) All of these

47. When significant risk had been identified by the auditor, then:

- (a) Audit evidence obtained solely from substantive analytical procedures is sufficient.
- (b) Audit evidence obtained solely from substantive analytical procedures is unlikely to be sufficient.
- (c) Auditor will perform test of details also.
- (d) Both b and c

48. Substantive Analytical Procedures are generally more applicable to:
- (a) Large volumes of transactions
 - (b) Transactions predictable over time
 - (c) Both a and b
 - (d) None of a and b
49.is the comparison of current data with the prior period balance.
- (a) Ratio Analysis
 - (b) Trend analysis
 - (c) Reasonableness test
 - (d) Structural Modelling
50. Statement 1: Analytical procedures are more useful while conducting the audit and at the completion phase and are of no use at the planning stage.
Statement 2 : In the planning stage, audit procedures assist the auditor in understanding the client's business and identifying the areas of potential risks.
- (a) Statement 1 & 2 are correct
 - (b) Statement 1 & 2 are incorrect
 - (c) Only Statement 1 is correct
 - (d) Only Statement 2 is correct
51. What are analytical procedures?
- (a) Substantive tests designed to assess control risk
 - (b) Substantive tests designed to evaluate the validity of management's representation letter
 - (c) Substantive tests designed to study relationships between financial and non-financial data
 - (d) All of the above
52. Which of the following is not an analytical procedure?
- (a) Tracing of purchases recurred in the purchase book to purchase invoices.
 - (b) Comparing aggregate wages paid to number of employees
 - (c) Comparing the actual costs with standard costs
 - (d) All of them are analytical procedures
53. Analytical procedures issued in the planning stage of an audit, generally:
- (a) help to determine the nature, timing and extent of other audit procedures
 - (b) direct attention to potential risk areas
 - (c) indicate important aspects of business
 - (d) All of the above

54. The basic assumption underlying the use of analytical procedures is:
- (a) It helps the auditor to study relationship among elements of financial information
 - (b) Relationship among data exist and continue in the absence of known condition to the contrary
 - (c) Analytical procedures will not be able to detect unusual relationships
 - (d) None of the above
55. Auditor Compares Gross Profit Ratio with that of previous year and it is discovered that there has been a fall in the ratio. This is an example of:
- (a) Analytical Procedure
 - (b) Test of Controls
 - (c) Walk through Test
 - (d) Audit Sampling
56. _____ means evaluation of financial information through analysis of plausible relationships among both financial and non-financial data.
- (a) Risk assessment
 - (b) Analytical Procedures
 - (c) Substantive Procedures
 - (d) Test of Controls
57. Which of the following statement is correct :
- (a) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time
 - (b) Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time
 - (c) Substantive analytical procedures are generally more applicable to small volumes of transactions that tend to be predictable over time
 - (d) None of the above

ANSWERS

1	(d)	2	(b)	3	(d)	4	(d)	5	(b)	6	(c)	7	(b)
8	(d)	9	(c)	10	(d)	11	(c)	12	(d)	13	(a)	14	(c)
15	(b)	16	(c)	17	(b)	18	(b)	19	(c)	20	(c)	21	(c)
22	(d)	23	(b)	24	(b)	25	(a)	26	(d)	27	(b)	28	(d)
29	(a)	30	(d)	31	(a)	32	(a)	33	(c)	34	(b)	35	(a)
36	(a)	37	(d)	38	(a)	39	(d)	40	(a)	41	(a)	42	(c)
43	(d)	44	(d)	45	(b)	46	(b)	47	(d)	48	(c)	49	(b)
50	(d)	51	(c)	52	(d)	53	(d)	54	(b)	55	(a)	56	(b)
57	(a)												



CASE STUDY MCQs

Case Study 1

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

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

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

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

Based on above, 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.

Answer to Questions involving Case Studies 1

1	(a)	2	(b)	3	(d)	4	(d)	5	(d)
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Case Study 2

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

- (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, 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

Answer to Questions involving Case Studies 2

1	(b)	2	(c)	3	(d)	4	(b)	5	(b)
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Case Study 3

Star Private Limited is a newly formed private limited company, engaged in the manufacturing of solar panels. Company has appointed Rajan Mehta and Associates, a Partnership Firm of CA Rajan Mehta and CA Piyush Mehta - as their First Auditors. Rajan Mehta and Associates accepted the assignment and CA Rajan Mehta being the engagement Partner, started their Audit.

During the course of Audit, CA Rajan Mehta asked the Management for name of the companies operating in similar business so that they can compare the Company's Figures. During this procedure, CA Rajan Mehta found that the Gross Margin of the Company is lower than the Industry Standard / Fellow Companies. He prepared an Interim Report dealing with this matter and asked the Management about the reasons for this deviation. Management asked him to give all the working along with the Working Papers as they believed it is the Company's Property. CA Rajan Mehta advised them that he can provide working but cannot give them the working papers as they are the property of the Firm.

Management agreed to that and asked CA Rajan Mehta to go into detail and tell him about the reasons for lower Gross Margin to which he agreed. During the detailed audit, CA Rajan Mehta came to know about the fact that the company dispatched its solar panels to its distributors on delivery challans and once the goods were accepted, sales bills were raised. Checking each challan against sales invoices, CA Rajan Mehta found that there were many challans for which no invoices were raised and thus sales was grossly understated and there was no mechanism where unbilled challans were recorded or tracked. Company employed a person to reconcile all the challans and prepared a list where bills are yet to be sent to the customers. In addition, company was also asked to seek confirmation of balances from all its customers. The management assured CA Rajan Mehta that inventories are physically verified and hence there will be no impact on them.

Based on above, answer the following questions:-

1. CA Rajan Mehta asked about other Companies, he was intending to perform which audit procedure?
 - (a) Analytical Procedures
 - (b) Substantive Procedures
 - (c) Random Sampling
 - (d) Statistical Sampling

2. What was the initial procedure carried on by CA Rajan Mehta?

(a) Trend Analysis	(b) Ratio Analysis
(c) Statistical Modelling	(d) Random Sampling

3. Who has the right to retain the audit working papers of the Company in current case?

(a) Audit Committee	(b) Board of Directors
(c) Auditor	(d) Chairman of the Audit Committee

4. When CA Rajan Mehta decided to go in detail checking of Sales, which Audit Procedure he applied to obtain the evidence?

(a) Test of Transactions	(b) Test of Balances
(c) Both (a) and (b)	(d) Analytical Procedures

5. The impact of the exercise carried on by the Company for unbilled challans will have an impact on

(a) Gross Receipts and Debtors	(b) Gross Receipts and Inventory
(c) Debtors	(d) Inventory

Answer to Questions involving Case Studies 3

1	(a)	2	(b)	3	(c)	4	(c)	5	(a)
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Case Study 4

M/s JJ & associates having office in Chennai are statutory auditors under Companies Act, 2013 of a company viz. Sweet Aroma Private Limited engaged in business of obtaining and manufacturing rice from paddy catering to both domestic as well as international market mainly in Gulf nations. The company has a huge plant capacity for rice extraction in one of the states in Northern India. Needless to state that inventories are in huge quantity in such type of business consisting of raw material, work in progress and finished goods.

The auditors want to obtain sufficient appropriate audit evidence regarding inventories.

In above context, answer the following questions:

1. Which of the following is most likely correct in relation to obtaining of sufficient appropriate audit evidence regarding existence and condition of inventory?
 - (a) It is mandatory for the auditor to attend physical inventory counting on the date of financial statements in all circumstances.
 - (b) Physical inventory counting may be attended by auditor on the date of financial statement or at a date other than date of financial statements in his discretion mandatorily in all circumstances.
 - (c) The attendance of auditors at physical inventory counting is impracticable due to time and costs involved because of auditor's office location vis-à-vis company's plant location. Hence, attendance at physical inventory counting may be skipped and alternative audit procedures may be performed to obtain sufficient appropriate evidence.
 - (d) The auditor shall attend at physical inventory counting unless impracticable. However, issue of time and costs involved because of auditor's office location vis-à-vis company's plant location is not a valid basis for skipping physical inventory counting.

2. Below are given certain cluster of matters which are relevant in planning attendance of auditor at physical inventory counting.
Which of the following clusters consists of a likely inappropriate combination?
 - (a) Nature of inventory, timing of physical inventory counting and stages of completion of work in progress
 - (b) Nature of inventory, timing of physical inventory counting and valuation method of inventory
 - (c) Nature of inventory, timing of physical inventory counting, considerations regarding maintenance of a perpetual inventory system
 - (d) Risks of material misstatements related to inventory, nature of internal control pertaining to inventory, considerations regarding maintenance of a perpetual inventory system

3. Which of the following is the most likely logical sequence of steps in relation to attendance at physical inventory counting by auditor?
 - (a) Observance of performance of management's count procedures, inspection of inventory, performing test counts and evaluation of management's procedures for recording and controlling results of physical inventory counting

- (b) Observance of performance of management's count procedures, performing test counts, inspection of inventory and evaluation of management's procedures for recording and controlling results of physical inventory counting
- (c) Performing test counts, inspection of inventory, Observance of performance of management's count procedures and evaluation of management's procedures for recording and controlling results of physical inventory counting
- (d) Evaluation of management's procedures for recording and controlling results of physical inventory counting, Observance of performance of management's count procedures, inspection of inventory and performing test counts

4. During attendance at physical inventory counting, the auditor inspects inventory.

Following outcomes stated as I, II & III are given below of this inspection procedure:

Outcome I --- Existence of inventory

Outcome II ---- Ownership of inventory

Outcome III ----- Condition of inventory

Which of following statements is most likely true?

- (a) Outcomes I, II and III are all necessarily established after inspection.
 - (b) Only Outcomes I and III are established after inspection and Outcome II is never established.
 - (c) Outcomes I and III are established after inspection. However, outcome II may not be necessarily established.
 - (d) Outcome II and III are established after inspection. However, outcome I may not be necessarily established.
5. It was observed by auditors that, out of total rice physically counted on 31st March, 2020 about 67 quintals of rice belonged to M/s PQR, a proprietary concern which had sent paddy to this company's plant for extraction of rice. What would be treatment of this item in financial statements of company?
- (a) The value of 67 quintals rice would be reflected in company's financial statements as per method of valuation adopted by the company.
 - (b) The value of 67 quintals rice would be reflected in company's financial statements as per method of valuation adopted by the proprietary concern.
 - (c) The value of 67 quintals rice would not be reflected in company's financial statements.

- (d) The value of 67 quintals rice would be reflected in proprietary concern's financial statements as per method of valuation adopted by the company.

Answer to Questions involving Case Studies 4

1	(d)	2	(b)	3	(d)	4	(c)	5	(a)
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Case Study 5

M/s UVW & Associates have been appointed as auditors of Mars Ltd. For the Financial Year 2019-20.

- During the course of audit, the auditors notice that there are certain legal expenses been charged to revenue during the financial year by Mars Ltd.
- These legal expenses are related to litigations going against the company regarding its Corporate Social Responsibility expenses incurred near its factory area.
- Further, M/s UVW & Associates noticed that there is a major change in the debtors and creditors account of Mars Ltd. During the financial year under audit. The auditors have decided to send balance confirmation requests to the debtors and creditors of Mars Ltd. Also the auditors decide to take management representation letters wherever required.
- Also, the auditors have noticed certain related party transactions reflected in the financial statements of Mars Ltd during the financial year under audit. The transaction is between Mars Ltd and a Company owned by wife of one of the directors of Mars Ltd.
- The auditors have become aware of certain subsequent events occurring in case of Mars Ltd. These are related to the outcomes of the litigations going against Mars Ltd.
- The auditors are also concerned whether the litigations going against Mars Ltd. and their outcomes have any impact on the going concern of the company.

Based on the above facts, answer the following:-

1. **Statement 1: Although Written Representations provide necessary audit evidence, they do not provide sufficient and appropriate audit evidence on their own about the matters with which they deal.**

Statement 2: Written Representations do not include financial statements, the assertions within, or supporting books and records.

- (a) Only Statement 1 is correct
- (b) Only Statement 2 is correct
- (c) Both Statement 1 & 2 are correct
- (d) None of Statement 1 & 2 is correct

2. The auditor can perform the following procedures to identify litigation and claims of Mars Ltd:-
- (a) Inquiry of management including in house legal counsel.
 - (b) Reviewing legal expenses account.
 - (c) Reviewing of minutes of meetings of those charged to governance and correspondence between entity and external legal counsel.
 - (d) All of the above.
3. Negative confirmation requests require the third party to respond in the following cases:
- (a) If there is agreement
 - (b) If there is disagreement
 - (c) In both cases of agreement as well as disagreement
 - (d) None of the above.
4. Statement 1:- A failure of the confirming party to respond, or fully respond to a positive confirmation request or a confirmation request returned undelivered is a case of Non Response.
Statement 2:- A response that indicates difference between information requested to be confirmed and contained in entity's records and information provided by the confirming part is a case of Exception.
- (a) Only Statement 1 is correct
 - (b) Only Statement 2 is correct
 - (c) Both Statement 1 & 2 are correct
 - (d) None of Statement 1 & 2 is correct
5. Which of the following is incorrect so far as the related party transactions are concerned:
- (a) Many related party transactions are in the normal course of business.
 - (b) Related party transactions may not be conducted under normal market term and conditions.
 - (c) In some circumstances, related party transactions may give rise to higher risks of material misstatement.
 - (d) None of the above.

Answer to Questions involving Case Studies 5

1	(c)	2	(d)	3	(b)	4	(c)	5	(d)
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Case Study 6

M/s KDR & associates, Chartered accountants have been appointed auditors of a company having operations spread in three states in India for the first time. The nature of business of company is such that there are about 50000 monthly entries in its books of accounts accompanied with commensurate records. The company has also robust internal control system. The auditors want reliable evidence. However, they are desirous of curtailing non-consequential routine checking.

Hence, while formulating strategy and plan for conducting audit, auditors desire to rely upon good audit samples both for tests of controls and tests of details.

In above context, answer the following questions: -

1. Consider the following statements for determining sample size for tests of control: -
Statement I--- An Increase in the tolerable rate of deviation leads to decrease in sample size.

Statement II--- An increase in the expected rate of deviation of the population to be tested leads to increase in sample size.

Statement III---An increase in the number of sampling units in the population leads to substantial increase in sample size.

Which of the following is most likely correct option?

- (a) All Statements I, II and III are true.
- (b) Statements I and II are true. However, Statement III is false.
- (c) Statements I and III are true. However, Statement II is false.
- (d) Statements II and III are true. However, Statement I is false.

2. Consider the following statements for determining sample size for tests of details: -
Statement I--- An increase in tolerable misstatement leads to increase in sample size.

Statement II--- An increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population leads to decrease in sample size.

Statement III---An increase in the amount of misstatement auditor expects to find in the population leads to increase in sample size.

Which of the following is most likely correct option?

- (a) All Statements I, II and III are true.
- (b) Statements I and II are false. However, Statement III is true.
- (c) Statements I and III are true. However, Statement II is false.
- (d) Statements II and III are true. However, Statement I is false.

3. Which of the following is not likely to be correct in evaluating results of audit sampling in case of tests of details?

- (a) The projected misstatement combined with anomalous misstatement is auditor's best estimate of misstatement in population.
- (b) In case projected misstatement combined with anomalous misstatement exceeds tolerable misstatement, the sample provides a reasonable basis for conclusions about population.
- (c) The closer the projected misstatement combined with anomalous statement is to tolerable misstatement, it is more likely that actual misstatement in the population may exceed tolerable misstatement.
- (d) In case the projected misstatement is greater than auditor's expectation of misstatement used to determine sample size, the auditor may conclude that there is unacceptable sampling risk of actual misstatement in the population exceeding tolerable misstatement.

4. Which of the following is not likely to be correct in relation to Block Sampling and audit samples drawn upon using this technique?

- (a) Block selection involves selection of a block/blocks of contiguous items within the population.
- (b) Most populations from which audit samples are drawn are structured in such a way that items in a sequence can be expected to have similar characteristics to each other but different characteristics from items elsewhere in population. Hence, it is not used ordinarily in audit sampling.
- (c) Block sampling has characteristics of simplicity and economy.
- (d) It is generally an appropriate sample selection technique when auditor intends to draw valid inferences about the entire population based upon sample.

5. Consider the below stated steps in relation to audit sampling.

What is the most likely logical order of these steps to be followed by auditors of this company?

Step I—Performing audit procedures

Step II - - - - Projecting Misstatements

Step III- - - - Sample design and selection of items for testing

Step IV-- Investigating Nature and cause of deviations

Step V--- Evaluating results of audit Sampling

(a) Step I, Step II, Step III, Step IV and Step V

(b) Step II, Step I, Step III, Step V and Step IV

(c) Step III, Step I, Step IV, Step II and Step V

(d) Step I, Step II, Step III, Step V and Step IV

Answer to Questions involving Case Studies 6

1	(b)	2	(b)	3	(b)	4	(d)	5	(c)
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Case Study 7

Moon Group of companies is a retail chain involved in the selling of daily consumer needs directly to the customer. They are in the process of appointing an audit firm for the audit of their accounts for the financial year 2019-20. Moon Group is a South Indian based consumer store having a total of 16 outlets across 4 cities in South India.

Sumant & Co. is appointed as the principal auditor for the entire group. Companies Act 2013 prescribes in detail the terms of this audit engagement. Further, there are many branch auditors appointed for the outlets in the other cities. The company also has an internal audit function conducted on quarterly basis by Ram & Co. Following are the observations during the course of the statutory audit:

- (a) One of the discounts offered by the store is in the form of payback cards where reward points are accumulated and the customer can redeem the same on subsequent purchase. The management and internal auditors are of the opinion that the points redeemed are to be treated as trade discount. The external auditors are doubtful on the matter.
- (b) One of the outlet in Chennai region is in the verge of getting closed and is only left with low value stock to be cleared before closure. During the year, the sales were only around 1,40,000/- and the auditor considers this component immaterial. All other outlets are performing well with good revenue share.
- (c) The gratuity valuation of the employees of the retail chain is done by an external valuer. The auditor, considering the quantum involved appoints an external auditor's expert for the verification of the actuarial calculation of gratuity.

From the above facts, answer the following questions by choosing the correct answer:

1. As per SA 210 – Agreeing the Terms of Audit Engagement, which of the following statement is correct?
 - (a) Though law prescribes in sufficient detail the terms of the audit engagement, the auditor still needs to record them in a written agreement and also seek written agreement from management that it acknowledges and understands that it has responsibility for the preparation of financial statements.
 - (b) Since law prescribes in sufficient detail the terms of the audit engagement, the auditor need not record them in a written agreement except for the fact that law or regulation applies and also seek written agreement from management that it acknowledges and understands that it has responsibility for the preparation of financial statements.
 - (c) The auditor has to take an extract of the law prescribing the details of the terms of the audit engagement & obtain the counter signature of the management in it.
 - (d) Though law prescribes in sufficient detail the terms of the audit engagement, the auditor still needs to record them in a written agreement, however it need not seek written agreement from management that it acknowledges and understands that it has responsibility for the preparation of financial statements.

2. With respect to the treatment of discount on redemption of points in payback card, what should be the action of the external auditor?
 - (a) The auditor can place reliance and go by the opinion of the branch auditor and internal auditor as they have only done a thorough and detailed audit of the accounts
 - (b) The auditor can place reliance on the management's accounting policy as prima facie they are only responsible for preparation of financial statements.
 - (c) The external auditor has sole responsibility for the audit opinion expressed and hence he should perform procedures to satisfy himself on the correct treatment and issue opinion accordingly.
 - (d) The auditor can advise management on correct treatment but cannot qualify his opinion as branch auditor's opinion has higher authority than external auditor's opinion.

3. What is the main objective of the external auditor, when he uses the work of the internal audit function of Ram & Co.?
- (a) To determine as to which areas, what extent the work can be used and whether that work is adequate for the purposes of the audit.
 - (b) To appropriately direct, supervise and review the work of the internal audit function
 - (c) Review the internal audit report and audit the areas not covered by the internal audit function
 - (d) Enquire from management on the special points that arose during internal audit and follow up on the course of action on those points.
4. Which of these is not a factor affecting the external auditor's evaluation of the objectivity of the internal audit function?
- (a) Whether the organizational status of the internal audit function supports the ability of the function to be free from bias, conflict of interest or undue influence of others to override professional judgment.
 - (b) Whether the internal audit function is free of any conflicting responsibilities.
 - (c) Whether the internal auditors have adequate technical training and proficiency in auditing.
 - (d) Whether those charged with governance oversee employment decisions related to internal audit function.

Answer to Questions involving Case Studies 7

1	(b)	2	(c)	3	(a)	4	(c)
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CORRECT / INCORRECT

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

1. Purchase invoice is an example of internal evidence.
2. Sufficiency is the measure of the quality of audit evidence.
3. Inquiry alone is 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.
5. Assertions refer to the representations by the auditor to consider the different types of the potential misstatements that may occur.
6. The method which involves dividing the population into groups of items is known as block sampling.
7. Universe refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.
8. Non Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.
9. Sample need not be representative.
10. The objective of stratification is to increase the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.
11. When statistical sampling is used to select a sample, sample need not be representative because the statistical sampling takes care of the representation.
12. Stratified Sampling is used for homogeneous population.
13. Non statistical sampling is considered to be more scientific than the statistical sampling.
14. In case of Statistical sampling, auditor's bias in choosing sample is involved.
15. In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population.
16. Low acceptable sampling risk requires larger sample size.
17. As per the Standard on Auditing (SA) 520 "Analytical Procedures" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among financial data only.

18. Auditor can depend on routine checks to disclose all the mistakes or manipulation that may exist in accounts.
19. Only purpose of analytical procedures is to obtain relevant and reliable audit evidence when using substantive analytical procedures.
20. Analytical Procedures are required in the planning phase only.
21. Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time.
22. Ratio analysis is useful in analyzing revenue and expense account only.
23. Reasonableness test rely only on the events of the prior period like other analytical procedures.
24. The statutory auditor of the company can apply analytical procedures to the standalone financial statements of a company only and not to the consolidated financial statements.

Answers to Correct/Incorrect

1. **Incorrect:** Internal evidence is the evidence that originates within the client's organisation. Since purchase invoice originates outside the client's organisation, therefore, it is an example of external evidence.
2. **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. **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. **Incorrect:** When auditor inquires the management as part of audit procedures such inquiries may range from formal written inquiries to informal oral inquiries.
5. **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. **Incorrect:** The method which involves dividing the population into groups of items is known as cluster sampling whereas block sampling involves the selection of a defined block of consecutive items.
7. **Incorrect:** Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.
8. **Incorrect:** Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.
9. **Incorrect:** Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.
10. **Incorrect:** The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.
11. **Incorrect:** Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.
12. **Incorrect:** Stratified sampling is used when the population is diversified i.e heterogeneous. The population is divided into sub population having similar characteristics. Sample are then chosen from these sub populations which are called as Stratum. Therefore, stratified sampling is not useful in case of homogeneous population.
13. **Incorrect:** Statistical sampling uses scientific method of choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected.
In the non statistical sampling, auditors' judgment and past experience is used to choose samples without any scientific method.

14. **Incorrect:** Statistical sampling uses scientific method choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected.
In the non statistical sampling, auditor's judgment and past experience is used to choose samples without and scientific method. Hence, personal bias is involved in Non statistical sampling and not Statistical.
15. **Incorrect:** In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to derive conclusion only on the respective stratum from where they are drawn and not the whole population.
16. **Correct:** Sampling risk arises from possibility that the auditor's conclusion based upon sample may be different from conclusion that would have been reached if same audit procedures were applied on the entire population. If acceptable sampling risk is low, large sample size is needed.
17. **Incorrect:** As per the Standard Auditing (SA) 520 "Analytical Procedures" the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and nonfinancial data.
18. **Incorrect:** Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis in addition to reasonable tests.
19. **Incorrect:** Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Analytical procedures are used for the following purposes:
- (i) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and
 - (ii) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

20. **Incorrect.** Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase.
21. **Incorrect.** Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.
22. **Incorrect:** Ratio analysis is useful for analysing asset and liability accounts as well as revenue and expense accounts
23. **Incorrect:** Unlike trend analysis, Reasonableness test does not rely on events of prior periods, but upon non-financial data for the audit period under consideration.
24. **Incorrect:** Analytical procedures may be applied to consolidated financial statements, components and individual elements of information.

5

AUDIT OF ITEMS OF FINANCIAL STATEMENTS



MCQs BASED QUESTIONS

- 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?
 - Occurrence; Existence
 - Occurrence; Completeness
 - Existence; Occurrence
 - Completeness; Occurrence
- Which of the following statement is most appropriate as regards to disclosure of goods in transit in financial statements of a company?
 - No separate disclosure of goods in transit is required.
 - Disclosure of total goods in transit under head of inventories is required.
 - Disclosure of goods in transit under each sub-head of inventories is required.
 - Disclosure of goods in transit for raw material and finished goods is required.
- Sweat Equity shares are issued by a company at a discount or for consideration other than cash to its:-
 - Directors only
 - Clients only
 - Directors or employees
 - Auditors only
- Which of the following is not an element of cost of an item of machinery included under head “Property, Plant and Equipment”?
 - Installation costs
 - Freight cost of bringing the item to its location
 - Inaugural costs
 - 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
6. Which assertion is common among the statement of profit and loss and balance sheet captions:
- (a) Existence
 - (b) Valuation
 - (c) Completeness
 - (d) Measurement
7. Direct confirmation procedures are performed during audit of accounts receivable balances to address the following balance sheet assertion:
- (a) Rights and obligations
 - (b) Existence
 - (c) Valuation
 - (d) Completeness
8. Obtaining trade receivables ageing report and analysis and identification of doubtful debts is performed during audit of accounts receivable balances to address the following balance sheet assertion:
- (a) Valuation
 - (b) Rights and obligations
 - (c) Existence
 - (d) Completeness
9. Observing inventory being counted and personally performing test counts to verify counts is performed during audit of inventory balances to address the following balance sheet assertion:
- (a) Rights and obligations
 - (b) Valuation
 - (c) Completeness
 - (d) Existence
10. Wages paid to workers would qualify as:
- (a) Revenue expenditure
 - (b) Capital expenditure
 - (c) Revenue or capital expenditure depending upon facts and circumstances.
 - (d) None of the above

11. During the course of audit of intangible assets, expenditure incurred during following phase is not capitalised:
- (a) Development phase (b) Research phase
(c) None of the above (d) Both (a) and (b)
12. Search for unrecorded liability is performed during audit of current liabilities to address the following balance sheet assertion:
- (a) Valuation (b) Rights and obligations
(c) Existence (d) Completeness
13. Cut-off testing is performed during audit of sales to address the following assertion:
- (a) Occurrence (b) Measurement
(c) Completeness (d) All of the above
14. All inventory units held by the audit entity and that should have been recorded, have been recognized in the financial statements. The assertion involved is :
- (a) Existence (b) Completeness
(c) Rights and Obligations (d) Valuation
15. Which of the following is not an example of revenue expenditure -
- (a) Salaries and wages of employees engaged directly or in-directly in production
(b) Repairs, maintenance and renewals of fixed assets
(c) Legal and professional expenses
(d) development expenditure on land
16. Useful life of assets is given in Schedule ----- of Companies Ac 2013.
- (a) II (b) IV (c) V (d) VII
17. _____are charges against profits to provide for known liabilities for which amounts cannot be determined with accuracy
- (a) Contingent Liabilities (b) Provision
(c) Securities Premium Reserve (d) Liabilities
18. Which of the following is not correct:-
- (a) AS 18 – Related Party Disclosures (b) AS 10 – Property, Plant & Equipment
(c) AS 28 – Impairment of Assets (d) AS 16 – Intangible Assets

19. Which of the following item should not be treated as an asset, as per provisions of AS 26 :
- (a) Computer software (b) Internally generated goodwill
(c) Fishing License (d) Brand Names
20. Which of the following in not an assertion about classes of transactions and events for the period under audit:
- (a) Occurrence (b) Accuracy (c) Classification (d) Existence
21. Which of the following is not an assertion about presentation and disclosure:
- (a) Occurrence and rights and obligations (b) Completeness
(c) Classification and understandability (d) Existence
22.is a possible obligation that arises from the past events and whose existence will be confirmed only by the occurrence/ non occurrence of one or more uncertain future events not wholly within the control of the entity:-
- (a) Provisions
(b) Reserves
(c) Contingent Liabilities
(d) Liability

ANSWERS

1	(a)	2	(c)	3	(c)	4	(c)	5	(b)	6	(c)	7	(b)
8	(a)	9	(d)	10	(c)	11	(b)	12	(d)	13	(c)	14	(b)
15	(d)	16	(a)	17	(b)	18	(d)	19	(b)	20	(d)	21	(d)
22	(c)												



CASE STUDY MCQs

Case Study 1

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 above, 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

Answer to Questions involving Case Studies 1

1	(c)	2	(d)	3	(c)	4	(b)	5	(a)
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Case Study 2

A partnership firm of Chartered Accountants, YZ and Associates were appointed as auditor of company UV Private Limited. The financial year for which YZ and Associates were to audit books of accounts of UV Private Limited began on 1 April, 2018 and ended on 31 March, 2019. YZ and Associates consisted of four partners namely Mr. Y, Mr. Z, Mr. G and

Mr. H. While auditing books of accounts of UV Private Limited for the period beginning on 1 April, 2018 and ending on 31 March, 2019, one of the partners of YZ and Associates namely Mr. H took up the expenses part for the purpose of audit.

The management of UV Private Limited had adopted various accounting policies and principles related to expenses which Mr. H as auditor of UV Private Limited was unable to understand. Some of the issues which Mr. H was unable to understand are mentioned as follows:

- (1) Power and Fuel expenses paid for the months of April, 2019 and May, 2019 have been included and shown as Power and Fuel expenses for the period beginning 1 April, 2018 and ending 31 March, 2019.
- (2) Personal Rent Expenses of the son of one of the director, Mr. T of UV Private Limited have been shown as Rent Expenses of business of UV Private Limited.
- (3) Repair and Maintenance Expenses for the months of February 2019 and March 2019 were still outstanding and were not shown in Balance Sheet of UV Private Limited.
- (4) Repair and Maintenance Expenses for the financial year 1 April, 2018 to 31 March, 2019 were very high as compared to financial year 1 April, 2017 to 31 March, 2018. The auditor Mr. H asked the appropriate authority about the reasons for such huge differences in amounts of two financial years.
- (5) While verifying the insurance expenses, the insurance policies were not shown to auditor Mr. H. The above mentioned five points were some of the issues which Mr. H was unable to understand.

Based on above, answer the following questions:

1. As per the point number (1) mentioned in the above case, the Power and Fuel Expenses paid for the months of April 2019 and May 2019 must be shown under asset side of balance sheet of UV Private Limited as on 31 March, 2019 as:
 - (a) Outstanding Power and Fuel Expenses
 - (b) Prepaid Power and Fuel Expenses
 - (c) Power and Fuel Expenses
 - (d) Power and Fuel Expenses Payable
2. As per point number (2) mentioned above in the case, the Personal Rent Expenses of the son of one of the director Mr. T were added to Rent Expenses of business of UV Private Limited. The amount of personal rent expenses of the son of the director Mr. T must be:

- (a) Subtracted from Rent Expenses of business of UV Private Limited
- (b) Remain Added to Rent Expenses of business of UV Private Limited
- (c) Again Added to Rent Expenses of business of UV Private Limited
- (d) Subtracted twice from Rent Expenses of business of UV Private Limited

3. As per point number (3) mentioned above in the case, the Repair and Maintenance Expenses outstanding for the months of February 2019 and March 2019 must be shown under liability side of balance sheet of UV Private Limited as on 31 March, 2019 as:

- (a) Prepaid Repair and Maintenance Expenses
- (b) Repair and Maintenance Expenses
- (c) Repair and Maintenance Expenses paid in advance
- (d) Repair and Maintenance Expenses Payable

4. As per point number (4) mentioned in the case above, the auditor Mr. H asked the appropriate authority for reasons of huge differences in the amount of two financial years of repair and maintenance expenses. By appropriate authority Mr. H was referring to:

- (a) All employees of UV Private Limited
- (b) Management of UV Private Limited
- (c) Members of UV Private Limited
- (d) Any one director of UV Private Limited

5. As per point number (5) mentioned in the case above, in verifying insurance expenses the insurance policies would provide auditor Mr. H as:

- (a) Invalid Supporting
- (b) No Supporting
- (c) Lack of proper Supporting
- (d) Valid Supporting

Answer to Questions involving Case Studies 2

1	(b)	2	(a)	3	(d)	4	(b)	5	(d)
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Case Study 3

M/s TPR & Associates have been appointed as the auditors of Octopus Ltd. for the Financial Year 2019-20.

- During the course of audit, the auditor notices that there is significant change in the number of debtors of the company. The auditor decided to check the debtors account in detail.
- Further the company has made various provisions like the provisions for taxation, provision for bad & doubtful debts.
- Also, during the current Financial Year, the auditor attended the physical verification of the inventory being carried out by the management.
- The auditor notices that there is no substantial change in the bifurcation of amount of items representing the liability side of the balance sheet of Octopus Ltd. Still the auditor understands that he needs to check the liability side in detail.
- Further the company has also recognised various incomes like interest income and dividend income which auditor understands need to be checked in detail.
- The auditor is of the understanding that certain matters need to be reported under Companies Auditors Report Order (CARO) Based on the above facts, answer the following:-

Based on above, answer the following questions:

1.is a possible obligation that arises from the past events and whose existence will be confirmed only by the occurrence/ non occurrence of one or more uncertain future events not wholly within the control of the entity:-

- | | |
|--------------------------|---------------|
| (a) Provision | (b) Reserve |
| (c) Contingent Liability | (d) Liability |

2. Which of the following is not correct with respect to the inventory held by Octopus Limited:-

- (a) All inventory units held by the company should have been recorded and recognized in the financial statements.
- (b) Any inventory held by a third party on behalf of the company should not be included as part of the inventory balance.
- (c) Inventory should be recognized at cost or net realizable value whichever is lower.
- (d) Inventory balance as at the year end does not include any element of next year

3. If the management of Octopus Ltd. refuses to allow the auditor, to send the confirmation request to the debtors, the auditor should:-
- Withdraw from the engagement.
 - Not listen at all to any requests of the management.
 - Consider the management's request for refusal and assess its validity and decide the nature, timing, extent of his audit procedures accordingly.
 - Agree to management request and proceed with audit of other items of the financial statements.
4. Which of the following statements is not true so far as the liabilities of a company are concerned:-
- Liabilities are the financial obligations of a company including owner's funds.
 - Liabilities include borrowing, trade payable and other current liabilities and provisions.
 - Verification of liabilities is as important as that of assets.
 - All of the above.
5. 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 1 & 2 are correct | (d) Both 1 & 2 are incorrect |

Answer to Questions involving Case Studies 3

1	(c)	2	(b)	3	(c)	4	(a)	5	(c)
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Case Study 4

XYZ Ltd. is a company engaged in the development of computer hardware. The company has purchased a software namely Zenith X in the current financial year i.e. FY 2019-20. This software will be used by XYZ Ltd. for the production of various hardware. M/s. ABC & Associates are working as the auditors of XYZ Ltd. since Financial Year 2017-2018. Since XYZ Ltd. has purchased the software during the current Financial Year, the auditors are of the understanding that there are certain requirements that the company should follow as per relevant provisions applicable in this case. Also, the auditors had advised

their audit staff to give special consideration to the expenditure being capitalized during the year and those which are charged to revenue during the current financial year. The auditors, M/s ABC & Associated have directed their audit staff to check the following in detail:

- the provisions relating to the depreciation and amortisation of assets and intangible assets and
- the applicability of various Accounting Standards applicable to the entity.

Based on the above facts, answer the following:

1. Which of the following expenses should not be charged to revenue by XYZ Ltd.:-
 - (a) Printing & Stationary
 - (b) Power & Fuel
 - (c) Salary & Wages of employees engaged directly or indirectly in production.
 - (d) Major repairs of fixed assets that increases its productivity.
2. XYZ Ltd. should recognize Zenith X software as intangible, if such software.....:
 - (a) Is held for use in production or supply of goods or services
 - (b) Is held for administrative purpose
 - (c) Is held for rental to others
 - (d) All of the above
3. In case any intangible asset is not in active use by the entity , the auditor should check whether:-
 - (a) The deletion with respect to the intangible asset has been recorded in the books of accounts post approval by the entity's management.
 - (b) The amortisation charge has ceased beyond the date of deletion.
 - (c) Both a & b
 - (d) None of a & b
4. With respect to the provisions of impairment of computer software, the following Accounting Standard is applicable:-

(a) AS 18	(b) AS 28
(c) AS 26	(d) AS 10

5. The following expenditure should not be capitalized with respect to the intangible assets:-

- (a) Expenditure during Development Phase
- (b) Expenditure during Research Phase.
- (c) None of the above
- (d) Both a & b

Answer to Questions involving Case Studies 4

1	(d)	2	(d)	3	(c)	4	(b)	5	(b)
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Case Study 5

One audit team is conducting statutory audit of Delta Robotics Limited for financial year ending 31st March, 2020 under Companies Act, 2013. The revenue from operations of company during year 2019-20 is 89,40,60,300. Certain observations and information stated as under have been noted during the course of audit by audit team: -

- [A] The said company is availing working capital credit facility to meet its normal operating cycle requirements amounting to 7.50 crores from a scheduled bank and outstanding balance as on 31st March, 2020 is 6,49,20,120. The financial statements disclose this outstanding balance in financial statements under the head “Long-term borrowings”. Further, the said credit facility is secured against equitable mortgage of an immovable property located at NOIDA. The said facility is guaranteed by all directors of the company, some of relatives of directors and two persons viz. Mr. Krishnamurthy and Mr. Ramalingam who are not related to directors in any manner.
- [B] The company has made current investments in Ceekay Limited to the tune of 1,10,00,000 by way of equity instruments. Further, the company has also made investment in a partnership firm to the tune of 25,00,000. The said partnership concern is in an upcoming and promising line of business activity.
- [C] It was observed that company had received some export orders during the year under audit and these orders had resulted in fructifying export turnover of 3,88,25,000. During the year under consideration, the company has reflected net loss in respect of foreign currency transactions amounting to 5,50,000. Further, the company has also imported components and spare parts having FOB value of 10.00 lacs (CIF 11.25 lacs) during the year.
- [D] The trade payables of the company include dues to micro and small enterprises amounting to 1,40,36,740.
- [E] Printing and stationery expenses, travelling expenses and fair participation expenses

are 74,320, 88,38,250 and 1,63,26,260 respectively. Based upon above, answer following questions keeping in view classification and disclosure requirements of Schedule III of Companies Act, 2013:

Based on the above facts, answer the following:

1. Consider the following statements: -

Statement I--- The company has correctly classified and disclosed outstanding balance of working capital credit facility under the head "Long- term borrowings."

Statement-II--- Nature of security for availing working capital credit facility needs to be disclosed.

Which of the following is correct?

- (a) Both statements I and II are true.
- (b) Statement I is true. However, statement II is false.
- (c) Statement I is false. However, statement II is true.
- (d) Both statements I and II are false.

2. Which of the following is most correct as regards to disclosure of fact of guarantee of working capital credit facility?

- (a) Disclosure regarding guarantee of loan by directors is in accordance with law.
- (b) Disclosure regarding guarantee of loan by directors and relatives only is in accordance with law.
- (c) Disclosure regarding guarantee of loan by directors, relatives and non-related persons i.e. Mr. Krishnamurthy and Mr. Ramalingam is in accordance with law.
- (d) No disclosure is required regarding guarantee of loan.

3. As regards current investments made by company in Ceekay Limited, which of following groups contain most valid requirements mandated by law?

- (a) Name of body corporate in which investment is made, Basis of valuation of individual investment, aggregate amount of quoted investments and their market value
- (b) Name of body corporate in which investment is made, Basis of valuation of individual investment, aggregate amount of quoted investments
- (c) Basis of valuation of individual investment, aggregate amount of quoted investments and their market value
- (d) Name of body corporate in which investment is made, aggregate amount of quoted investments and their market value.

4. As regards current investments made by company in partnership firm, which of following classification and disclosure requirements include requirements mandated by law?

- (a) Name of firm in which investment is made, names of all the partners, total capital and shares of each partner
- (b) Name of firm in which investment is made, names of all the partners, nature of business of firm and total capital
- (c) Name of firm in which investment is made, names of all the partners, nature of business of firm and shares of each partner
- (d) names of all the partners, nature of business of firm, total capital and shares of each partner.

5. As regards foreign currency transactions, consider the following statements: -
Statement I Earnings in foreign exchange regarding export of goods on CIF basis needs to be disclosed in notes to accounts.

Statement II Net loss of foreign currency transactions is required to be disclosed separately in statement of profit and loss.

Which of the following statements is correct?

- (a) Both statements I and II are true.
- (b) Both statement I and II are false.
- (c) Statement I is true. Statement II is false.
- (d) Statement I is false. Statement II is true.

Answer to Questions involving Case Studies 5

1	(c)	2	(c)	3	(a)	4	(a)	5	(d)
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Case Study 6

M/s Arun Karun & Associates have been appointed as the statutory auditors of HKM Ltd. for the FY 2019-20. HKM Ltd. is a company engaged in the manufacture of computer hardwares. CA Arun is the engagement partner and his team consists of two article assistants, namely Mr. Ram & Mr. Shyam. While performing the audit procedures, Mr. Ram did production analysis and calculated the expenditure per unit and compared the same with the previous year and the present year industry trends. When Mr. Ram asked the management about the reasons for variations, he was told that such reasons have already been explained to the cost auditors and the statutory audit team need not spend their time on matters which are of concern for the cost auditor. Mr. Ram was convinced

and agreed to the suggestions of the management of HKM Ltd. Further, during the course of audit, CA Arun found that there has been an increase in the paid up share capital of the company. CA Arun obtained a written representation from the management with respect to such increase in the share capital. Also, CA Arun found that in the company there is a cashier, a petty cashier and in addition there are imprest balances with the employees. Further, the audit team verified all the travelling expenses recognised during the period to confirm whether they relate to the current accounting period only.

CA Arun directed Mr. Ram to verify whether the employee benefit expense has been fairly allocated between the operating expenses incurred in production activities and the general expenses. CA Arun also directed his team to check in detail the particulars of Revenue reserve and share premium account of the company.

Based on the above facts, answer the following:

1. With respect to the audit of cash balance of HKM Ltd. which is the correct course of action for M/s Arun Karun & Associates?
 1. The cash balance with the cashier, petty cashier, and imprest balances with the employees should be checked simultaneously.
 2. The cashier should be present while cash is being counted and he should sign the statement prepared containing the details of the cash balance so counted.
 3. Since the company is having more than one cash balances i.e. with cashier, petty cashier, and imprest balances with employees, CA Arun should ask the management to get the cash balance verified by the main cashier and furnish cashier's report to him.
 4. CA Arun should ask any of the cashiers to verify the cash balances and provide him with a report on the same.
 - (a) Statement 1 & 2
 - (b) Statement 1 & 4
 - (c) Statement 1,3 & 4
 - (d) Statement 1 & 3
2. Verification of all the travelling expenses of HKM Ltd. by the audit team addresses the following assertion related to the Income Expense account:
 - (a) Valuation
 - (b) Completeness
 - (c) Measurement
 - (d) Existence

3. Verifying whether employee benefit expense of HKM Ltd. has been fairly allocated between the operating expense incurred in production activities and general expense addresses which of the following assertions?
- (a) Completeness (b) Presentation and Disclosure
(c) Measurement (d) Occurrence
4. Which of the following is correct with respect to the provisions relating to revenue reserves of HKM Ltd?
- i. Revenue Reserves of HKM Ltd. can be used to supplement divisible profits in lean years.
ii. Revenue Reserve cannot be used to augment the working capital of the business of HKM Ltd.
iii. Revenue Reserve cannot be used to finance an extension of the business of HKM Ltd.
iv. Revenue Reserve can be used to generally strengthen the company's financial position.
- (a) ii & iii are correct (b) i & iv are correct
(c) i, ii, iii are correct (d) i, ii, iii, iv are correct

Answer to Questions involving Case Studies 6

1	(a)	2	(b)	3	(b)	4	(b)
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Case Study 7

M/s ANS & Associates have been appointed as the auditors of Star Ltd. for the Financial Year 2019-20.

- During the year under audit, Star Ltd has issued share capital at a premium of Rs 5 per share. The auditors understand that certain provisions as per the Companies Act 2013 related to the issue of shares at premium are applicable to the company.
- Also, Star Ltd. has issued Sweat Equity shares to its employees during the year. M/s ANS & Associates has advised its audit staff to check in particular whether the company has complied with the relevant provisions related to the issue of sweat equity shares as per the Companies Act 2013.
- Further, the auditor understands that the Company Star Ltd. needs to file various forms with different authorities when there is a change in the share capital of the company during the year.

- Also special consideration is given under audit to the treatment of reserves as Revenue vs Capital by the company during the financial year.

Based on the above facts, answer the following:

- The Securities Premium Account can be used by the Star Ltd. for various purposes, except one:-**
 - In writing off the preliminary expenses of the company
 - Towards the issue of the unissued shares of the company to the members of the company as fully paid bonus shares
 - For purchase of its own shares and other securities under section 68.
 - To be used as working capital.
- With regard to the issue of Sweat Equity shares following conditions have to be complied. Identify the incorrect one:-**
 - The issue is authorized by ordinary resolution passed by the company.
 - The resolution should specify the number of shares, the current market price.
 - Not less than one year has at the date of such issue, elapsed since the date on which the company has commenced business
 - Where the equity shares of the company are listed on recognized stock exchange, the shares are issued in accordance with requirements by SEBI.
- Which of the following is not correct:-**
 - Section 52- Securities Premium Account
 - Section 53- Issue of shares at discount
 - Section 54- Issue of Bonus Shares
 - Section 68- Buyback of shares
- With respect to which of the following, passing of a Special Resolution is required by a company:-**

(a) Issue of Sweat Equity Shares	(b) Reduction of Share Capital
(c) Both a & b	(d) None of a & b

Answer to Questions involving Case Studies 7

1	(d)	2	(a)	3	(c)	4	(c)
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Case Study 8

During the financial year 2020-21, a Partnership Firm of Chartered Accountants HW and Associates was appointed to audit the books of accounts of Extremely Healthy and Very Delicious Limited. HW and Associates consists of two partners, Mr. H and Mr. W. While auditing the books of accounts of the above mentioned company for the financial year 2020-21, Mr. H observed certain accounting transactions and accounting treatments which he was not able to understand. Such accounting transactions and accounting treatments are provided as follows:

- (1) The books of accounts of Extremely Healthy and Very Delicious Limited showed profit for the financial year 2020-21. The closing stock was incorrectly recorded in books of accounts of the company for 11,45,000. However, the actual closing stock was of 11,05,000.
- (2) Expenses and Incomes were not recorded on Accrual Basis and such fact was not disclosed in the financial statements.
- (3) Each and every type of inventory was valued at higher of Cost and Market Value.
- (4) An amount of 15,500 received in cash from one of the trade receivable was presented in the cash flow statement as Inflow of Cash of 15,500 from Investing Activities.
- (5) A payment of 16,600 was done in cash for the purpose of purchasing Machinery 22. This accounting transaction was presented in the cash flow statement as Inflow of Cash of 16,600 from Financing Activities.
- (6) Extremely Healthy and Very Delicious Limited received certain amount in cash on issue of shares. One such amount of 19,100 received in cash was presented as Outflow of Cash of 19,100 from Operating Activities in the Cash Flow Statement.
- (7) Fair Value of Equipment 31 = 1,07,300.

Carrying Amount of Equipment 31 = 90,400.

Residual Value of Equipment 31 = 79,600.

No depreciation was charged on Equipment 31 for the financial year 2020-21 as Management of Extremely Healthy and Very Delicious Limited was of the opinion that no depreciation would be charged as Fair Value of Equipment 31 was more than Carrying Amount of Equipment 31.

Keeping the basic concepts of Accounting Standard 1 relating to Disclosure of Accounting Policies, Accounting Standard 2 relating to Valuation of Inventories, Accounting Standard 3 relating to Cash Flow Statements, Accounting Standard 10 relating to Property, Plant and Equipment and Audit of Items of Financial Statements in mind answer the multiple choice questions that follow:

Based on the above facts, answer the following:

1. Closing Stock of 11,05,000 was incorrectly recorded in books of accounts of Extremely Healthy and Very Delicious Limited for 11,45,000. This means profit before correction in books of accounts of the company was:
 - (a) Understated by 20,000.
 - (b) Understated by 40,000.
 - (c) Overstated by 20,000.
 - (d) Overstated by 40,000.

2. Inventory of Extremely Healthy and Very Delicious Limited must be valued at:
 - (a) Cost
 - (b) Lower of Cost and Net Realizable Value.
 - (c) Market Value.
 - (d) Higher of Cost and Net Realizable Value.

3. The amount of 15,500 which was received in cash from one of the trade receivable of Extremely Healthy and Very Delicious Limited, must be presented in Cash Flow Statement as:
 - (a) Inflow of Cash of 15,500 from Miscellaneous Activities.
 - (b) Inflow of Cash of 15,500 from Operating Activities.
 - (c) Inflow of Cash of 15,500 from Investing Activities.
 - (d) Inflow of Cash of 15,500 from Financing Activities.

4. For the purpose of purchasing Machinery 22, a payment of 16,600 was done by Extremely Healthy and Very Delicious Limited in cash. This accounting transaction must be presented in the Cash Flow Statement as:
 - (a) Outflow of Cash of 16,600 from Investing Activities.
 - (b) Outflow of Cash of 16,600 from Operating Activities.
 - (c) Outflow of Cash of 16,600 from Financing Activities.
 - (d) Outflow of Cash of 16,600 from Miscellaneous Activities.

5. During the financial year 2020-21, the fair value of Equipment 31 of Extremely Healthy and Very Delicious Limited was more than the carrying amount of Equipment 31. In this situation which of the following statement is correct:

- (a) No depreciation would be charged on Equipment 31 for the financial year 2020-21 as Fair Value was more than Carrying Amount for Equipment 31.
- (b) No depreciation would be charged on Equipment 31 for the financial year 2020-21 as Fair Value was more than Residual Value for Equipment 31.
- (c) Depreciation would be charged on Equipment 31 for the financial year 2020-21 as Carrying Amount was less than Fair Value for Equipment 31.
- (d) Depreciation would be charged on Equipment 31 for the financial year 2020-21 as Residual Value is less than1 Carrying Amount for Equipment 31

Answer to Questions involving Case Studies 8

1	(d)	2	(b)	3	(b)	4	(a)	5	(d)
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Case Study 9

A private company by the name of Very Composed Private Limited was required to be audited for the financial year 2020-21. A partnership firm of Chartered Accountants, ST and Associates was appointed as company auditor of Very Composed Private Limited. The partnership firm ST and Associates had two partners, Mr. S and Mr. T. During the course of audit, one of the partners of ST and Associates, Mr. S took up one of the important item of financial statements namely tangible fixed assets for the purpose of audit. While auditing tangible fixed assets Mr. S observed various accounting policies, procedures and principles which management of Very Composed Private Limited had adopted for maintaining books of accounts of the above mentioned company which he was unable to understand. For Example:

- (1) Expenses incurred on installation of new machinery purchased were treated as revenue expenditure.
- (2) Expenses incurred regarding normal maintenance of old machinery were treated as capital expenditure.
- (3) Depreciation was not charged on building of Very Composed Private Limited on the reason that it was non – depreciating in nature.
- (4) The appropriate authority of Very Composed Private Limited had not taken steps for assessing impairment loss on machinery.

The above mentioned four examples were some of the issues which Mr. S was unable to understand while auditing tangible fixed assets of Very Composed Private Limited. Keeping the basic concepts and accounting principles regarding tangible fixed assets in mind answer the following multiple choice questions that follow:

Based on the above facts, answer the following:

1. Expenses incurred on installation of new machinery by Very Composed Private Limited should be treated as:
 - (a) Revenue Expenditure
 - (b) Capital Expenditure
 - (c) Deferred Revenue Expenditure
 - (d) Partly Revenue and Partly Capital Expenditure

2. Expenses incurred on normal maintenance of old machinery by Very Composed Private Limited should be treated as:
 - (a) Capital Expenditure
 - (b) Deferred Revenue Expenditure
 - (c) Partly Revenue and Partly Capital Expenditure
 - (d) Revenue Expenditure

3. In books of accounts of Very Composed Private Limited, building should be treated as:
 - (a) Depreciating Tangible Fixed Asset
 - (b) Non-Depreciating Tangible Fixed Asset
 - (c) Depreciating Intangible Fixed Asset
 - (d) Non-Depreciating Intangible Fixed Asset

4. In example 4 in integrated case scenario above, Mr. S mentions about appropriate authority of Very Composed Private Limited which has not taken steps for assessing impairment loss on machinery. By appropriate authority Mr. S was referring to:
 - (a) Members of Very Composed Private Limited
 - (b) All employees of Very Composed Private Limited
 - (c) Management of Very Composed Private Limited
 - (d) Any one Director of Very Composed Private Limited

5. The method of depreciation used by Very Composed Private Limited must be such that it allocates amount of depreciation of a tangible fixed asset in a systematic manner over its:
 - (a) Complete Life
 - (b) Service life
 - (c) Economic life
 - (d) Useful Life

Answer to Questions involving Case Studies 9

1	(b)	2	(d)	3	(a)	4	(c)	5	(d)
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Case Study 10

Vyom is a CA student who has just enrolled for his articleship training with M/s Kumar & Co., a LLP of Chartered Accountants with Mr. Kumar & Mr. Kanwar as its designated Partners. Vyom has only theoretical knowledge till now of accounting work and wants to gain practical knowledge of Accounting & Auditing. He asks Mr. Kumar to take him to important assignments along with him so that he can also get exposure to practical auditing. Mr. Kumar, sensing his ambition, advises him to proceed slowly with less complex work in the beginning to understand the process of accounting and auditing from the core instead of jumping directly to be a part of the engagement teams for large audits. He assigns him a small audit of a sole trader Client 'X' and asks him to document each and every step of the Audit Programme being handed over to him as a part of the audit team auditing the accounts of Mr. X. Mr X follows accrual system of accounting.

Vyom, on advice from Mr. Kumar, reads first about the Financial Statements, their inclusions and assertions they contain. He learns that a 'Financial Statement Audit' is the most common one but different from all other audits. In preparing the financial statements, an entity's management makes implicit or explicit claims known as assertions regarding the completeness, existence/occurrence, valuation/ measurement, rights and obligations and presentation and disclosure of financial statement items. While auditing the books of Mr. X, he observes the following and documents audit evidence gathered by him:-

- ▶ Assets have been shown at their Historical Cost in the Balance Sheet.
- ▶ Prepaid & Outstanding Expenses have not been accounted for as per accrual basis.
- ▶ Specific audit procedures to check the consistency of audit evidence obtained externally with those generated internally have been carried out.

CA Kumar discusses the evidence collected by Vyom and tells him that they are insufficient and makes him aware of the factors which he needs to consider in his future audits as to determine the sufficiency of audit evidence collected.

Based on the above facts, answer the following:

1. Company X's Balance-Sheet shows Building with carrying amount of INR 5 Lakh, the auditor gathers evidence about the Company's ownership and control over such building. This is an assertion w.r.t-
 - (a) Completeness
 - (b) Valuation
 - (c) Existence
 - (d) Rights & Obligations.

2. The Advance Salary given to Mr. Y in the above case has not been accounted for properly in the accounts of the Company and shown on payment basis only. This is a violation of assertion of:
- (a) Completeness (b) Valuation
(c) Rights and obligations (d) Existence
3. Relating and tallying information obtained from audit evidence internally and externally is an example of _____ evidences as observed in the above case.
- (a) Corroborative (b) Supplementary
(c) Contrasting (d) Contradictory
4. Which assertion would Vyom find to be common among Income Statement and Balance Sheet.
- (a) Existence (b) Valuation
(c) Completeness (d) Measurement
5. Sufficiency of the Audit Evidence collected as per the above case is referred to by CA Kumar as _____ of Audit Evidence?
- (a) Quality (b) Quantum
(c) Source (d) Form

Answer to Questions involving Case Studies 10

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

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

1. Employee benefits expenses represent the sum an entity pays to its employees for their labour/ efforts only.
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.
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.
4. Capital reserves represent profits that are available for distribution to shareholders held for the time being or any one or more purpose.
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.
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.
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.
8. Material and wages are considered to be revenue expenditure when incurred for construction of building.
9. PPE are depreciated when the asset is actually put to active use.
10. Increase in authorised capital of the company requires special resolution to be passed at the general meeting.
11. Capital redemption reserve can be used for distribution of dividends.
12. Dividends are recommended by the Board, and declared by the Shareholders.
13. In verifying Trade Receivables balance, Direct Confirmation Procedure is one of the important audit activity.

Answers to Correct/Incorrect

1. **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. **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. **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. **Incorrect:** Revenue reserves represent profits that are available for distribution to shareholders.
5. **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. **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. **Incorrect:** The securities premium account may be applied by the Company:
- (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
 - (b) in writing off the preliminary expenses of the Company;
 - (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
 - (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
 - (e) for the purchase of its own shares or other securities under section 68.
8. **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. **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. **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. **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. **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. **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.

6

AUDIT DOCUMENTATION



MCQs
BASED QUESTIONS

1. Which of the following statement is appropriately suited to preparation of audit documentation?
 - (a) Audit documentation has to be prepared simultaneously as audit progresses.
 - (b) Audit documentation has to be prepared 60 days after date of audit report.
 - (c) Audit documentation has to be prepared when information is required by regulator.
 - (d) Audit documentation has to be prepared 60 days after completion of audit work.

2. Audit documentation is owned by:
 - (a) Client
 - (b) Auditor
 - (c) Team member responsible for documentation
 - (d) Regulator

3. Which of the following is least likely to be included in audit documentation of a company engaged in manufacturing and export of goods?
 - (a) Previous years audited financial statements
 - (b) Projected cash flow statement for next twelve months provided by management in support of going concern assumption
 - (c) Statements showing dispatch of overseas consignments in accordance with delivery schedules of overseas buyers
 - (d) Statement showing verification of ageing of trade receivables as on date of balance sheet

4. Which of the following is false in relation to audit documentation when an external auditor relies upon work of internal auditor?
- (a) Evaluation of objectivity and competence of internal auditor has to be documented.
 - (b) Nature of work used and reason for relying upon work used forms part of documentation.
 - (c) Documentation on whether quality control is exercised in internal audit work forms part of audit documentation.
 - (d) Documentation on what specific recommendations were given by internal auditor for risk assessment to external auditor forms part of audit documentation.
5. Standard on Quality Control (SQC) 1 provides that,
- (a) unless otherwise specified by law or regulation, audit documentation is the property of the management.
 - (b) unless otherwise specified by law or regulation, audit documentation is the property of those charged with governance.
 - (c) unless otherwise specified by law or regulation, audit documentation is the property of the management or those charged with governance.
 - (d) unless otherwise specified by law or regulation, audit documentation is the property of the auditor.
6. CA Vijay is the statutory auditor of XYZ Ltd. for the FY 2020-21. During the process of assembling the audit file, CA Vijay briefed his team as to what all changes can be made to the audit documentation at that stage. Which of the following changes cannot be made to the audit documentation during the final assembly process?
- (a) Sorting, collating & cross referencing of working papers.
 - (b) Signing off completion checklists relating to the file assembly process.
 - (c) Deleting or discarding superseded documents.
 - (d) Recalculation of Depreciation.
7. Audit documentation provides:
- (a) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; or evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

- (b) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.
- (c) evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor
- (d) evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

8. Which of the following is correct :

- (a) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.
- (b) The auditor shall assemble the audit documentation in an audit file and shall not complete the administrative process of assembling the final audit file.
- (c) The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis before the date of the auditor's report.
- (d) The auditor shall not assemble the audit documentation in an audit file.

9. _____ refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

- (a) Audit Techniques
- (b) Audit evidence
- (c) Audit Documentation
- (d) Audit Procedures record

10. _____ may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

- (a) Audit File
- (b) Audit evidence
- (c) Completion Memorandum
- (d) Audit Folder

11. As per SQC-1 "An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than _____ days after the date of the auditor's report".

- (a) 30
- (b) 60
- (c) 90
- (d) 45

12. A current audit file would always contain which of following?

- (a) Loan agreements, pension plans, agreements with parent company and subsidiaries
- (b) Company documents such as corporate charter or articles of association and corporate bylaws.
- (c) A record of the nature, timing and extent of audit procedures performed and the results of such procedures.
- (d) Prior year analysis of fixed assets, long term debt, and terms of stock and bond issues.

13. After assembly of audit file, the auditor _____

- (a) May delete audit documentation if it is of no use
- (b) May delete audit documentation if it is occupying much of its space
- (c) Shall not delete audit documentation before its retention time period
- (d) May delete audit documentation before its retention period if it is required by any law

14. Which of the following is not true of working papers?

- (a) They record the audit evidence to provide support for the auditor's opinion
- (b) They assist in review of the audit work
- (c) They are a direct aid in the planning of the audit
- (d) They provide proof of the correctness of the financial statements.

15. An important factor in determining the form, content and extent of audit documentation of significant matters is the extent of _____ exercised in performing the work and evaluating the results.

- (a) professional skepticism
- (b) professional integrity
- (c) professional judgment
- (d) Professional sincerity

16. Which of the following is not an example of audit documentation:

- (a) Audit programmes
- (b) Summaries of significant matters
- (c) Audit file
- (d) Checklists.

ANSWERS

1	(a)	2	(b)	3	(c)	4	(d)	5	(d)	6	(d)	7	(b)
8	(a)	9	(c)	10	(a)	11	(b)	12	(c)	13	(c)	14	(d)
15	(c)	16	(c)										



CASE STUDY MCQs

Case Study 1

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.

Answer to Questions involving Case Studies 1

1	(c)	2	(c)	3	(d)	4	(d)	5	(d)
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Case Study 2

Auditors while conducting audits are governed by SA 230 “Audit Documentation” in relation to record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

CA. Harry is a statutory auditor of Potter Ltd. The auditor of Rowling Ltd. a parent company of Potter Ltd. asked Harry the working papers of Potter Ltd for commenting on the important requirement of the Central Government.

Also, CA. Bean is statutory auditor of Rowling Ltd. against which Income tax department started search and seizer procedure .CA. Bean was asked for the working papers of the company on the directions and permission of CIT (A) to provide for the relevant information asked.

Based on the above specific cases and in general, answer the following questions as per guidance provided by SA 230.

1. _____ is the file containing the records and data that comprise the audit documentation for a specific engagement.

- (a) Audit file
- (b) Engagement file
- (c) Working file
- (d) Client’s file

2. Which of the following does not affects form, content & extent of documentation

- (a) Size and complexity of the entity
- (b) nature of audit team who will perform audit
- (c) identified Risk of material misstatement
- (d) audit methodology and tools to be used

3. If in exceptional circumstances the auditor departs from Standards on Auditing, he shall_____

- (a) Document the reason for departure
- (b) document how the alternative procedures were performed for achieving the objective
- (c) Both (a) and (b)
- (d) Auditor is not allowed to depart from SAs.

4. Which of the following is not true of working papers?

- (a) They record the audit evidence to provide support for the auditor's opinion
- (b) They assist in review of the audit work
- (c) They are a direct aid in the planning of the audit
- (d) They provide proof of the correctness of the financial statements.

5. Can CA. Bean provide access to working papers to Income Tax department during search & seizure operation?

- (a) CA. Bean can provide as it is the requirement of law
- (b) CA. Bean is guilty of professional misconduct
- (c) CA. Bean should not provide the working paper
- (d) None of the above

Answer to Questions involving Case Studies 2

1	(a)	2	(b)	3	(c)	4	(d)	5	(a)
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Case Study 3

GSR & Company have been appointed as the statutory auditors of Raj Textiles Ltd. for the FY 2021-22. The engagement partner, CA Rahul Dhawan established the overall audit strategy and made the detailed plan with respect to the audit assignment of Raj Textiles Ltd. after discussing the same with the engagement team.

The strategy adopted by GSR & Company consisted of relying on the internal control system of the company and the audit plan and program were developed accordingly and the audit team started to work in accordance with the developed audit plan and program. During the course of audit, the engagement partner, CA Rahul Dhawan found that some internal controls implemented by the company were not operating effectively. So, he decided not to rely on the internal control system of the company & accordingly changed the overall audit strategy, audit plan & audit program.

While conducting the audit, the engagement partner also discussed with his team regarding the audit procedures to be performed to verify the debtors' balances of the company. CA Rahul Dhawan asked for the addresses of various debtors from the management of Raj Textiles Ltd. for the purpose of sending balance confirmation request to such debtors. The management provided such addresses to the audit team. However, the management of Raj Textiles Ltd. asked the debtors to send the responses of such confirmation requests to

General Manager of accounts department of the company, who will in turn provide such responses to the audit team.

Further, the audit team found that a legal case has been filed against the company on account of customer complaint. CA Rahul Dhawan discussed with his team regarding the audit procedures that can be performed by the audit team to verify the implications of such litigation on the financial statements of the company.

One of the audit team members, Mr. Girish had the following understanding with respect to the audit file to be maintained by the audit team with respect to the audit assignment:
Point no. 1: The completion of assembly of final audit file after the date of the auditor's report is an administrative process involving the performance of new audit procedures or drawing of new conclusions.

Point no. 2: After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.

CA Rahul Dhawan briefed his engagement team regarding the documents to be included in the audit file with respect to the audit assignment of Raj Textiles Ltd. and also discussed with his team in detail regarding the various aspects of audit file.

1. Is CA Rahul Dhawan right in changing the overall audit strategy and plan after the audit team has started working as per the earlier strategy established & plan so developed?
 - (a) CA Rahul Dhawan is not right as once the audit team has started the audit work, it is not correct to change the audit strategy and plan.
 - (b) CA Rahul Dhawan is not right as once the overall audit strategy has been established the same cannot be changed. Audit plan however can be revised.
 - (c) CA Rahul Dhawan is right in making changes to the overall audit strategy and the audit plan.
 - (d) CA Rahul Dhawan can change the overall audit strategy and audit plan only after taking due permission from the management of Raj Textiles Ltd.

2. Which of the following audit procedures should the audit team perform with respect to verification of debtors' balances?
- (a) GSR & Company can compare the debtors' balance reflected in financial statements with invoices, debit notes, credit notes, monthly accounts statement sent to the customers.
 - (b) GSR & Company can obtain direct balance confirmation from the debtors as this is external evidence which is most reliable and relevant.
 - (c) GSR & Company can obtain management representations with respect to the debtors' balances from the management of ABC Ltd and need not perform other audit procedure as obtaining written representation from management constitutes sufficient and appropriate audit evidence.
 - (d) Both a & b.
3. Is management correct in asking the debtors to provide the reply of confirmation request directly to the General Manager of accounts department of the company?
- (a) Yes, the management has correctly asked the debtors to respond directly to the GM of accounts department.
 - (b) No, management is not correct in asking for a direct response to GM of accounts department as external confirmation is the response obtained directly by the auditor.
 - (c) Yes, the management is correct in advising direct response to the GM of accounts department as this will ensure that only correct confirmation is provided to the auditors.
 - (d) No, management is not correct as this is the option of the auditor to see if the response to external confirmation is to be obtained by management or auditor himself.
4. For confirming/verifying the litigation going against the company which of the following audit procedures is not correct?
- (a) GSR & Company can enquire the management including in house legal counsel.
 - (b) GSR & Company should review the minutes of meetings of those charged with governance.
 - (c) GSR & Company can review the legal expense account.
 - (d) GSR & Company need not perform audit procedures with respect to litigation claims of the company except for obtaining written representation from the management in this regard.

5. Is the understanding of Mr. Girish regarding the assembly of audit file with respect to an audit assignment, mentioned as point no. 1 & point no. 2 in the case scenario, correct?
- (a) Only understanding as per point no. 1 is correct.
 - (b) Only understanding as per point no. 2 is correct.
 - (c) Understanding as per point no. 1 & point no. 2 both are correct.
 - (d) Understanding as per point no. 1 & point no. 2, both are incorrect.

Answer to Questions involving Case Studies 3

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

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

- (i) As per SA 230 on “Audit Documentation”, the working papers are not the property of the auditor.
- (ii) 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.

Answers to Correct/Incorrect

- (i) **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.
- (ii) **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.

7

COMPLETION AND REVIEW



MCQs
BASED QUESTIONS

1. An auditor of a company communicates significant findings from audit with those charged with governance in the company. Which of the statements is false in regard to communication made?
 - (a) Evaluation of adequacy of communication process is required on part of the auditor.
 - (b) Planned scope and timing of audit has also to be communicated.
 - (c) Communication of rationale behind audit procedures is necessary.
 - (d) Significant difficulties encountered during audit, if any, have to be communicated.

2. Written representations are:
 - (a) Necessary audit evidence
 - (b) Sufficient appropriate audit evidence
 - (c) Not audit evidence
 - (d) Audit evidence depending upon auditor's professional judgment

3. Which of the following is false regarding communication of misstatements identified during course of an audit?
 - (a) The auditor should request those charged with governance for correction of identified misstatements.
 - (b) The auditor should obtain written representation acknowledging management belief that effect of uncorrected misstatements is material.
 - (c) The auditor should obtain written representation acknowledging management belief that effect of uncorrected misstatements is immaterial.
 - (d) The auditor should communicate effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

4. Which of the following is not an example of subsequent event?
- (a) Event occurring between date of financial statements and date of auditor's report.
 - (b) Event occurring on date of financial statements.
 - (c) Event occurring after filing audit report with tax authorities. Had such an event been known earlier, auditor would have amended report.
 - (d) Event occurring during course of performing audit procedures after date of financial statements.
5. Which of the following is not an example of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern?
- (a) Adverse key financial ratios
 - (b) Inability to invest in modernisation of plant
 - (c) Inability to pay creditors on time
 - (d) Inability to pay salary of staff
6. Which of the following is not correct?
- (a) SA 230- Audit Documentation
 - (b) SA 500- Audit Evidence
 - (c) SA 505- Written Representation
 - (d) SA 560- Subsequent Events
7. The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
- (a) Discuss the matter with management and, where appropriate, those charged with governance.
 - (b) Determine whether the financial statements need amendment.
 - (c) Inquire how management intends to address the matter in the financial statements.
 - (d) All of the above
8. The auditor is required to evaluate management's assessment of the entity's ability to continue as a going concern. Certain events/ conditions were identified that may cast significant doubt on the entity's ability to continue as a going concern but, based

on the audit evidence obtained, the auditor concludes that no material uncertainty exists, and no disclosures are explicitly required by the applicable financial reporting framework regarding these circumstances.

If management's assessment of the entity's ability to continue as a going concern covers less than twelve months from the date of the financial statements, the auditor is required to request management to extend its assessment period to at least twelve months from that date. The management of the company would provide the financial support letter extended by its parent company.

In the given case, which one of the following options is correct?

- (a) The auditor may obtain the financial support letter from the parent company for a period of 12 months from year end date.
- (b) The auditor may obtain the financial support letter from the parent company for a period of 12 months from date of signing of the financial statements.
- (c) The auditor may obtain the financial support letter from the parent company for a period of 12 months or less from year end date.
- (d) The auditor may obtain the financial support letter from the parent company for a period of 12 months or less from date of signing of the financial statements.

9. The auditor shall obtain sufficient and appropriate evidence that all events after the balance sheet date but before or up to the date of _____ that require adjustment or disclosure in _____ have been identified.

- (a) Board's approval; Board report
- (b) Board's approval; financial statements
- (c) Auditor's report; Board report
- (d) Auditor's report; financial statements

10. A limited company is having a pending case filed against it on 31st March, 2018. A decision has been received from the court on 14th April, 2018. i.e. after the balance sheet date.

- (a) It is a subsequent event
- (b) It should be considered by the management while preparing the financial statements.
- (c) Auditor needs to check whether it has been dealt with in the financial statements as per applicable financial reporting framework.
- (d) All of these

11. Statement (1)

Under the going concern assumption, an entity is viewed as continuing in business forever.

Statement (2)

General purpose financial statements are prepared on a going concern basis if management neither intends to liquidate the entity nor to cease the operations

- (a) Only Statement (1) is true
- (b) Only Statement (2) is true
- (c) Both the statements are true
- (d) None of the Statements is true

12. If going concern basis of accounting is appropriate, however, there is a material uncertainty which is not disclosed in the financial statements, then auditor shall express

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

13. Which of the following is operating event or condition which may cast significant doubt on the entity's ability to continue as going concern

- (a) Loss of major market segment
- (b) Loss of key customer
- (c) Inability to pay creditors on due date
- (d) (a) and (b)

14. When any event or condition is identified by auditor which may cast significant doubt on the entity's ability to continue as going concern, the auditor's additional procedure shall include the following

- (a) Communicating the facts to the regulatory authority of the entity
- (b) Communicate the matter to the Central Government
- (c) Request written representation from management or TCWG regarding their future action and feasibility of these plan
- (d) All of the above

15. Statement 1

Written representation do not include financial statements and supporting records etc.

Statement 2

Written representation should be addressed to the management and TCWG

- (a) Only Statement 1 is true (b) Only Statement 2 is true
(c) Both the statements are true (d) None of the Statements is true

16. The auditor has serious concern about the going concern of the company. It is dependent on company's obtaining a working capital loan from a bank which has been applied for. The management of the company has made full disclosure of these facts in the notes to the balance sheet. The auditor is satisfied with the level of disclosure. He should issue_

- (a) unqualified opinion
(b) unqualified opinion with reference in the going concern paragraph in audit report
(c) qualified opinion
(d) disclaimer of opinion

17. Statement (1)

Generally, auditor has no obligation to perform any audit procedures regarding the financial statements after the date of auditor's report.

Statement (2)

In case auditor comes to know about a fact after the date of auditor's report, he should not consider the same.

- (a) Only Statement (1) is true (b) Only Statement (2) is true
(c) Both the statements are true (d) None of the Statements is true

18. If the management has prepared financial statements based on going concern assumption but auditor concludes that use of going concern basis is inappropriate, then auditor shall

- (a) Express a qualified opinion (b) Express an adverse opinion
(c) Disclaim his opinion (d) Either option (a) or option (b)

19. _____ is a control deficiency or a combination of deficiencies in internal controls that is important enough to merit the attention of those charged with governance since there is a reasonable possibility that a material misstatement will not be prevented or detected in a timely manner by management.

- (a) Material Weakness (b) Material deficiency
(c) Control Risk (d) Significant Deficiency

20. _____ is sent by auditor to management and TCWG to communicate weakness in internal control system

- (a) Letter of weakness (b) Engagement letter
 (c) Internal control questionnaire (d) Written representation

ANSWERS

1	(c)	2	(a)	3	(b)	4	(b)	5	(b)	6	(c)	7	(d)
8	(a)	9	(d)	10	(d)	11	(b)	12	(c)	13	(d)	14	(c)
15	(a)	16	(b)	17	(a)	18	(b)	19	(d)	20	(a)		

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CASE STUDY MCQs

Case Study 1

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 a 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.

Answer to Questions involving Case Studies 1

1	(c)	2	(c)	3	(d)	4	(a)	5	(a)
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8

AUDIT REPORT



MCQs BASED QUESTIONS

1. While expressing an unmodified opinion on financial statements, the auditor shall not use which of the following phrases?
 - (a) present fairly in all material respects
 - (b) give a true and fair view
 - (c) with the foregoing explanation
 - (d) All of the above
2. is a paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgement, is of such importance that it is fundamental to the user's understanding of the financial statements.
 - (a) Emphasis of Matter Paragraph
 - (b) Other Matter Paragraph
 - (c) Key Audit Matter
 - (d) Management Responsibility Paragraph.
3. Statement 1: Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements.
Statement 2: Instead of modifying an opinion in accordance with SA 705, the statutory auditor can use Key Audit Matter paragraph in the audit report with an unmodified opinion.
 - (a) Only Statement 1 is correct
 - (b) Only Statement 2 is correct
 - (c) Both the statements are correct
 - (d) 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
6. Which of the following is not a type of modified opinion:
- (a) qualified opinion
 - (b) adverse opinion
 - (c) disclaimer of opinion
 - (d) negative opinion
7. The auditor shall express _____ opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
- (a) Adverse
 - (b) Qualified
 - (c) Disclaimer
 - (d) unmodified opinion with key audit matter paragraph.
8. SA-700 requires the use of specific headings, which are intended to assist in making auditor's reports that refer to audits that have been conducted in accordance with SA more recognizable. Which of the following is the specific heading:
- (a) Key audit matters
 - (b) Basis of opinion
 - (c) Date
 - (d) All of the above
9. The Opinion section of the auditor's report shall:
- (a) Identify the entity whose financial statements have been audited;
 - (b) State that the financial statements have been audited;
 - (c) Identify the title of each statement comprising the financial statements;
 - (d) All of the above

10. As per SA 710, the auditor shall also consider–
- (a) SA 510
 - (b) SA 560
 - (c) SA 720
 - (d) Both (a) and (b)
11. Under which of the following section auditor shall mention in his report that he has conducted audit engagement in accordance with SAs issued by ICAI and has complied with code of ethics and relevant ethical requirements
- (a) Opinion
 - (b) SA and Code of Ethics
 - (c) Compliance with Standards
 - (d) Basis for Opinion
12. The auditor shall describe each key audit matter in the auditor's report unless
- (a) Law or regulation precludes public disclosure about the matter
 - (b) In extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected outweigh the public interest benefits of such communication
 - (c) (a) or (b)
 - (d) None of these
13. Which of the following is true
- (a) If auditor concludes that opening balances contain misstatements that materially affects the current period's financial statements, the auditor shall express disclaimer of opinion.
 - (b) If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or disclaimer of opinion, as appropriate, in accordance with SA 705.
 - (c) If auditor concludes that the current period's accounting policies are not consistently applied in relation to opening balances, or a change in accounting policies is not properly accounted for, or not adequately disclosed in accordance with applicable reporting framework, the auditor shall express a qualified opinion or an adverse opinion as appropriate, in accordance with SA 705.
 - (d) Both (b) and (c)

14. The date on auditor's report should not be__
- (a) the data of AGM
 - (b) later than the date on which the accounts are approved in board's meeting
 - (c) earlier than the date on which the accounts are approved by the management
 - (d) Both (a) and (b)
15. Auditor's report on prior period i.e. year ended 31 March 2017 included a modified opinion on an unresolved matter. If such matter is not relevant/ immaterial to the current period figures in the financial statements for the year ended 31 March 2018, how should the auditors deal with this matter in his auditors report for the year ended 31 March 2018?
- (a) Since the matter is not relevant/ material to current period figures, no reporting in respect of this matter would be required in the auditors report for the year ended 31 March 2018.
 - (b) Modify opinion on current period's financial statements because of the effects or possible effects of the unresolved matter on the comparability of the current period and corresponding figures in the auditors report for the year ended 31 March 2018.
 - (c) Considering the matter is not relevant/ material to current period figures, the management may include a note in the financial statements and basis that no reporting in respect of this matter would be required in the auditors report for the year ended 31 March 2018.
 - (d) Include an emphasis of matter because of the effects or possible effects of the unresolved matter on the comparability of the current period and corresponding figures in the auditors report for the year ended 31 March 2018.
16. If auditor is unable to obtain sufficient appropriate audit evidence with respect to any material item(s) of the financial statements and possible effect if pervasive, he shall express
- (a) Unmodified opinion
 - (b) Adverse opinion
 - (c) Disclaimer of opinion
 - (d) Qualified opinion
17. Which of the following is title of auditor's report
- (a) Auditor's Report
 - (b) Independent Auditor's Report
 - (c) Audit Report on the Financial Statements
 - (d) Reporting on the Financial statements

18. Which of the following is not content of basis of opinion section

- (a) Name of the entity
- (b) Statement that audit was conducted in accordance with SAs
- (c) Statement that auditor believes that audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.
- (d) Reference to the section of auditor's report that describes the auditor's responsibilities under the SAs.

19. The place in auditor's report represent

- (a) Address of auditor
- (b) Name of city, where audit report has been signed
- (c) Name of city, where office of entity is situated
- (d) None of these

20. Key Audit Matters are selected from matters

- (a) Communicated to members of engagement team
- (b) Communicated to management of the entity
- (c) Communicated to TCWG of the entity
- (d) Communicated to CG.

21. The auditor's report shall not include a Key Audit Matter section in accordance with SA 701, in case of

- (a) Disclaimer of Opinion
- (b) Adverse Opinion
- (c) Qualified Opinion
- (d) All of the above

22. To disclose an early application by entity (where permitted) of a new accounting standards that has a pervasive effect on the financial statements in advance of its effective date, auditor shall introduce _____ paragraph in his report.

- (a) Emphasis of Matter
- (b) Other Matter
- (c) Key Audit Matter
- (d) Basis for Modified Opinion

23. The matters relating to going concern may
- (a) Be a key audit matter as per SA 701
 - (b) Should not be a key audit matter as per SA-701 because these are dealt only in SA-570
 - (c) Key audit matters must not include going concern matters
 - (d) None of these
24. _____ framework means comparative information is included as an integral part of current period financial statements ---
- (a) Corresponding figures
 - (b) Comparative financial statements
 - (c) Both option (a) and option (b)
 - (d) Either option (a) or option (b)
25. If last year financial statements are unaudited, then as per SA 710 the auditor shall state in _____ section of audit report that corresponding financial statements are unaudited.
- (a) Auditor's responsibility
 - (b) Opinion
 - (c) Emphasis of matter
 - (d) Other matters
26. SA 299 does not deal with the relationship between
- (a) Principal auditor and component's auditor
 - (b) Auditor and expert
 - (c) Auditor and internal auditor
 - (d) All of these.
27. If joint auditors are in disagreement with respect to the opinion to be covered by audit report, they shall
- (a) Express their opinion in a separate audit report
 - (b) Notify to the client
 - (c) Express their opinion in a common audit report through a note
 - (d) Notify ROC regarding disagreement in audit opinion.
28. Which of the following statements is incorrect
- (a) The joint auditors shall obtain common engagement letter and common management representation letter

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

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

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

32. Which of the following is not a type of modified opinion:

- (a) qualified opinion
- (b) adverse opinion
- (c) disclaimer of opinion
- (d) None of the above

33. Reporting on fraud is made by auditor under which of the following clause of para 3 of CARO, 2020

- (a) Clause (xi)
- (b) Clause (xii)
- (c) Clause (xiii)
- (d) Clause (xiv)

34. Which of the following is incorrect

- (a) Branch office in relation to company means any establishment described as branch by the company.
- (b) The provisions of regarding reporting of fraud by the auditor shall not be applicable to the branch auditor.
- (c) The duties and power of the company's auditor with reference to the audit of the branch and branch auditor, if any, shall be as contained u/s 143(1) to 143(4).
- (d) The branch auditor shall prepare a report on the accounts of the branch examined by him and sent it to the auditor of the company who shall deal with it in his report in such manner as he considers necessary.

35. CARO 2020 is applicable on which of the following companies
- (a) One Person Company (b) Small Company
(c) Public Company (d) Banking Company
36. Which of the following is not reporting requirement w.r.t fixed assets under CARO 2020
- (a) Purchase and sale of fixed assets made during the FY
(b) Maintenance of proper records
(c) Physical verification by management at reasonable intervals
(d) Title deeds of immovable properties
37. Outstanding statutory dues as at last day of financial year concerned for a period of more than _____ months from the day they became payable, shall be indicated by the auditor.
- (a) 1 (b) 2 (c) 5 (d) 6
38. With respect of cost records, what is the reporting requirement under CARO 2020
- (a) Whether such accounts and record are properly audited
(b) Whether such accounts and records have been made and maintained
(c) Both (a) and (b)
(d) None of these
39. Any default in the repayment of loans or borrowings to _____ are reported by auditor under CARO 2020
- (a) Bank, Financial Institution (b) Government
(c) Debenture holders (d) All of above
40. Application of money raised by way of preferential allotment or private placement is reported under which clause of CARO 2020
- (a) Clause (xi) (b) Clause (ix) (c) Clause (xiii) (d) Clause (x)
41. For the purpose of applicability of CARO 2020 status of company is considered
- (a) As on 1st day of FY
(b) Though out the FY
(c) As on Balance Sheet date of FY
(d) As on Balance Sheet date of immediate preceding FY

42. How many matters are specified under CARO 2020 for reporting by Co's auditor
- (a) 12 (b) 13 (c) 15 (d) 21
43. LM Ltd. had obtained a Term Loan of rupees 300 lakhs from a bank for the construction of a factory. Since there was a delay in the construction activities, the said funds were temporarily invested in short term deposits. Under which clause of CARO 2020 the auditor is required to report -
- (a) Under Clause (viii) of paragraph 3 of the CARO, 2020
(b) Under Clause (xi) of paragraph 3 of the CARO, 2020
(c) Under Clause (x) of paragraph 3 of the CARO, 2020
(d) Under Clause (ix) of paragraph 3 of the CARO, 2020
44. Bhishm Limited decided to appoint Mr. Rajvir, chartered accountants as the branch auditor for the audit of its Lucknow branch accounts for the year 2017-18. The decision to appoint branch auditor as taken by way of Board Resolution in the meeting of Board of Directors of the company, held in April 2017, subject to shareholders' approval in AGM of the company scheduled to be held in June 2017. Meanwhile, the Principal Auditor of the company raised an objection that the branch auditor cannot be appointed without his consent. Whether the objection raised by company auditor is valid?
- (a) The objection raised by company auditor is not valid as per section 143(8) of the companies Act, 2013 and the Board has authority to appoint branch auditor but should be approved by shareholders in General Meeting.
(b) The objection raised by company auditor is valid as it is necessary to consult/ obtain the consent of Principal Auditor before appointing Branch Auditor.
(c) The Board of Directors has no authority to appoint Branch Auditor so the objection raised by Principal Auditor is valid.
(d) The objection raised by company auditor is not valid as it is compulsory to appoint branch auditor as per Sec.139 of the Companies Act, 2013.
45. Eeyore Pvt. Ltd. is incorporated on 1st July, 2021. During the Financial Year ending on 31st March, 2022, the company did not opt for any borrowing at any point of time and have a total revenue of Rs. 60 Lakh. At the year end, it provides the following information regarding its paid-up capital and reserve & surplus :-
- You are provided with the provisions regarding applicability of Companies (Auditor's Report) Order, 2020 (CARO, 2020) issued under section 143(11) of the Companies

Act, 2013 to a private limited company that it specifically exempts a private limited company having a paid up capital and reserves and surplus not more than Rs. 1 crore as on the Balance Sheet date and which does not have total borrowings exceeding Rs. 1 crore from any bank at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 exceeding Rs. 10 crore during the financial year. Considering the information given above, which of the following shall be considered as a reason regarding applicability or non- applicability of CARO, 2020?

- (a) Reporting under CARO 2020 shall be applicable as the company is having a paid up capital and reserves and surplus of Rs. 1.07 crore i.e. more than Rs. 1 crore as on the Balance Sheet date.
- (b) Reporting under CARO 2020 shall be applicable as the company is having a paid up capital and reserves and surplus of Rs. 1.02 crore i.e. more than Rs. 1 crore as on the Balance Sheet date.
- (c) Reporting under CARO 2020 shall not be applicable as the company is having a paid up capital and reserves and surplus of Rs. 0.92 crore i.e. not more than Rs. 1 crore as on the Balance Sheet date.
- (d) Reporting under CARO 2020 shall not be applicable as the company is having a paid up capital and reserves and surplus of Rs. 0.82 crore i.e. not more than Rs. 1 crore as on the Balance Sheet date

ANSWERS

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



CASE STUDY MCQs

Case Study 1

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 the 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

Answer to Questions involving Case Studies 1

1	(b)	2	(c)	3	(c)	4	(b)	5	(d)
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Case Study 2

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 the 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 out 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 sale was 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 the following questions:

1. In case of M/s Persistent & Company, what would be an ideal Audit Opinion?
 - (a) Unmodified
 - (b) Qualified
 - (c) Adverse
 - (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

Answer to Questions involving Case Studies 2

1	(b)	2	(c)	3	(c)	4	(b)	5	(d)
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Case Study 3

ARG & Associates who have been the auditors of Sigma Ltd for the financial year 2019-20 have concluded their audit, prepared their notes and are ready to draft the Auditor's Report. As per SA 700, the auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

There seems to be some confusion between the audit team members in regard to format of Audit report, its contents, issues to be incorporated etc. in the Auditor's report.

Also, Sigma Ltd received a grant of ₹ 50 lakhs under the PM Make in India Subsidy Scheme for acquiring machinery for setting up new plant.

The entire grant received was credited to Profit and Loss Account. Mr Ram and Mr Sham (two partners of ARG & Associates) differ on an audit point relating to audit of Sigma Ltd. Mr Ram is of the view that it will attract qualification however Mr Sham disagreed with his opinion. Based on above facts, you are required to answer below questions which require special attention while preparing the Audit report of Sigma Ltd.

1. The auditor shall express _____ when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

- (a) qualified opinion
- (b) adverse opinion
- (c) unmodified opinion
- (d) disclaimer of opinion

2. In relation to grant of ₹ 50 lakhs, while preparing the audit report, the auditor needs to:
- (a) qualify the report stating the fact that the income has been overstated to the extent of the amount of grant net of proportionate credit that would have been worked out.
 - (b) qualify the report stating the fact that the income has been understated to the extent of the amount of grant net of proportionate debit that would have been worked out.
 - (c) express unmodified opinion as Accounting Standard-12 allow the recognition of grant received as income.
 - (d) None of the above
3. The auditor shall express _____ when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.
- (a) qualified opinion
 - (b) adverse opinion
 - (c) unmodified opinion
 - (d) disclaimer of opinion
4. Assume Mr Ram and Mr Sham from two different joint auditor's firms. How audit report should be made in circumstances where two joint auditors have difference of opinion in relation to a specific issue -
- (a) The view of Mr Ram will prevail because of prudence
 - (b) Joint Auditors should come at a common point and give opinion accordingly
 - (c) The matter should be referred to a senior joint auditor firm
 - (d) Mr Ram and Mr Sham would issue separate audit reports
5. Communicating key audit matters in the auditor's report is
- (a) 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.
 - (b) a substitute for the auditor expressing a modified opinion when required by the circumstances of a specific audit engagement in accordance with SA 705.
 - (c) a substitute for reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern;
 - (d) a separate opinion on individual matters.

Answer to Questions involving Case Studies 3

1	(c)	2	(a)	3	(b)	4	(d)	5	(a)
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Case Study 4

Ravish and Co, a chartered accountancy firm, has been auditing the books of PQ groups of banks, from the past 6 years. Ravish and Co. has a good standing reputation as auditor and there are regular quality control activities performed by the firm's engagement partner. The recent weekly meeting of the firm's staff included discussions on each of the element of the firm's system of quality control as per SQC 1 and code of ethics as per SA 200. During the 7th year of audit, there have been some changes in the bank due to which the firm is considering revision of audit terms as per SA 210. Also, new laws and updates in the field of accounting makes the auditor feel that the financial reporting framework used by the bank is not acceptable as per law and is considering the impact of this on his audit report. Owing to the changes, Mr. Ravish instructs his articles to go through the audit programme once again and make necessary changes to it. He also reviews the audit plan developed for the bank. After the above exercise of re-planning and revision in terms of the engagement as per SA 210, Mr. Ravish and Co. carries on the audit of the 7th year and observes the following issues:

- (a) As per the Income Tax Act 1961, the banks are to report certain high value transactions to the department. On verification of certain records, the auditor suspects that there is noncompliance with the law and in his judgment; the effect of the suspected non-compliance may be material to the financial statements. On discussion with management, he does not get sufficient information supportive that the bank is in compliance with the law
- (b) The management of the bank shows recent investigation reports by external authorities to the auditor wherein red flags have been raised in the internal control system of the bank. The management blames the auditor that he has not audited the entity's internal system correctly and threatens to hold the auditor responsible for the same. Considering the above facts, answer the following questions by choosing the correct answer.

1. Which among the following is NOT an element of firm's system of quality control?
 - (a) Ethical Requirements
 - (b) Acceptance and continuance of client relationships and specific engagements
 - (c) Engagement review
 - (d) Monitoring

2. When conducting an audit of financial statement, which of the following is NOT a fundamental principle of professional ethics?
 - (a) Integrity
 - (b) Professional Skepticism
 - (c) Confidentiality
 - (d) Objectivity

3. Which of the following statement is incorrect considering the context of revision in audit terms as per SA 210?
 - (a) Indication that the entity has misunderstood the objective & scope of the audit
 - (b) A significant change in ownership of the bank
 - (c) A change in legal or regulatory requirements
 - (d) Significant change in the audit team

4. The auditor has found that the financial reporting framework provided by law or regulation is unacceptable. What should be the impact of this on his report?
 - (a) Issue an adverse opinion owing to unacceptable financial reporting framework
 - (b) Include an "Emphasis of Matter Paragraph" drawing user's attention to additional disclosures other than those as per law.
 - (c) Include an "Other Matter paragraph" drawing user's attention to additional disclosure other than those as per law.
 - (d) No need of any mention in report as law or regulation has prescribed the framework and law holds highest authority.

5. Which among the following best defines an Audit Programme?

- (a) An audit programme consists of a series of verification procedures to be applied to the financial statements and accounts of a given company for the purpose of obtaining sufficient evidence to enable the auditor to express an informed opinion on such statements.
- (b) An audit programme is a statement containing the details of the hours worked, work done and output achieved by the staff of the audit firm used by the principal for review purpose
- (c) An audit programme is a checklist developed by the audit firm covering verification aspects which are common to clients handled by the audit firm.
- (d) An audit programme is the policies and procedures adopted by the company for ensuring orderly and efficient conduct of audit, including timely provision of records to auditors and prompt response to audit queries.

Answer to Questions involving Case Studies 4

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

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

- (i) 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.
- (ii) There is no need of addressee in the Auditor's report.
- (iii) 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.
- (iv) 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.
- (v) Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements.
- (vi) 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.
- (vii) 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.
- (viii) The concept of "joint audit" has legal foothold under the Companies Act, 2013.

Answers to Correct/Incorrect

- (i) **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.
- (ii) **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.

- (iii) **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.
- (iv) **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.
- (v) **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.
- (vi) **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.
- (vii) **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).
- (viii) **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.

9

SPECIAL FEATURES OF AUDIT OF DIFFERENT TYPES OF ENTITIES



MCQs BASED QUESTIONS

- 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?
 - To report on the adherence to legal and administrative requirements
 - To report on whether value is being fully received for money spent
 - To report on the weakness of systems of financial control
 - To provide better civic amenities to residents of metro city
- “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?
 - Income Tax Act, 1961
 - Foreign Contribution Regulation Act, 2010
 - Companies Act, 2013
 - Orders issued by Ministry of Social Justice and Empowerment
- 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
- Consider following revenue sources of Union Government.
 - Revenues from direct taxes
 - Revenues from Goods and Services Tax
 - Revenues from Custom Duties
 - Revenues from Excise Duties

Out 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 |

6. CAG has a right to order conduct of supplementary audit within _____ days from the date of receipt of audit report

- | | | | |
|--------|--------|--------|---------|
| (a) 30 | (b) 60 | (c) 90 | (d) 120 |
|--------|--------|--------|---------|

7. Public enterprises are required to maintain commercial accounts and are generally classified under three categories.

Which of the following is not a category relating to above:

- (a) departmental enterprises engaged in commercial and trading operations, which are subject to the same laws, financial and other regulations as other government departments and agencies;
- (b) statutory bodies, corporations, created by specific statutes mostly financed by government in the form of loans, grants, etc.; and
- (c) government companies set up under the Companies Act, 2013.
- (d) Charitable Trusts.

8. Article 151 requires that the reports of the C&AG relating to the accounts of the Union/State shall be submitted to the _____ who shall cause them to be laid before House of Parliament/State Legislature

- (a) President/Governor
- (b) Prime Minister/ Chief Minister
- (c) Union Finance Minister/State Finance Minister
- (d) Union Cabinet

9. _____ aims at ascertaining that the expenditure incurred has been on the purpose for which the grant and appropriation had been provided and that the amount of such expenditure does not exceed the appropriation made.

- | | |
|--------------------------------------|------------------------------------|
| (a) Audit against provision of funds | (b) Propriety audit |
| (c) Audit of sanctions | (d) Audit against rules and orders |

10. The Auditor of a Sole Proprietor Concern is appointed by
- (a) CAG (b) Bank
(c) Sole Proprietor himself (d) District Administration
11. Every LLP would be required to file annual return in Form with ROC within 60 days of closer of financial year:
- (a) Form 11 (b) Form 8 (c) Form 9 (d) Form DPIN
12. In addition to the audit certificate in the prescribed form and various schedules, the auditor of a Co-operative society in the applicable State has to answer two sets of questionnaires called as
- (a) Internal Control Questionnaires
(b) Audit Supplements
(c) Audit Memos
(d) Memorandum reports
13. While conducting the audit of a local body, the auditor's areas of audit do not include
- (a) Budgetary Procedure (b) Expenditure Control
(c) Accounting System (d) Dispute Resolution
14. After a Government expenditure has been incurred and the accounts are closed, the Appropriation Accounts are prepared which are scrutinized by the
- (a) CAG (b) President
(c) Public Accounts Committee (d) Parliament
15. The part of Government Audit which is concerned with examining whether the money has been spent for the purpose specified in Appropriation/ Budget Act is called.
- (a) audit of sanctions (b) audit of provision of funds
(c) audit of rules and orders (d) audit of financial propriety
16. The income Tax Department has sent Mr. X double refund of advance tax. The Government Auditor detected this while conducting
- (a) audit of expenditure (b) performance audit
(c) audit of stores and stock (d) audit of receipts

17. A state Government spent rupees fifty lakhs on renovation of Raj Bhavan' for its Governor. In the C & AG's opinion, this expenditure was more than what occasion demanded? It is an example of –

- (a) Propriety audit (b) Performance audit
(c) Audit against provision of funds (d) None of the above

18. Audit reports on PSU are

- (a) submitted to the President/Governor for being laid before the parliament
(b) sent to concerned ministries/departments
(c) Submitted to BOD of concerned PSU
(d) Any of the above

19. The C & AG, some years ago, gave adverse comments on expenditure incurred on buying coffins for soldiers killed in a war. In his opinion, the coffins cases imported could have been replaced with less expensive, domestically produced ones.

This is an aspect of –

- (a) Audit of sanctions (b) Audit of stores and stocks
(c) Propriety audit (d) All of the above

20. Which of the following is not objective of audit of local bodies

- (a) Reporting on the fairness of the content and presentation of financial statements
(b) Reporting on office infrastructure and maintenance of local bodies
(c) Reporting on the adherence to legal and/or administrative requirements
(d) Detection and prevention of error, fraud and misuse of resources

21. _____ is generally in charge of the audit of municipal accounts.

- (a) CAG (b) CG
(c) Local Fund Audit Wing of the State Government (d) ROC

22. CAG can resign any time through a resignation letter addressed to

- (a) Prime Minister of India (b) Parliament
(c) CBI (d) President of India

23. The CAG shall be paid salary equivalent to

- (a) Judge of High Court (b) Judge of Supreme Court
(c) Prime Minister (d) President of India

24. _____ is competent to make laws to determine salary and other conditions of service

- (a) The Parliament
- (b) President of India
- (c) Prime Minister of India
- (d) CBI

25. The CAG shall hold office

- (a) For 6 Years
- (b) Up to the age of 65 Years
- (c) (a) or (b) whichever is earlier
- (d) (a) or (b) whichever is later

26. The CAG shall audit

- (a) Receipts of Union or State
- (b) Account of Store and Stock
- (c) Grants and Loans given from Consolidated Fund[®]
- (d) All of these

27. Which of the following is not power of CAG

- (a) To inspect any office of accounts under the control of the union or a State Government
- (b) To require that any account, book, paper and other documents which deal with or are otherwise relevant to the transaction under audit, be sent to specified places
- (c) To attend Parliament Session
- (d) To put such questions or make such observations as he may consider necessary to the person in charge.

28. Which of the following is not a standard for audit of public expenditure

- (a) Audit of Rules and Orders
- (b) Audit of Sanction
- (c) Audit of Propriety
- (d) None of these

29. While auditing a cinema hall, the auditor needs to verify that

- (a) Entrance to the cinema hall during show is only through printed tickets
- (b) Tickets are serially numbered and bound into books
- (c) That for advance booking a separate series of tickets is issued
- (d) All of above

ANSWERS

1	(d)	2	(b)	3	(b)	4	(b)	5	(c)	6	(b)	7	(d)
8	(a)	9	(a)	10	(c)	11	(a)	12	(c)	13	(d)	14	(c)
15	(b)	16	(d)	17	(a)	18	(b)	19	(c)	20	(b)	21	(c)
22	(b)	23	(a)	24	(a)	25	(c)	26	(d)	27	(c)	28	(d)
29	(d)												

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CASE STUDY MCQs

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

Answer to Questions involving Case Studies 1

1	(c)	2	(d)	3	(a)	4	(c)	5	(b)
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Case Study 2

As per Section 143(5) of the Companies Act, the power to appoint auditor of Government Company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government/s rests with Comptroller & Auditor General of India. Sigma & Associates (a practicing Chartered Accountant firm) having good practice spread across regions, industries now applied to Comptroller & Auditor General of India for allotment of audits of Government departments, Local bodies, Co-operative societies etc. The firm is also interested in taking up LLP audits and wants to know peculiarities related to LLP audits in accordance with LLP Rules 2009. Two senior Chartered Accountants are entrusted for this division within Sigma & Associates. Both of them are seasoned and highly experienced Chartered Accountants. Based on below queries/cases, you are required to answer on specific cases which require special attention while conducting audit of Government departments, Local bodies, Co-operative societies etc.

1. Public money should not be utilized for the benefit of a particular person or a section of the community or for the person who is sanctioning the expenditure.

These are the principles covered in

- (a) Performance Audit
- (b) Audit against rules and orders
- (c) Propriety Audit
- (d) Efficiency Audit

2. In case of co- operative societies, bad debts and irrecoverable losses before being written off against Bad Debt funds, Reserve fund etc. should be certified as bad debts or irrecoverable losses by the
- auditor where the law so requires
 - the managing committee of the society , when law is silent as to certification by auditor
 - the managing committee of the society , irrespective of the provisions of the law
 - Both (a) and (b)
3. As per Rule 24 of LLP Rules, 2009, Statement of Account and Solvency shall be filed in _____ with the _____, within a period of _____.
- Form 5, SEBI, 30 days from the end of 3 months of the financial year to which the Statement of Account and Solvency relates.
 - Form 5, Registrar, 30 days from the end of 6 months of the financial year to which the Statement of Account and Solvency relates.
 - Form 8, SEBI, 30 days from the end of 3 months of the financial year to which the Statement of Account and Solvency relates.
 - Form 8, Registrar, 30 days from the end of 6 months of the financial year to which the Statement of Account and Solvency relates
4. LLP, whose turnover does not exceed _____ or whose contribution does not exceed _____, is not required to get its accounts audited.
- 40 Lakhs, 25 Lakhs
 - 50 Lakhs, 25 Lakhs
 - 40 Lakhs, 20 Lakhs
 - 60 Lakhs, 30 Lakhs
5. Which of the following matter is not required to be inquired by auditor of multistate co-operative society under Sec. 73(2) of Multi-State Co-operative Societies Act, 2002:
- Whether loans and advances made on the basis of security have been properly secured and whether the terms on which they have been made are not prejudicial to the interests of the society or its members;
 - Whether transactions which are represented merely by book entries are not prejudicial to the interest of Society;
 - Whether personal expenses have been charged to revenue account; and
 - Whether loans and advances shown as deposits.

Answer to Questions involving Case Studies 2

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

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

- (1) Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the Finance Minister may on the advice of the C&AG prescribe.
- (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.
- (3) Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads: (a) general administration and revenue collection, (b) public health, (c) public safety, (d) education, (e) public works, and (f) others such as interest payments.
- (4) The external control of municipal expenditure is exercised by the Central Government through the appointment of auditors to examine municipal accounts.
- (5) NGOs may be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives.
- (6) The accounts of every LLP shall be audited in accordance with rule 24 of LLP Rules 2009.
- (7) The auditor of an LLP may be appointed by the Designated Partners or other Partners whosoever is available at the time of appointment.
- (8) The Comptroller and Auditor General does not have any authority to audit the accounts of stores and inventory kept in any office or department of the Union or of a State .
- (9) An Operating Lease is a kind of Financing arrangement.
- (10) An auditor should ensure that proper valuation of occupancy-in-progress at the balance sheet date is made and included in the accounts in the case of audit of a Hotel.
- (11) The first auditor of a Multi-State co-operative Society will be appointed in Annual General Meeting.
- (12) Small LLPs are mandatorily required to get their Books of account audited.

Answers to Correct/Incorrect

1. **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. **Correct-** According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations i.e. the expenditure is incurred with due regard to broad and general principles of financial propriety.
3. **Correct-** Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads: (a) general administration and revenue collection, (b) public health, (c) public safety, (d) education, (e) public works, and (f) others such as interest payments, etc., mostly related to civic amenities and local area development and maintenance.
4. **Incorrect-** The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. However, the municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit.
5. **Correct-** NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situations. These would include religious organisations, voluntary health and welfare agencies, charitable organisations, hospitals, old age homes, research foundations etc. The scope of services rendered by NGOs is extremely wide.
6. **Incorrect-** Rule 24 of LLP Rules 2009 provides that any LLP, whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty five lakh rupees, is not required to get its accounts audited. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rules.

7. **Incorrect-** The auditor is to be appointed by the designated partners of the LLP. However, the Partners may appoint the auditors only if the Designated Partners have failed to appoint them.
8. **Incorrect-** The Comptroller and Auditor General shall have authority to audit and report on the accounts of stores and inventory kept in any office or department of the Union or of a State. Audit of the accounts of stores and inventories has been developed as a part of expenditure audit with reference to the duties and responsibilities entrusted to C&AG.
9. **Incorrect-** A Finance Lease is a Financing arrangement. An Operating lease, on the other hand, is a simple arrangement where, in return for rent, the lessor allows the lessee to use the asset for a certain period.
10. **Correct-** The auditor should ensure that proper valuation of occupancy-inprogress at the balance sheet date is made and included in the accounts for proper recording of closing and opening entries and maintenance of accounts on Accrual basis as per the Matching concept.
11. **Incorrect-** Section 70 of the Multi-State Co-operative Societies Act, 2002 provides that the first auditor or auditors of a Multi-State co-operative society shall be appointed by the board within one month of the date of registration of such society and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. If the board fails to exercise its powers under this sub-section, the Multi-State Co-operative Society in the general meeting may appoint the first auditor or auditors.
12. **Incorrect-** The accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009, which provide that any LLP whose turnover does not exceed, in any financial year, forty lakh rupees, or whose contribution does not exceed twenty-five lakh rupees, is not required to get its accounts audited. Further, a Small LLP is any LLP the Contribution of which, does not exceed twenty-five lakh rupees (INR 25,00,000) or such higher amount, not exceeding five crore rupees, as may be prescribed; and the Turnover of which, as per the Statement of Accounts and Solvency for the immediately preceding financial year, does not exceed forty lakh rupees (INR 40,00,000) or such higher amount, not exceeding fifty crore rupees, as

may be prescribed; Hence, the provisions of audit are not applicable on Small LLP's. Therefore, the Small LLPs can prepare its financial statement merely with the signatures of the Designated Partners.

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10

AUDIT OF BANKS



MCQs BASED QUESTIONS

- Which of the following is included in "Interest Earned" in Profit & loss A/c of a bank?
 - Discount on Bills
 - Commission on bills for collection
 - Loan Processing fees
 - Credit Card Fees
- While auditing advances of a bank as statutory auditor, which of the following is not a likely concern of auditor?
 - Appropriate documentation of advances
 - Ensuring budgeted targets of advances given by bank management
 - Compliance of sanctioned terms and conditions
 - Operations in advance accounts
- 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
 - it is not paid within 30 days of due date fixed by the bank
 - it is not paid within 60 days of due date fixed by the bank
 - it is not paid within 90 days of due date fixed by the bank
- Which of the following statement is true regarding appointment of statutory branch auditor of a nationalized bank?
 - The appointment is made by bank acting through its board of directors with prior approval of Central govt.
 - The appointment is made by bank acting through its board of directors with prior approval of RBI
 - The appointment is made by bank acting through its board of directors with prior approval of ICAI
 - The appointment is made by shareholders in AGM.

13. The term “Drawing Power” is associated with which of the following facilities as sanctioned by any Bank :-

- (a) Letter of Credit (b) Term Loan
(c) Staff Advances (d) Cash Credit Limit

14. Drawing Power in case of a Consortium advance is computed and allocated to member banks by the

- (a) Bank members proportionately (b) Lead bank
(c) Borrower (d) Reserve Bank of India

15. A Ltd. has been assigned a Cash Credit limit of INR 20 lacs as against its Book Debts furnished as security. What kind of Security creation is it?

- (a) Pledge (b) Mortgage (c) Assignment (d) Set-off

16. Mrs. Reema has availed a Personal Loan for her Boutique of INR 5 lakhs and a Vehicle Loan to purchase an Activa Scooter for INR 60,000. She is regular in depositing EMI of the Activa Loan but has not made any payments towards the Personal Loan due to low business during the year. In this case, which of the following facilities should be categorized as NPA ?

- (a) Activa Loan (b) Personal Loan
(c) Higher of the two (d) Both the Activa Loan & the Personal Loan

17. The term “Drawing Power” is associated with which of the following facilities as sanctioned by any Bank:

- (a) Letter of Credit (b) Term Loan
(c) Staff Advances (d) Cash Credit Limit

ANSWERS

1	(a)	2	(b)	3	(a)	4	(b)	5	(c)	6	(c)	7	(d)
8	(a)	9	(b)	10	(a)	11	(c)	12	(a)	13	(d)	14	(b)
15	(c)	16	(d)	17	(d)								



CASE STUDY MCQs

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 the 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.

Answer to Questions involving Case Studies 1

1	(c)	2	(c)	3	(b)	4	(b)	5	(a)
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Case Study 2

M/s RGL has been appointed as auditors of New Indian Bank (a nationalised bank) for the Financial year 2018-19 by its Board of Directors. Appointment of M/s RGL has been challenged by a shareholder in the Bank’s Annual General Meeting stating that the appointment should have been made by the shareholders in the bank’s AGM. Their appointment as auditors of the bank throws some questions for the bank’s management. New Indian bank has exposure to crop loans as many branches are located in the rural area. While conducting the audit, the auditors are faced with the question of classification of non performing advances. Also, New Indian bank has lot of Credit cards issued to its clients, some of which are overdue for long. While conducting the audit, the auditors came across various peculiarities relating to Bank Audits like classification of NPA’s, reporting etc. to name a few. On the basis of above facts, please suggest appropriate treatments in respective cases.

1. As per the provisions of relevant enactments, please advise who can appoint auditors of a Nationalised bank.
- (a) Board of Directors of the Bank
 - (b) Reserve Bank of India
 - (c) Comptroller and Auditor General of India
 - (d) Central Government
2. The matters which the banks require their auditors to deal with in the Long Form Audit Report is to be specified by
- (a) Banking Regulation Act, 1949
 - (b) Central Government
 - (c) Comptroller and Auditor General of India
 - (d) Reserve Bank of India

3. The auditors should classify Credit card accounts as NPA, if _____ amount due, as mentioned in the credit card statement is not paid fully within _____ days from next statement date.
- (a) Total, 90 (b) Minimum, 90
(c) Minimum, 30 (d) Minimum, 60
4. An agricultural advance is classified as NPA, if interest or principal is overdue for _____ in case of short duration crops or if interest or principal is overdue for _____ in case of long duration crops.
- (a) One crop season, two crop season
(b) Two crop season, one crop season
(c) 90 days, 120 days
(d) 120 days, 90 days
5. The bank is a consortium member of Cash Credit Facilities of Rs 100 crores to Bottle Limited. Bank's own share is Rs 20 crores only. During the last two quarters against a debit of Rs 1.75 crores towards interest the credits in Bottle Ltd's account are to the tune of Rs 1.25 crores only.
- The auditors have classified the account of Bottle Ltd as performing
- (a) Incorrect, Bottle ltd is Non Performing Asset (NPA)
(b) Correct, Bottle ltd is performing asset
(c) Bottle Ltd's classification is subjective
(d) None of the above.

Answer to Questions involving Case Studies 2

1	(a)	2	(d)	3	(b)	4	(b)	5	(a)
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Case Study 3

PK & Associates, a 20 year old CA firm was duly appointed as Statutory Auditors of one of the major branches of KBC Bank Ltd., a Nationalised bank , as per the applicable procedure of the appointment of auditors. The Engagement Partner, CA Raman Kumar, carries out discussions with the Engagement team on how to plan, start & conclude this Statutory Bank Audit. He also makes them aware of the importance of such Engagement discussion. CA Raman also discusses with other Partners of the firm regarding the Professional Remuneration the firm will be getting against the completion of this Statutory Audit assignment as fixed by the relevant authorities in this case.

He tells the engagement team about various reports they would be required to issue after the conclusion of audit as the Statutory auditors such as the Statutory Report, LFAR , etc. During the course of the audit , the audit team suspects a fraud having been committed in the Bank branch involving an amount of INR 2.5 crores and they report of the same to the Bank's Board of Directors (BOD) but receive no reply against it from them and therefore proceed further as per their legal obligation as the Statutory auditors. They also observe that more than 80% the Bank Branch's advances consist of Gold Loans.

Also , more than 90% of the remaining advances are overdue between 61 to 90 days but the Bank has not categorized them accordingly.

1. As per CA Raman's discussions with other partners of the firm, their Professional remuneration as per the assignment allotted in the above case is fixed by the
 - (a) The Shareholders of the Bank at their AGM.
 - (b) The Reserve Bank of India in consultation with the Central Government.
 - (c) The Bank through its Board of Directors.
 - (d) The Central Government.
2. The Engagement Team's discussions as held by CA Raman are a part of which of the following phases of an audit?
 - (a) Audit Planning
 - (b) Developing an Audit Programme
 - (c) Risk Assessment
 - (d) Audit Reporting.
3. Which of the following types of Audit Report do PK & Associates will have to issue to comply with the requirements as laid down by RBI circulars as narrated by CA Raman to the Engagement team ?
 - (a) Statutory Audit Report
 - (b) Tax Audit Report.
 - (c) LFAR.
 - (d) GST Audit Report.
4. In the given case , what should be CA Raman's legal obligation & reporting requirement w.r.t. the fraud noticed by the team during the course of the audit ?
 - (a) Report the nature of , amount & parties involved in the fraud in his audit report.
 - (b) Ask for the matter to be disclosed in the Board's Report by the BOD..
 - (c) Forward the reply received from the BOD to the Central Government along with his report and his comments upon the reply received.
 - (d) Forward his Report with a Note to the Central Govt. stating the non-receipt of any observations from the BOD.

5. The Bank’s major advances constitute a specific type of Loan product. What according to you must have been the most common form of Security Creation in the Bank against such types of Loans?

- | | |
|-------------------|------------|
| (a) Mortgage | (b) Pledge |
| (c) Hypothecation | (d) Charge |

Answer to Questions involving Case Studies 3

1	(b)	2	(a)	3	(c)	4	(d)	5	(b)
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Case Study 4

Kwatra & Co. is a CA firm based at New Delhi. They were appointed as the Statutory Auditors of Mannalaxmi Bank Ltd. For the Financial year 2019-20. After having a good discussion with the Engagement team , CA Vikas , the Engagement Partner , started the Bank audit with his team and made the following observations during the course of the audit:-

- One of the borrowers , Mr. Rakesh Verma has availed a Machinery Loan from the Bank but has not paid the EMI since the past 100 days. However, his business is going good and the Bank Manager is of the view that such loan need not be classified as NPA as they have his Factory building available with them as Mortgaged Security against the Machinery Loan and good amount could be realized by its auction in the case of default by Mr. Verma.
- Mrs. Lata , one of the prime customers of the Bank has availed a CC facility for her Garment business , a Car Loan for her personal purpose and an Education loan for her son’s higher studies , all from the Bank branch under audit. She has been regular in meeting the EMI obligations of all the loans except for the Car loan where she has not been able to pay the EMI since the past 4 months.
- Mr. Kapoor has been sanctioned a Cash Credit Limit of INR 55 lakhs by the Bank and the outstanding balance in his CC account is INR 55 lakhs since the past 3 months. There are no credits continuously for 90 days as on the date of Balance Sheet
- Sakhi Cooperative Society’s Term Loan of INR 10 lakhs has been guaranteed by the Central Government and is overdue since the past 120 days . The CG guarantee has not been invoked or repudiated till now.
- Similarly , Vishwas NGO’s loan of INR 7 lakhs has been guaranteed by the State Government but it is overdue since the past 105 days but the Bank manager is of the view that this not be categorized as NPA as it has been guaranteed by the State Government and the guarantee has not been invoked/repudiated.

- The RBI inspection team had identified a KCC Loan given to Mr. Khara , a farmer as a Loss in its RBI Report but the Bank has not provisioned it accordingly as the manager is hopeful of recovery from such loan.
 - There is a Term Loan advance by the Bank as a Lead Bank together with two other major banks under a specific agreement to a big Corporate house in the city.
1. Mr. Verma's Loan account in the above case should be categorized as-
 - (a) NPA because of no recovery for more than 90 days.
 - (b) Loss asset as there are minute chances of recovery.
 - (c) Standard asset as per the Manager as security is available against this loan and also the net worth of the borrower is strong.
 - (d) SMA 02 Loan.
 2. Which of the following Loan facilities given to Mrs. Lata be categorized as NPA by the Bank -
 - (a) Cash Credit Facility
 - (b) Education Loan
 - (c) Car Loan
 - (d) All loans advanced
 3. Mr Kapoor's loan account as per the above case is -
 - (a) Overdue
 - (b) SMA 01
 - (c) Doubtful asset
 - (d) Out of Order
 4. The loan sanctioned to Sakhi Cooperative Society in the above case should be categorized as _____ for the purpose of Provisioning of Assets but/and deemed/ taken to be as _____ for the purpose of Income recognition by the Bank, respectively.
 - (a) NPA ; NPA
 - (b) NPA ; Standard
 - (c) Standard ; NPA
 - (d) Standard ; Standard.
 5. The loan sanctioned to Vishwas NGO in the above case should be categorized as _____ for the purpose of Provisioning of Assets but/and deemed/taken to be as _____ for the purpose of Income recognition by the Bank , respectively.
 - (a) NPA ; NPA
 - (b) NPA ; Standard
 - (c) Standard ; NPA
 - (d) Standard ; Standard

Answer to Questions involving Case Studies 4

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

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

1. RBI has been entrusted with the responsibility of regulating the activities of commercial banks only.
2. In the computerised environment, the auditor need not be familiar with latest applicable RBI guidelines.
3. The auditor can assume that the system generated information is correct and relied upon.
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.
5. Registered mortgage 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.
7. An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.
8. Banks recognize income on Non-Performing Assets on accrual basis.
9. Auditor of a Nationalised bank is to be appointed at the annual general meeting of the shareholders.
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.
11. Central Govt. guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets.

Answers to Correct/Incorrect

1. **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. **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. **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. **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. **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. **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. **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. **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. **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. **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. **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.

11

ETHICS AND TERMS OF AUDIT ENGAGEMENTS



MCQs BASED QUESTIONS

1. Identify the most appropriate statement: -
 - (a) SA 220 applies at the level of firm.
 - (b) SQC 1 is premised on the basis that firm is subject to SA 220.
 - (c) SA 220 is premised on the basis that firm is subject to SQC 1.
 - (d) SA 220 applies to all engagements.
2. Professional skepticism includes -
 - (a) Overlooking unusual circumstances.
 - (b) Using inappropriate assumptions in determining extent of audit procedures.
 - (c) Over generalising when drawing conclusions from audit observations.
 - (d) Being vigilant to conditions that might indicate possibilities of fraud.
3. Which of the following is not a fundamental principle governing professional ethics?
 - (a) Professional competence and due care
 - (b) Integrity
 - (c) Objectivity
 - (d) Safeguards to independence
4. Which of the following is not necessary to establish preconditions for an audit?
 - (a) Acceptability of financial reporting framework.
 - (b) Acknowledgment of cooperation from management in designing audit procedures.
 - (c) Acknowledgment from management of providing access to persons within company.
 - (d) Acknowledgment of management in understanding its responsibility for preparation of financial statements.

5. Identify the most appropriate statement in context of SQC 1.
- (a) Assembly of engagement files should be completed in not more than 60 days after date of auditor's report in case of audit engagements.
 - (b) Engagement files should be completed before date of auditor's report in case of audit engagements.
 - (c) Engagement files should be completed in not more than 60 days after completion of an engagement.
 - (d) Engagement files should be completed on date on which audit report is signed in case of audit engagements.
6. (IESBA Code) related to an audit of financial statements establishes which of the following as the fundamental principle of professional ethics relevant to the auditor when conducting an audit of financial statements:
- (a) professional judgement;
 - (b) professional skepticism;
 - (c) professional intelligence;
 - (d) professional competence and due care.
7. The auditor's _____ safeguards the auditor's ability to form an audit opinion without being affected by any influences.
- | | |
|---------------------|------------------|
| (a) Objectivity | (b) independence |
| (c) Confidentiality | (d) Integrity |
8. If the auditor concludes that there is reasonable justification to change the engagement and if the audit work performed complied with the SAs applicable to the changed engagement, the report issued would be appropriate for the revised terms of engagement. In order to avoid confusion, the report would not include reference to:
- (a) the original engagement; or any procedures that may have been performed in the original engagement.
 - (b) the original engagement ;
 - (c) any procedures that may have been performed in the original engagement
 - (d) the original engagement and any procedures that may have been performed in the original engagement.

13. Which of the following is exception of confidentiality by auditor
- (a) If permitted by client to disclose any information
 - (b) If there is any legal professional duty of auditor to disclose any information
 - (c) Both (a) and (b)
 - (d) None of these
14. The auditor shall establish existence of preconditions for an audit of financial statements
- (a) Before confirming common understanding between the auditor and management of the terms of audit engagement.
 - (b) After confirming common understanding between the auditor and management of the terms of audit engagement.
 - (c) Before appointment of auditor
 - (d) After the date of auditor's report.
15. If auditor is requested by management to change the audit engagement to an engagement that conveys a lower level of assurance, then the auditor shall
- (a) Reject the management's request
 - (b) Accept the management's request
 - (c) Determine that there is a reasonable justification for doing so
 - (d) Shall not entertain any such request
16. Which of the following SAs deals with responsibilities of auditor regarding quality control procedures for an audit of financial statements
- (a) SA 200
 - (b) SA 210
 - (c) SA 220
 - (d) SA 260
17. The partner who is responsible for the auditing engagement and its performance and for the report that is issued on behalf of the firm is called as:
- (a) Active partner
 - (b) Performing partner
 - (c) Engagement Partner
 - (d) Working Partner
18. Policies and procedures w.r.t human resources address which of the following issues
- (a) Recruitment
 - (b) Capabilities
 - (c) Competence
 - (d) All of above

19. Independence comprises

- | | |
|--------------------------|--------------------------------|
| (a) Independence by mind | (b) Independence in appearance |
| (c) Both (a) and (b) | (d) None of these |

20. If the professional becomes a witness where the part to litigation is his client, it will result in

- | | |
|-------------------------|--------------------------|
| (a) Self- review threat | (b) Advocacy threat |
| (c) Familiarity threat | (d) Self-interest threat |

21. If the professional who is preparing the books of accounts is also auditing the financial statements, it shall give rise to

- | | |
|------------------------|--------------------------|
| (a) Self-review threat | (b) Advocacy threat |
| (c) Familiarity threat | (d) Self-interest threat |

22. Engagement letter is

- (a) Always required when auditor is appointed
- (b) Always required when auditor is reappointed
- (c) Not always required when auditor is reappointed but except for certain exceptions
- (d) (a) and (C)

23. Which of the following is not element of quality control in an audit of financial statements

- (a) Leadership Responsibilities
- (b) Assignment of Engagement Team
- (c) Acceptance and Continuance of Client Relationship and Audit Engagements
- (d) Signing on Audit Report

24. Judging the significance of a matter requires _____ of the facts and circumstances.

- (a) objective analysis
- (b) subjective analysis
- (c) Both subjective and objective analysis
- (d) qualitative analysis

25. IESBA Code related to an audit of financial statements establishes which of the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements :
- (a) Integrity; (b) Objectivity;
(c) Professional competence and due care; (d) All of the above
26. Loan or guarantee to or from the concerned client is an example of –
- (a) Self-review threats (b) Self-interest threats
(c) Advocacy threats (d) Intimidation threats
27. When an auditor deals with shares or securities of the audited company is an example of :
- (a) Self-review threat (b) Self-interest threats
(c) Advocacy threats (d) Intimidation threats
28. _____ refers to an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.
- (a) Professional skepticism (b) Professional Judgment
(c) Integrity (d) Objectivity

ANSWERS

1	(c)	2	(d)	3	(d)	4	(b)	5	(a)	6	(d)	7	(b)
8	(a)	9	(c)	10	(d)	11	(b)	12	(c)	13	(c)	14	(a)
15	(c)	16	(c)	17	(c)	18	(d)	19	(c)	20	(b)	21	(a)
22	(d)	23	(d)	24	(a)	25	(d)	26	(c)	27	(c)	28	(a)



CASE STUDY MCQs

Case Study 1

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 the following questions:

1. Considering discussion about Sukanya and Sushant, which of the following statements seems most appropriate?
 - (a) The above discussion is irrelevant in context of proposed offer.
 - (b) The proposed offer should be accepted by firm. The engagement team may be headed by CA Sukanya for better coordination and results.
 - (c) The proposed offer should be accepted by firm. The engagement team may be headed by a different partner of the firm.
 - (d) The matter is too trivial to be reported by CA Sukanya to other partners of firm.

2. Keeping in view request of the company to be visibly associated with company's new services, identify which type of threat is being faced by audit firm.
- (a) Self-interest threat (b) Familiarity threat
(c) Self-review threat (d) Advocacy threat
3. The previous auditors, Walker & Co., have not replied to communication of Das & Co. Which fundamental principle of professional ethics is not followed by them?
- (a) Objectivity (b) Professional behaviour
(c) Professional competence and due care (d) Integrity
4. Das & Co. have failed to advise the company regarding audit of consolidated financial statements. Which fundamental principle of professional ethics is violated by Das & Co.?
- (a) Professional behaviour
(b) Integrity
(c) Objectivity
(d) Professional competence and due care
5. Which of the following statements is most appropriate regarding providing offer of work of IT services by auditors to the company?
- (a) Such offer may create a self-review threat.
(b) Such offer may create an advocacy threat.
(c) Such offer does not constitute any threat.
(d) Such offer may create self-review and advocacy threats.

Answer to Questions involving Case Studies 1

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

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

- (i) The audit engagement letter is sent by the client to auditor.
- (ii) 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.

Answers to Correct/Incorrect

- (i) **Incorrect:** As per SA 210 "Agreeing the Terms of Audit Engagements", the Audit engagement letter is sent by the auditor to his client.
- (ii) **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.