

INTERMEDIATE COURSE

PAPER – 5

AUDITING AND ETHICS

[RELEVANT FOR MAY, 2025 EXAMINATION AND ONWARDS]

BOOKLET ON CASE SCENARIOS



BOARD OF STUDIES

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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PREFACE

Under the New Scheme of Education and Training which began from 1st July, 2023, 30% of the examination assessment is by the way of Objective Type Questions at Intermediate and Final level. Therefore, to facilitate hands on practice for such type of questions, the BOS launched MCQ Paper Practice Portal on 1st July, 2023. This online portal carried independent MCQs as well as case scenario based MCQs both for conceptual clarity and practice of the students.

In continuation to this handholding initiative and to provide quality academic inputs to the students to help them grasp the intricate aspects of the subject, the Board of studies had brought forth subject-wise booklets on Case Scenarios at Intermediate and Final level. These booklets are meticulously designed to assist Chartered Accountancy (CA) students in their preparation of the CA course.

At the Intermediate level, the '**Booklet on Case Scenarios for Paper 5: Auditing and Ethics**' includes integrated case scenarios that cover Engagement and Quality Control Standards, Audit of items of financial statements, applicable regulatory frameworks and miscellaneous audits. This booklet assimilates practical audit situations, ensuring that students develop a comprehensive and application-based understanding of the subject. The case scenario-based MCQs presented in this booklet are designed to be application-oriented, requiring students to analyze facts, apply relevant Standards on Auditing, Regulations and guidelines, and arrive at the correct conclusions.

Each case scenario is followed by MCQs, along with correct answer and reason or hint for the same. These reasonings/hints are intended to help students recognize key concepts and identify areas requiring additional focus.

Students are strongly encouraged to first gain a thorough understanding of the topics covered in syllabus and study material before attempting the case scenario-based MCQs in this booklet. Achieving conceptual clarity will enable students to apply their knowledge effectively, refine their analytical and problem-solving abilities, and confidently approach their examinations with a strategic mindset.

We are confident that this booklet will prove to be a valuable asset in your preparation journey. We encourage students to immerse in the case scenarios, engage critically with the MCQs, and embrace the learning experience to excel in the CA Intermediate Examination.

**Best wishes for your studies and success in the CA Intermediate
Examination!**

CASE SCENARIO 1

Sunlight Ltd. is a company engaged in the manufacture of solar panels. It is one of the largest solar panel manufacturing companies in India. With over a decade of experience, the company has implemented projects across the length and breadth of the country in both commercial and residential sectors. For the F.Y. 2023-24, Singhania & Co., an LLP of Chartered Accountants was appointed as the statutory auditors of the company. The audit work for the F.Y. 2023-24 is on the verge of completion.

During the audit, one of the audit team members, Mr. Rishab, was asked by the engagement partner, to verify the ownership assertion of the inventories held by the company. To verify such assertion, Mr. Rishab asked the concerned official of the company to make arrangements for the attendance of the audit team at the physical inventory count being conducted by the company. Mr. Rishab was of the view that only by attending the physical inventory count, the ownership assertion with respect to inventory of the company can be checked. He discussed his view with another audit team member Ms. Soni who had a different point of view for such situation. According to her, the correct course of action in this regard is that Mr. Rishab should verify the purchase requisition, purchase order, receiving reports, vendor invoices, inventory records, payment file etc. as ownership assertion cannot be verified by attending the physical inventory count only.

Further, while verifying the creditors and purchases balances, Ms. Soni decided to check the creditors balance on sample basis with a sample size of 50 creditors as she was satisfied with the Internal Control Procedures applied for the same. She asked the management to provide the list of all the 550 creditors. For deciding the sample, she took the sampling interval of every 11th creditor balance and in this way created a sample size of 50 creditors balance for the purpose of audit.

During the audit, while verifying the share capital balance of the company, Mr. Rishab and Ms. Soni noticed that there has been no change in the share capital raised by the company. Ms. Soni was of the view that since there has

been no change in the share capital of the company, the audit team is not required to obtain any evidence with respect to the share capital balance. However, Mr. Rishab opined that they should obtain audit evidence even if there is no change in the company's capital structure during the year. According to him such evidence can be a written confirmation from the accounts manager.

Before finalising the audit report, the Engagement Partner asked Mr. Rishab to coordinate with the client for requesting written representation from the management of the company with respect to the management responsibilities and information provided by the management. Mr. Rishab did not accept the representation given by the management as the same contained a qualifying language to the effect that representations are made to the best of its knowledge and belief, which according to Mr. Rishab was not reasonable to accept.

Since the engagement partner was about to finalise and sign the audit report, Mr. Rishab and Ms. Soni were discussing the various requirements of assembly of the final audit file and the changes that can be made in the audit documentation during the final assembly process. According to Ms. Soni only changes of administrative nature can be made, like deleting superseded documentation, sorting, collating and cross-referencing working papers and changes like recalculation of depreciation etc. should not be made during such final assembly process.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. While verifying the inventory as asked by the engagement partner, which specific assertion can be best verified by following the specific audit procedure considered appropriate by Mr. Rishab?
 - (a) Rights and Obligations.
 - (b) Existence and condition.
 - (c) Valuation.
 - (d) Presentation & Disclosure.

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2. While selecting the sample for verification of creditors, which method of sampling has been applied by Ms. Soni?
 - (a) Stratified sampling.
 - (b) Haphazard sampling.
 - (c) Systematic sampling.
 - (d) Simple random sampling.
 3. What is the best course of action to be taken by Mr. Rishab for verifying the assertion with respect to the inventory of the company, as asked by the engagement partner?
 - (a) Mr. Rishab should attend the physical inventory count as the only audit procedure.
 - (b) Mr. Rishab should agree with Ms. Soni and follow the course of action as suggested by her.
 - (c) Mr. Rishab should ask the management to provide a written representation in this regard as it is a sufficient and appropriate audit evidence.
 - (d) Mr. Rishab should perform test count and inspection while attending the physical inventory count to verify the assertion as requested by the engagement partner.
 4. With respect to verification of the share capital balance of the company, which of the following is the most appropriate?
 - (a) The point of view of Ms. Soni is correct.
 - (b) The point of view of Mr. Rishab is correct.
 - (c) The point of view of Mr. Rishab is partly correct as written confirmation should be obtained from the Company Secretary.
 - (d) The point of view of Ms. Soni is partly correct as no evidence is required to be obtained if the same audit firm has conducted the audit of the previous year thereby verifying the closing balance of share capital in the previous year, which becomes the opening balance of the share capital for the year under audit.

5. Whether non-acceptance of the written representation by Mr. Rishab is correct?
- (a) The non-acceptance of written representation by Mr. Rishab is not correct as the management of the company has the sole discretion to decide as to which language is used or what limitations are imposed in the written representation provided to the auditor.
 - (b) The non-acceptance of written representation by Mr. Rishab is correct as it is not reasonable for the auditor to accept any qualifying language in the written representations given by the management.
 - (c) The non-acceptance of written representation by Mr. Rishab is correct as SA 580 requires the auditor to accept the written representation only if it is in the language as used in the letter of audit engagement.
 - (d) The non-acceptance of written representation by Mr. Rishab is not correct as it is reasonable for the auditor to accept such qualifying language 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.
6. Whether the view of Ms. Soni regarding assembly of the final audit file is correct?
- (a) View of Ms. Soni is not correct as changes which are administrative in nature, cannot be made in the audit documentation during the final assembly process.
 - (b) View of Ms. Soni is correct.
 - (c) View of Ms. Soni is not correct as changes in the form of recalculation of depreciation amount can be made in the audit documentation during the final assembly process.
 - (d) View of Ms. Soni is partly correct as during the final assembly process changes like deleting superseded documents cannot be made.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** Existence and condition.

Reason:

As per SA 501, by attending the physical inventory count conducted by the client organisation, the auditor can verify the existence and conditions with respect to the inventory of the company.

2. **Option (c)** Systematic sampling.

Reason:

Interval Sampling or Systematic Sampling is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval.

3. **Option (b)** Mr. Rishab should agree to Ms. Soni and follow the course of action as suggested by her.

Reason:

For verifying the ownership assertion i.e. rights of the entity over the inventory, the auditor should verify the purchase requisition, purchase order, receiving reports, vendor invoices, inventory records, payment file etc. Only by attending the physical inventory count, the auditor can verify the existence assertion and not the ownership assertion.

4. **Option (c)** The point of view of Mr. Rishab is partly correct as written confirmation should be obtained from the company secretary.

Reason:

In case there is no change in the share capital during the year, auditor should obtain a written confirmation/ representation from the Company Secretary that there were no changes to entity's capital structure during the year.

5. **Option (d)** The non acceptance of written representation by Mr. Rishab is not correct as it is reasonable for the auditor to accept such qualifying language 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.

Reason:

In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. 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.

- 6. Option (b)** View of Ms. Soni is correct.

Reason:

As per SA 230, changes may be made to the audit documentation during the final assembly process, if they are administrative in nature. Examples of such changes include deleting or discarding superseded documentation, sorting, collating and cross-referencing working papers, changes like recalculation of depreciation cannot be made at such stage.

CASE SCENARIO 2

Aditya & Co. LLP are the statutory auditors of Benuka Furniture Ltd., a company engaged in the manufacture of wide range of office furniture that suits various workspaces ranging from home offices to corporate environments. The audit team is headed by CA Aditya, being the engagement partner who is further assisted by 2 articled assistants namely Rohit and Mudit. Before starting the audit work of the company, CA Aditya briefed the engagement team about the client's business, the various audit procedures the team can perform and the Standard on Auditing that the team needs to be complied with while conducting the audit of this company. While such discussions were going on, Mudit showed no inclination towards understanding the business and business environment of the company. He was of the view that as a member of the audit team he needs to obtain an understanding about the audit procedures to be performed during the course of audit and not about the client's business.

Rohit was asked by CA Aditya to verify the trade receivables, loan and advances given by the company, amounting to ₹ 20 crore and ₹ 20 lakhs respectively. Rohit asked the concerned official of the company to provide him with the ageing of trade receivables. Rohit decided to send confirmation requests to debtors having balance as on the balance sheet date exceeding ₹ 5 lakhs. He further decided to request to the third party in the request letters to reply positively whether the balance in their books tallies with the balance mentioned in the request letters. Also, while verifying the balance of loans and advances given by the company, Rohit selected the sample for checking without following any structured approach though he made sure to avoid any conscious biasness or predictability. Thus, he made sure that all the individual balances constituting the total of loans and advances given by the company had a chance of selection.

While checking the balances of fixed assets, Mudit asked the concerned employee of the company to provide him with various documents related to all the fixed assets appearing as on the balance sheet date. He asked for the title deeds with respect to the building owned by the company and the purchase bills for assets purchased by the company. While asking for such documents from the client company, Mudit was of the view that as a member of the audit team he can force the employee of the company to provide him with the required documents.

Further with respect to the inventory of the company, Mudit performed the audit procedures to verify that any inventory balance as at the year end does not include any element of next financial year.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Whether the view of Mudit regarding obtaining understanding of the client business is correct?
 - (a) The view of Mudit is correct because as a member of the audit team, he needs an understanding only about the audit procedures to be performed by him.
 - (b) The view of Mudit is not correct because while conducting an audit, the understanding of business and business environment of the client whose audit is to be conducted is very important.
 - (c) The view of Mudit is partially correct because such understanding is required only for the engagement partner and not be the members of the audit team.
 - (d) The view of Mudit is not correct because such information forms a crucial part of the audit report to be issued at the end of the audit process.
2. Which type of confirmation requests Rohit decided to send the debtors for verification of balances of trade receivables?
 - (a) Negative confirmation.
 - (b) Positive confirmation.
 - (c) Exception letter.
 - (d) Written Representation.
3. Which sample selection methods has been opted by Rohit while verifying the loans and advances given by the company?
 - (a) Interval Sampling.
 - (b) Block Sampling.

- (c) Haphazard Sampling.
 - (d) Monetary Unit Sampling.
4. While verifying the inventory of the client company, which assertion is being verified by Mudit?
- (a) Cut-off assertion.
 - (b) Valuation assertion.
 - (c) Presentation & Disclosure assertion.
 - (d) Rights & Obligations assertion.
5. With respect to fixed assets, which assertion does Mudit want to check?
- (a) Valuation assertion.
 - (b) Presentation and Disclosure assertion.
 - (c) Rights and obligations assertion.
 - (d) Existence assertion.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** The view of Mudit is not correct because while conducting an audit, the understanding of business and business environment of the client whose audit is to be conducted is very important.

Reason

As per SA 315 understanding the entity and the environment in which it operates is very significant. It helps the auditor in planning the audit and in identifying areas requiring special attention. Gaining knowledge about client's business is one of the important principles in developing an overall audit plan. In fact, without adequate knowledge of client's business, a proper audit is not possible.

2. **Option (b)** Positive confirmation

Reason

As per SA 505, "External Confirmations", positive confirmation request is 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.

3. Option (c) Haphazard Sampling

Reason

Haphazard sampling has no structured approach, does not involve judgement and does not even use the random number tables.

4. Option (a) Cut Off assertion

Reason

While verifying the Cut off assertion with respect to balance sheet caption, the auditor verifies as to whether all assets and liabilities are reported in the appropriate period. For example, for inventory, auditor will verify whether inventory balance as at the year- end does not include any element of next financial year.

5. Option (c) Rights and obligations assertion

Reason

While checking the rights and obligations assertion with respect to assets the auditor will verify whether entity has the right to assets i.e. (whether the entity has ownership and legal title to assets) as at a given date.

CASE SCENARIO 3

Nath Shah & Associates is a firm of Chartered Accountants practicing in Delhi. The firm consists of two partners namely, CA Ajay Nath and CA Ria Shah. The Statutory audit team is generally headed by CA Ajay Nath and his team consists of three articled assistants and one qualified Chartered Accountant, CA Reshu. With respect to the audit work of 4 clients for which the audit team intends to start the audit work, CA Ajay discussed with the team members about the development of audit programmes for individual clients. One of the articled assistants, Mr. Sumit, was of the view that one single audit programme can be developed for all the 4 clients operating in different industries.

With respect to one of the clients namely, Saraswati Ltd., a labour intensive company, CA Ajay asked CA Reshu to compare the amount of wages paid by the company in the current year and last year. Also, she was asked to verify the relationship between the number of employees and wages paid in both the years by the company.

The audit firm started the audit of another client, namely, Sarthak Ltd. having maximum transactions in foreign currency. CA Ajay asked one of the team members, Mr. Rahul, to verify whether the calculations related to conversion of the foreign currency into local currency is proper or not.

While verifying the share issue transactions of one client, namely, Laxman Ltd., CA Reshu found that the company has issued sweat equity shares during the year under audit. She asked one of the articled assistants, Mr. Saurabh, to further verify whether the relevant provisions of the Companies Act 2013, have been complied by the company in this regard. Also, with respect to Sarthak Ltd., there was reduction of share capital during the year. Mr. Saurabh was asked by the engagement partner to verify the compliance of relevant provisions of the Companies Act, 2013 in this regard also. Mr. Saurabh was of the view that there is requirement of passing of Special Resolution by the respective company for both.

While starting the audit work of another client, Rintex Ltd., the audit team noticed that the company has its internal audit team. Mr. Sumit was of the view that the statutory audit team can use and rely on the work of the Internal

Auditors of the company and as such there is no requirement for the statutory audit team to perform audit procedures again as the internal audit team must have verified the financial transactions of the company in detail. Further, while verifying the expenses ledger, Mr. Sumit noticed that the company has implemented a system whereby the entries related to expenses incurred during the year can be entered into the accounting system by authorised personnels only. However, with respect to travelling expenses which constituted about 30% of the total expenses, the entries were made by employees who were not authorised to make such entries.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Is the view of Mr. Sumit with respect to the development of audit programme correct?
 - (a) Yes, the view of Mr. Sumit is correct as developing one audit programme for all the clients will avoid duplication of efforts of audit team.
 - (b) No, the view of Mr. Sumit is not correct as all the four clients operate in different industries and evolving one audit programme for all businesses is not practicable.
 - (c) Yes, the view of Mr. Sumit is correct as development of audit programme is not affected by the nature of client business.
 - (d) No, the view of Mr. Sumit is not correct as development of audit programme is not the responsibility of the audit team. The individual clients will develop their respective audit programmes.
2. With respect to Saraswati Ltd., Ms. Reshu was asked by CA Ajay to perform which kind of audit procedures?
 - (a) Substantive Analytical Procedures.
 - (b) Test of details.
 - (c) Test of transactions.
 - (d) Test of Controls.

3. Whether understanding of Mr. Saurabh regarding the passing of Special Resolution is correct?
 - (a) The understanding of Mr. Saurabh is partly correct as ordinary resolution is required in case of issue of sweat equity shares by the company though special resolution is required to be passed by the company in case of reduction of share capital.
 - (b) The understanding of Mr. Saurabh is partly correct as special resolution is required in case of issue of sweat equity shares by the company though ordinary resolution is required to be passed by the company in case of reduction of share capital.
 - (c) The understanding of Mr. Saurabh is correct as special resolution is required in case of issue of sweat equity shares by the company and reduction of share capital.
 - (d) The understanding of Mr. Saurabh is not correct as ordinary resolution is required in case of issue of sweat equity shares by the company as well as in case of reduction of share capital.
4. Is the view of Mr. Sumit correct with respect to using and relying on the work of the Internal Audit team of Rintex Ltd.?
 - (a) Yes, the view of Mr. Sumit is correct.
 - (b) No, the view of Mr. Sumit is not correct as the statutory audit team cannot use the work of the internal audit team of the client company.
 - (c) No, the view of Mr. Sumit is not correct as the statutory auditor has the sole responsibility for the audit opinion expressed.
 - (d) The view of Mr. Sumit is partly correct as the statutory audit team can use and rely on the work of the internal audit team if the same is agreed while signing the engagement letter.

5. Which kind of risk is noticed by Mr. Sumit with respect to entries related to travelling expenses entered into the accounting system of Rintex Ltd.?
- (a) Inherent Risk.
 - (b) Detection Risk.
 - (c) Control Risk.
 - (d) No risk is being noticed.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** No, the view of Mr. Sumit is not correct as all the four clients operate in different industries and evolving one audit programme for all businesses is not practicable.

Reason:

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.

2. **Option (a)** Substantive Analytical Procedures.

Reason:

The term analytical procedures means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. One of the examples of analytical procedures is comparing the entity's financial information with the information pertaining to prior periods.

3. **Option (c)** The understanding of Mr. Saurabh is correct as Special Resolution is required in case of issue of sweat equity shares by the company and reduction of share capital.

Reason:

As per Section 54 of the Companies Act, 2013, the issue of sweat equity shares should be authorised by a Special Resolution passed by the company. Also, as per requirements of section 66 which deals with

reduction of share capital, Special Resolution is required in case of reduction of share capital by the company.

4. **Option (c)** No, the view of Mr. Sumit is not correct as the statutory auditor has the sole responsibility for the audit opinion expressed.

Reason:

As per SA 610, the external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal audit function or internal auditors to provide direct assistance on the engagement.

5. **Option (c)** Control Risk.

Reason:

In accordance with SA 200, control risk 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.

CASE SCENARIO 4

DLP & Associates, a firm of Chartered Accountants, are in midst of conducting audit of Twist and Spin Limited. The company is in the business since last 15 years and have appointed DPL & Associates as their auditor for the first time for a term of 5 years beginning from financial year 2023-24. While identifying and assessing the risk of material misstatement at assertion level, the engagement team had assessed risk of material misstatement for revenues and trade receivables to be high.

The team is considering to send negative confirmation requests as sole substantive procedure to some business entities representing trade receivables appearing in the financial statements of the company. The company had made sales to these business entities in January, 2024. Such business entities are few and have quite large balances as on 31st March, 2024. However, team members are not on the same page regarding sending negative confirmation requests.

Besides considering sending confirmation requests, the engagement team has planned certain audit procedures pertaining to trade receivables. These procedures include:

1. Verification of invoices issued during the last 7 days of financial year 2023-24 to verify that goods have been despatched by the company.
2. Selection of a few invoices from the ageing report of the month March 2024 for verification of correctness of the billed amounts, to correct customers and on correct dates.
3. Preparation of schedule of movement of bad debts.
4. Review of the process of providing discounts to ensure that it is in accordance with company policy.

Another junior team member, S, observed that "Share Options Outstanding Account" reflected in the financial statements of the company. He started searching classification requirements of Schedule III of the Companies Act, 2013 in this regard.

The engagement team wants to ensure that only the inventories held by the company have been recorded in the financial statements and do not include

any inventories belonging to third parties. They are keen to verify completeness assertion for inventories. The team has planned the following audit procedures in this respect: -

1. Comparison of inventory turnover ratio of current period with previous years;
2. Vertical analysis of current period with previous years;
3. Comparison of budgetary expectations vis-à-vis actuals;
4. Performing purchase and sales cut-off tests.

During the course of audit, R, a team member concluded that company has followed a particular accounting policy for revenue recognition during year 2023-24 which is in accordance with Accounting Standards and applicable financial reporting framework, but it was not consistently applied in preceding period having an impact upon opening balances of trade receivables of current year 2023-24. R is confused regarding the possible implications on auditor's report on this issue.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. The engagement team members are not able to take decision on sending negative confirmation requests to some entities described in case scenario. Which of the following statements is in accordance with Standards on Auditing?
 - (a) It would be appropriate for engagement team to send negative confirmation requests to these business entities.
 - (b) It would be inappropriate for engagement team to send negative confirmation requests to these business entities.
 - (c) Sending negative confirmation requests depends upon auditor's professional judgment and Standards on Auditing do not spell out any confirmation requirements in this respect.
 - (d) Business entities are more likely to respond in case of disagreement. Therefore, sending negative confirmation requests always provides

better qualitative audit evidence as compared to other confirmation modes.

2. Which of the planned audit procedure(s) pertaining to trade receivables described in case scenario is/are not related to verification of "Completeness assertion"?
 - (a) 2 only.
 - (b) 2 and 3.
 - (c) 3 only.
 - (d) 1 and 3.
3. Guide team member S by selecting the correct option with respect to "Share Options Outstanding Account":
 - (a) It is required to be classified under head "Current liabilities".
 - (b) It is required to be classified under Shareholder funds under "Share Capital". Further, it is to be classified separately under "Paid up Share Capital".
 - (c) It is required to be classified under Shareholder funds under "Reserves & Surplus". Further, it is to be classified separately as such under "Reserves & Surplus".
 - (d) It is required to be classified under Shareholder funds under "Reserves & Surplus". However, it is shown as part of Capital Reserve. No Separate disclosure is mandated under Schedule III of the Companies Act, 2013.
4. Which of the planned audit procedures in relation to the inventories described in the case scenario is/are not in nature of analytical procedure(s)?
 - (a) 2 and 3.
 - (b) 3 only.
 - (c) 2 and 4.
 - (d) 4 only.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** It would be inappropriate for engagement team to send negative confirmation requests to these business entities.

Reason:

As per SA 505, "External Confirmations", the auditor shall not use negative confirmation requests as the sole substantive audit procedure to address an assessed risk of material misstatement at the assertion level unless all of the following are present:

- (i) The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate audit evidence regarding the operating effectiveness of controls relevant to the assertion;
- (ii) The population of items subject to negative confirmation procedures comprises a large number of small, homogeneous, account balances, transactions or conditions;
- (iii) A very low exception rate is expected; and
- (iv) The auditor is not aware of circumstances or conditions that would cause recipients of negative confirmation requests to disregard such requests.

In the given case, aforementioned conditions are not present.

2. **Option (c)** 3 only.

Reason:

Preparation of the schedule of movement of bad debts is pertaining to valuation assertion and all other procedures are related to completeness assertion.

3. **Option (c)** It is required to be classified under Shareholder Funds under "Reserves & Surplus". Further, it is to be classified separately as such under "Reserves & Surplus".

Reason:

Share Options Outstanding Account is required to be classified under "Reserve & Surplus" separately in accordance with requirements of Schedule III.

4. Option (d) 4 only.**Reason:**

Purchase and sales cut-off tests are not in the nature of analytical procedures.

CASE SCENARIO 5

Oval Services Ltd. appointed Rupa & Associates as the auditors for the financial year 2023-24. The auditors believe that an audit program is crucial in providing clear and comprehensive instructions for the tasks to be carried out, offering a total perspective of the work involved. This is particularly important for large audits, and as such, they prepared an initial audit program based on the company's organisational structure and effective internal controls. During the audit, CA Nitin, Engagement Partner identified issues with the company's debt management practices, prompting the inclusion of a more detailed review of the loan agreements. However, in his opinion the planned review of petty cash was unnecessary due to the company's policy of limiting cash transactions. Thus, review procedure was removed from the audit programme.

To verify the balances of trade payables, the auditor decided to send external confirmation requests to the creditors of the company. These requests were made to verify the balances as on 20th March, 2024, a date chosen deliberately to ensure the accuracy and completeness of the liabilities, free from any influence or prior knowledge of management. This approach was taken to maintain the integrity of the confirmation process. However, it was noted that M/s. Keshav Traders and M/s. Amrit Distributors did not respond to the confirmation requests.

Furthermore, the auditor noted that in the financial year 2023-24, the company's Property, Plant, and Equipment (PPE) was revalued, resulting in an increase of 5% in the net carrying value of its machinery from ₹ 10 lakh to ₹ 10.5 lakh.

Also, due to the significant compliance burden, company is considering to convert into a Limited Liability Partnership (LLP). Management views the LLP structure as a hybrid business model that combines the advantages of both companies and partnerships. Additionally, they believe this conversion would relieve them from mandatory audit requirements.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Whether audit team is correct in excluding the planned review of petty cash from the audit programme?
 - (a) No, as the audit programme should always include a petty cash review, regardless of company policy.
 - (b) Yes, as the company's internal controls and policy of limiting cash transactions reduce the need for a petty cash review in the audit programme.
 - (c) No, as the audit programme must cover all the areas of financial transactions, including petty cash, to ensure comprehensive auditing.
 - (d) Yes, as the audit programme should only focus on areas with high financial risk, and petty cash is not a high-risk area.
2. Whether the decision of auditor to send the confirmation request to the creditors of the company as on 20th March, 2024 justified?
 - (a) Yes, decision of the auditor is correct as the auditor is allowed to choose any date reasonably close to the balance sheet date for confirmation, and the selected date helps to ensure the accuracy of the liabilities without consultation from the management.
 - (b) No, decision of the auditor is not correct as the auditor should have sent the confirmation requests for the balance sheet date as this would accurately reflect the liabilities as on that date.
 - (c) Yes, decision of the auditor is correct as the auditor is allowed to choose any date which is reasonably close to the balance sheet date for confirmation, and the selected date should be decided in consultation with the management.
 - (d) No, decision of the auditor is not correct as confirmation should be asked within a week of the date of audit report.
3. Which of the following is not an appropriate procedure to verify the balances for M/s. Keshav Traders and M/s. Amrit Distributers?

-
- (a) Breaking down the balance into individual transactions and making sure they actually happened.
 - (b) Checking payments made after the year-end to vendors who didn't respond to confirmation requests.
 - (c) Comparing the balance to the original invoices from the vendors.
 - (d) Request a written representation from management confirming that all payables are accurately recorded and complete.
4. In the given case, is there any requirement for separate disclosure of the PPE revaluation?
- (a) Yes, separate disclosure is required due to the 5% increase in carrying value.
 - (b) No, separate disclosure is not required as the change in carrying value is less than 10%.
 - (c) Yes, separate disclosure is required regardless of the percentage change.
 - (d) No, separate disclosure is not required unless the revaluation results in a material change in the carrying value.
5. What is your perspective on the management's view regarding the audit requirements for an LLP?
- (a) An LLP is always required to conduct an audit, regardless of its turnover or capital contribution.
 - (b) An LLP is always required to conduct an audit if either the turnover exceeds ₹ 40 lakhs or the capital contribution exceeds ₹ 25 lakhs.
 - (c) An LLP is always required to conduct an audit if either the turnover exceeds ₹ 25 lakhs or the capital contribution exceeds ₹ 40 lakhs.
 - (d) An LLP is always required to conduct an audit if the capital contribution exceeds ₹ 25 lakhs and the turnover exceeds ₹ 40 lakhs.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** Yes, as the company's internal controls and policy of limiting cash transactions reduce the need for a petty cash review in the audit programme.

Reason:

To start with, an auditor having regard to the nature, size and composition of the business and the dependability of the internal control and the given scope of work, should frame a programme which should aim at providing for a minimum essential work which may be termed as a standard programme. As experience is gained by actually carrying out the work, the programme may be altered to take care of situations which were left out originally but are found relevant for the particular concern. Similarly, if any work originally provided for proves beyond doubt to be unnecessary or irrelevant, it may be dropped.

2. **Option (c)** Yes, decision of the auditor is correct as the auditor is allowed to choose any date which is reasonably close to the balance sheet date for confirmation, and the selected date should be decided in consultation with the management.

Reason:

The trade creditors may be requested to confirm the balances either (a) as at the date of the balance sheet, or (b) as at any other selected date which is reasonably close to the date of the balance sheet. The date should be decided by the auditor in consultation with the Company.

3. **Option (d)** Request a written representation from management confirming that all payables are accurately recorded and complete.

Reason:

Where no reply is received, the auditor should perform additional testing regarding the balances. This testing could include:

- ☐ Testing of subsequent payments in respect of the trade payables to whom confirmations were rolled out but no replies received;

- Agreeing the details of the respective balance to the underlying vendor invoices;
- Preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these purchases/expense transactions actually occurred.

4. **Option (b)** No, separate disclosure is not required as the change in carrying value is less than 10%.

Reason:

A reconciliation of the gross and net carrying amounts of each class of assets at the beginning and end of the reporting period showing additions, disposals, acquisitions through business combinations, amount of change due to revaluation (if change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant and Equipment) and other adjustments and the related depreciation and impairment losses/reversals shall be disclosed separately.

5. **Option (b)** An LLP is always required to conduct an audit if either the turnover exceeds ₹ 40 lakhs or the capital contribution exceeds ₹ 25 lakhs.

Reason:

The accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009. Such rules, inter-alia 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.

CASE SCENARIO 6

Shreyansh, a Chartered Accountancy student, is part of an engagement team conducting audit of the Coimbatore branch of XYZ Bank under the guidance of CA Dilip, the Engagement Partner. Shreyansh has been assigned the task of verifying provisions made for the branch's non-performing assets (NPAs) and classification of certain loans as on March 31, 2024, of which details are as under:

Non-Performing Assets (NPAs):

Name of Account	NPA classification	Outstanding amount as on March 31st, 2024 (In ₹ lakhs)	Amount of provision made (In ₹ lakhs)	Security Available
AB Industries	Doubtful (D1)	10.00	5.00	Fully secured
Mars Traders	Substandard asset	50.00	7.50	Fully secured
RS Enterprises	Doubtful (D2)	30.00	30.00	Fully secured
NPS & Sons	Loss	1.00	1.00	Only personal guarantee of proprietor (Net worth ₹ 50 lakhs)

Housing Loan and Car Loan

A borrower Mr. Shyam has availed following two loans from the branch:

- ◆ Housing Loan: EMIs are overdue for 120 days as on March 31, 2024.
- ◆ Car Loan: EMIs are overdue for 60 days as on March 31, 2024.

CA Dilip has clarified that the NPA classification has been verified and is in accordance with RBI guidelines. He instructed Shreyansh to focus on evaluating the adequacy of the provisions, considering RBI Guidelines mandate specific

percentages for provisioning based on the NPA classification and the nature of the security.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Is the provision made for AB Industries (Doubtful—D1) appropriate?
 - (a) Yes, as it exceeds the required 25% provisioning for secured assets.
 - (b) No, as it should be 40% of the outstanding amount.
 - (c) No, as the required provision is ₹ 2.50 lakhs (25% of ₹ 10.00 lakhs).
 - (d) Yes, as provisions for Doubtful assets can exceed the minimum requirement.
2. Considering the Housing Loan and Car Loan availed by the borrower Shyam, which of the following statements is appropriate?
 - (a) Both Housing Loan and 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. However, Car Loan should be classified as Standard Asset.
 - (c) Car Loan should be classified as “Non-Performing Asset.” However, Housing Loan should be classified as Standard Asset.
 - (d) Both Housing Loan and Car Loan should be classified as Standard Assets.
3. What is the minimum provision required for RS Enterprises (Doubtful—D2), considering the account is fully secured?
 - (a) ₹ 30.00 lakhs.
 - (b) ₹ 12.00 lakhs.
 - (c) ₹ 15.00 lakhs.
 - (d) ₹ 25.00 lakhs.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (c)** No, as the required provision is ₹ 2.50 lakhs (25% of ₹ 10.00 lakhs).

Reason:

Provision required for Doubtful assets up to 1 Year is 25% of secured amount.

2. **Option (a)** Both Housing Loan and Car Loan should be classified as "Non-Performing Assets" in accordance with RBI norms on asset classification.

Reason:

Car loan and Housing Loan both would be treated as an NPA because the NPA classification is Borrower wise and not Facility wise.

3. **Option (b)** ₹ 12.00 lakhs.

Reason:

Doubtful (D2) category requires provision of 40% of secured amount.

CASE SCENARIO 7

M/s MCP Associates are having 3 partners namely CA Mahavir, CA Chandana and CA Prabha. CA Mahavir is about to conclude audit of a company. During the audit, he noticed that there is a shortage of important raw material supplies being imported from China due to prevailing geopolitical 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. He also verified that all subsequent events have been accounted for and requested written representations from management, although the representations include qualifying language. Significant findings were communicated both orally and in writing to those charged with governance, with relevant communications documented.

CA Chandana is conducting an audit of a manufacturing company dealing in towels and bedspreads. The company's inventory is spread across its own locations and third-party premises. As part of audit procedures, she is performing many audit procedures required under different Standards on Auditing. She attends the physical inventory count, sends confirmation requests for trade receivables, and assesses controls. She relies on sampling extensively while auditing transactions, balances, and controls.

CA Prabha is auditing a firm's financial statements and performs detailed procedures to verify assertions. 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. She checks classification of expenses, ensures trade payables are genuine, compares current and past wages, examines title deeds for land, and check the accuracy of calculation of the conversion of foreign currency into Indian rupees for export invoices.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which of the following best describes CA Mahavir's responsibility for subsequent events as per SA 560?
 - (a) He has no obligation to perform audit procedures for events occurring between date of financial statements and date of auditor's report.
 - (b) He should perform necessary audit procedures to know about events occurring between the date of financial statements and date of auditor's report.
 - (c) He has no obligation to perform audit procedures after signing of auditor's report, even if he comes to know of an event, which if known to him earlier would have caused him to amend the audit report.
 - (d) He has to only rely upon written representation of management regarding subsequent events. He has no other means to know about such events.
2. Which is the most appropriate action CA Chandana should take for verifying inventories held at third-party premises?
 - (a) Request confirmation of the inventory's quantity and condition from third parties or inspect the inventory at their premises.
 - (b) Inspect all inventories at third-party premises without requesting confirmation.
 - (c) Rely on management's written representation regarding inventories at third-party locations.
 - (d) Confirm the inventory's value along with its quantity and condition from third parties.
3. Which audit procedure CA Prabha performed to verify whether conversion of foreign currency into Indian rupees is proper or not?
 - (a) Inspection.
 - (b) Recalculation.

- (c) Observation.
- (d) Reperformance.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** He should perform necessary audit procedures to know about events occurring between the date of financial statements and date of auditor's report.

Reason:

As per SA 560, "Subsequent Events", events occurring between the date of the financial statements and the date of the auditor's report and facts that become known to the auditor after the date of the auditor's report are known as subsequent events.

2. **Option (a)** Request confirmation of the inventory's quantity and condition from third parties or inspect the inventory at their premises.

Reason:

When inventory under the custody and control of a third party is material to the financial statements, the auditor shall request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity

3. **Option (b)** Recalculation.

Reason:

Recalculation consists of checking the mathematical accuracy of documents or records. It may be performed manually or electronically.

CASE SCENARIO 8

While auditing ANJ Industries Private Limited, CA J has decided that it would be appropriate to examine 100% of the items comprising turnover of ₹ 30 crores as reflected in its financial statements. For these transactions, he has designed tests of details. The sales function is automated in the company's information system involving repetitive nature of calculations. Further, in respect of designing of tests of controls pertaining to turnover, he is in a fix.

While verifying turnover of the company, CA J ensures that all the sales are correctly recorded in the books of accounts and discounts have been properly adjusted based on invoices. Similarly, in respect of verification of employee benefit expenses reflected in the financial statements, he ensured that TDS related adjustments are correctly reconciled and accounted for.

Ankush, a newly joined articled assistant under CA J, is also a part of the team assisting seniors. Although he has read about assertions, there remain several doubts about assertions in his mind. He noted down the following points about assertions as per his understanding:

1. Assertions are the representations made by the auditors.
2. Assertions are generally explicit and not implicit.
3. Verification of the assertions helps the auditor in finding out whether financial statements are in accordance with applicable financial reporting framework or not.

In normal course of business, the company also holds a part of goods as a consignee. While verifying assertions relating to inventories, he ensures that inventory held by the company as consignee of goods on behalf of third parties is excluded from inventories.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Based on CA J's approach in designing tests of details and tests of controls for sales, which of the following statements is the most appropriate?
 - (a) The approach for both designing tests of details and tests of controls is proper.
 - (b) The approach for designing tests of details is proper. However, it is an unlikely approach for tests of controls.
 - (c) The approach for designing tests of controls is proper. However, it is an unlikely approach for tests of details.
 - (d) The approach for designing tests of details as well as tests of controls is not proper.
2. Which assertion is CA J checking while verifying correctness of recording of sales based on invoices (including adjustment of discounts) and TDS adjustments for employee benefit expenses respectively?
 - (a) Measurement, Measurement.
 - (b) Completeness, Measurement.
 - (c) Existence, Measurement.
 - (d) Measurement, Completeness.
3. Considering the view of Ankush, which of the following(s) is/are false?
 - (a) 1 and 2.
 - (b) 1, 2 and 3.
 - (c) 1 only.
 - (d) 2 only.
4. As regards the matter of holding of certain inventories as consignee of goods, which type of assertion(s) is/are being verified by the auditor?
 - (a) Cut-off and Valuation.
 - (b) Completeness and Rights & Obligations.
 - (c) Completeness only.
 - (d) Rights & Obligations only.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** The approach for designing tests of details is proper. However, it is an unlikely approach for tests of controls.

Reason:

The auditor may decide that it will be most appropriate to examine the entire population of items that make up a class of transactions or account balance (or a stratum within that population). 100% examination is unlikely in the case of tests of controls; however, it is more common for tests of details.

2. **Option (a)** Measurement, Measurement.

Reason:

Transactions have been recorded accurately at their appropriate amounts in the financial statements are verified under 'Measurement' assertion. In the given case, the auditor is ensuring that sales are recorded correctly in the books on the basis of invoices and discounts have been properly adjusted or accounted for. In respect of employee benefit expenses, he is verifying that any adjustments such as tax deduction at source have been correctly reconciled and accounted for.

3. **Option (a)** 1 and 2.

Reason:

Assertions are representations by management and not by auditor. The assertions are generally implied and not specifically spelt out. In representing that the financial statements are in accordance with the applicable financial reporting framework, management makes assertions, which are verified by auditor.

4. **Option (b)** Completeness and Rights & Obligations.

Reason:

All assets, liabilities and equity balances that were supposed to be recorded have been recognised in the financial statements is covered under Completeness assertion. Further, entity has the right to assets i.e.

(whether the entity has ownership and legal title to assets) is covered under Rights and Obligation Assertion. In the given case, the auditor ensures that the inventory held by the entity as a Consignee (on behalf of third party i.e. Consignor) is excluded and is covered under Completeness assertion. Whereas verification of the inventory held by the entity on behalf of another entity has not been recognised as part of inventory of the entity is Rights and obligation assertion.

CASE SCENARIO 9

Revanth, Manohar and Piyush are planning to set up a new business of trading electronic goods. They have heard in business circles that many entrepreneurs are setting up their organisations as Limited Liability Partnerships (LLPs). However, they are least knowledgeable about such legal structures. In this regard, they have decided to approach CA S through a mutual contact.

They want to understand the difference between a partnership firm, an LLP and a private company as well as legal provisions regarding number of partners allowed in an LLP and the paperwork involved in forming an LLP. Further, they also have doubts regarding maintenance of books of accounts and the audit requirement for such organisations. Revanth, being cost conscious, specifically asks CA S regarding requirement of audit of LLPs. During the discussion, he shares that they are expecting a turnover of ₹ 5 crores in the first year of their business and funds amounting to ₹ 50 lakhs would be brought by partners as their contribution.

Manohar is worried about the rules pertaining to the maintenance of accounts in a software having feature of audit trail. He has unambiguous idea of such rules to have become effective through social media handles. Additionally, he feels that such features are useful only for the auditors. CA S tries to brief them on these matters.

After resolving their doubts, they decided to constitute an LLP named Blitz Products LLP with the professional assistance of CA S, who helped them in completing the necessary paper formalities. After constituting an LLP, they shifted their energies towards running their business. They acquired dealerships of few reputed companies and received a good response from market due to prominent location of their showroom and are confident of achieving their turnover expectation within the first year of business.

They plan to get their accounts audited after closure of the financial year 2023-24 from CA S. The finance and accounts function of business is being seen by Piyush and he plans to contact him somewhere around August 2024 for getting audit of financial statements conducted, filing income tax return and making necessary regulatory compliances on behalf of LLP.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which of the following is correct regarding the difference in types of organisational structures and connected matters?
 - (a) LLP gives the benefit of flexibility of limited liability of a partnership and good governance of a company. A minimum of two individuals are required to form an LLP and at least 2 partners are required to obtain DIN. The regulatory authority in the case of LLPs is the Registrar of firms of the respective state where the LLP is located.
 - (b) LLP gives the benefit of limited liability of a company and flexibility of partnership. A minimum of two individuals are required to form an LLP and at least 2 partners are required to obtain DPIN. The regulatory authority in the case of LLPs is the Registrar of Companies (ROC).
 - (c) LLP gives the benefits of limited liability of a company and flexibility of partnership. A minimum of two individuals are required to form an LLP and at least 2 partners are required to obtain DIN. The regulatory authority in the case of LLPs is the Registrar of Companies (ROC).
 - (d) LLP gives the benefits of limited liability of a company and flexibility of partnership. A minimum of three individuals are required to form an LLP and at least 2 partners are required to obtain DPIN. The regulatory authority in the case of LLPs is the Registrar of Companies (ROC).
2. In the above case scenario, what guidance would CA S have likely provided to Revanth regarding audit of financial statements of LLP?
 - (a) There is no provision for compulsory audit of LLPs under the LLP Act, 2008 and relevant rules. However, partners may choose to get accounts audited due to advantages associated with an audit.
 - (b) Every LLP is compulsorily required to get its accounts audited under the LLP Act, 2008 and relevant rules.

- (c) There exist provisions under the LLP Act, 2008 and relevant rules for audit of LLPs based upon twin criteria of turnover and contribution thresholds. However, the proposed business doesn't meet thresholds and would not be required to get its accounts audited.
 - (d) There exist provisions under the LLP Act, 2008 and relevant rules for audit of LLPs based upon twin criteria of turnover and contribution thresholds. The proposed business meets thresholds and would be required to get its accounts audited.
- (3) Which of the following statement is correct regarding Manohar's point of view?
- (a) Audit trails are useful only for auditors. However, maintenance of accounts in a software having feature of audit trail is not compulsory for LLPs.
 - (b) Audit trails are useful for businesses as well as auditors. However, maintenance of accounts in a software having feature of audit trail is not compulsory for LLPs.
 - (c) Audit trails are useful for businesses as well as auditors. Maintenance of accounts in a software having feature of audit trail is compulsory for LLPs.
 - (d) Audit trails are useful for businesses as well as auditors. Maintenance of accounts in a software having feature of audit trail is compulsory for LLPs having certain turnover thresholds.
4. Which of the following statement is correct regarding Piyush's plan?
- (a) Auditor is required to be appointed at least 30 days prior to March 31st, 2024. Therefore, Piyush's plan to approach CA S is not in accordance with the relevant rules and regulations.
 - (b) Auditor is required to be appointed at least 60 days prior to March 31st, 2024. Therefore, Piyush's plan to approach CA S is not in accordance with the relevant rules and regulations.
 - (c) Auditor is required to be appointed at any time before March 31st, 2024. Therefore, Piyush's plan to approach CA S is not in accordance with the relevant rules and regulations.

- (d) Piyush's plan is proper and there are no specific provisions for appointment of auditor of an LLP in accordance with relevant rules and regulations.
5. Considering Piyush's plan to contact CA S in August 2024 for making necessary regulatory compliances. What would be its consequences for LLP?
- (a) Default by LLP in filing its annual return.
 - (b) Default by LLP in filing its Statement of Account and Solvency.
 - (c) Default by LLP in filing its annual return as well as Statement of Account and Solvency.
 - (d) No default by LLP in making necessary compliances.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** LLP gives the benefit of limited liability of a company and flexibility of partnership. A minimum of two individuals are required to form an LLP and at least 2 partners are required to obtain DPIN. The regulatory authority in the case of LLPs is the Registrar of Companies (ROC).

Reason:

LLP gives the benefits of limited liability of a company and flexibility of partnership. Minimum two persons are required to form an LLP. Further, at least 2 partners are required to take DPIN (Designated Partner Identification number). The regulatory authority in the case of LLPs is Registrar of Companies (ROC) and returns/forms are to be filed with ROC.

2. **Option (d)** There exist provisions under the LLP Act, 2008 and relevant rules for audit of LLPs based upon twin criteria of turnover and contribution thresholds. The proposed business meets thresholds and would be required to get its accounts audited.

Reason:

The accounts of every LLP shall be audited in accordance with Rule 24 of LLP, Rules 2009. Such rules, inter-alia, 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. Other LLPs are required to get their accounts audited.

3. **Option (b)** Audit trails are useful for businesses as well as auditors. However, maintenance of accounts in a software having feature of audit trail is not compulsory for LLPs.

Reason:

Audit trails (or audit logs) act as record-keepers that document evidence of certain events, procedures or operations, because their purpose is to reduce fraud, material errors, and unauthorised use. Audit trails help to enhance internal controls and data security. Systems which have a feature of audit trail inspire confidence in auditors. It helps auditors in verifying whether controls devised by the management were operating effectively or not. Therefore, audit trails are used for businesses as well as auditors. However, maintenance of accounts in a software having feature of audit trail is not compulsory for LLPs.

4. **Option (c)** Auditor is required to be appointed at any time before March 31st, 2024. Therefore, Piyush's plan to approach CA S is not in accordance with the relevant rules and regulations.

Reason:

The auditor may be appointed by the designated partners of the LLP at any time for the first financial year but before the end of first financial year.

5. **Option (a)** Default by LLP in filing its annual return.

Reason:

Every LLP would be required to file annual return in Form 11 with ROC within 60 days of closure of financial year. Every LLP is also required to submit a Statement of Account and Solvency in Form 8 which shall be filed within a period of thirty days from the end of six months the financial year to which the Statement of Account and Solvency relates. Therefore, plan to visit CA S in August 2024 could lead to default by LLP in filing its annual return.

CASE SCENARIO 10

Vama & Associates were appointed as auditors for Royal Constructions Ltd. for the financial year 2023-24. During the audit, the auditors observed a significant amount of work-in-progress inventory. Instead of attending the physical inventory count, they relied on alternative procedures. These included reviewing production reports, reconciling them with recorded inventory levels, and analysing variance trends to assess the accuracy of the work-in-progress balance.

The auditor also noticed that the company has obsolete inventory of ₹ 1,75,000, which had an estimated realisable value of ₹ 50,000, and the company has valued it at cost in its financial statements.

During the review of Property Plant and Equipment (PPE), the audit team noted that the company included ₹ 1,05,000 for employee benefits related to the acquisition of PPE and ₹ 1,25,000 for testing the functionality of the equipment, offset by ₹ 35,000 received from the sale of samples produced during testing.

Vama & Associates derive a significant portion of their income from Royal Constructions Ltd., amounting to ₹ 10,00,000, which represents 65% of their total annual revenue. Despite finding financial discrepancies of ₹ 3,00,000 in the company's accounts, the partners decided to overlook these issues to maintain their lucrative relationship with the client.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Royal Constructions Ltd. should value the obsolete inventory at:
 - (a) ₹ 50,000.
 - (b) ₹ 1,25,000.
 - (c) ₹ 1,75,000.
 - (d) It should be written off completely.

2. What amount should be included in the cost of PPE in the financial statements of Royal Constructions Ltd.?
- (a) ₹ 1,95,000.
 - (b) ₹ 2,30,000.
 - (c) ₹ 2,65,000.
 - (d) ₹ 1,05,000.
3. What potential threat to the independence of Vama & Associates arises from receiving fees of ₹ 10,00,000 from Royal Constructions Ltd.?
- (a) Self-interest Threat.
 - (b) Self-review Threat.
 - (c) Intimidation Threats.
 - (d) Familiarity Threats.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (a)** ₹ 50,000.

Reason:

The auditor should follow up valuation of all damaged or obsolete inventories noted during observance of physical counting with a view to establishing a realistic net realisable value.

2. **Option (a)** ₹ 1,95,000.

Reason:

Directly attributable costs in the Property, Plant and Equipment includes costs of employee benefits (as defined in AS 15, Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment; costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition.

3. Option (a) Self-interest Threat.**Reason:**

Self-interest Threats occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include (i) direct financial interest or materially significant indirect financial interest in a client (ii) loan or guarantee to or from the concerned client (iii) undue dependence on a client's fees and, hence, concerns about losing the engagement (iv) close business relationship with an audit client (v) potential employment with the client and (vi) contingent fees for the audit engagement.

CASE SCENARIO 11

Ekum & Associates is a firm of Chartered Accountants practicing in Delhi. The firm has been appointed as the statutory auditors of Energy Synergy Ltd. The company is engaged in the manufacture of energy equipment and related systems.

At the time of starting the audit work of the company, CA Ekum, the engagement partner, reviewed the Gross Profit Ratio of the company for the year under audit. He also compared GP ratio of Energy Synergy Ltd. with the other companies operating in similar industry. During the audit, Mr. Sachin, one of the team members, was asked by CA Ekum to verify the expenditure incurred on PPE to analyse whether the cost of an item of PPE is recognised as an asset only when such cost meet the criteria as specified in AS 10. Mr. Sachin is of the view that the cost of an item of PPE comprises the following:

- ◆ Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- ◆ Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
- ◆ Costs of introducing a new product or service (including cost of advertising and promotional activities).
- ◆ Administration and other general overhead costs.

Mr. Sachin was also asked by CA Ekum to verify various assertions related to sales transactions of the company during the year. Before conducting detailed testing of sales transactions, Mr. Sachin decided to evaluate the internal control system implemented by the company with respect to sales transactions. For this, he gave a comprehensive series of questions concerning the internal control related to sales to the client and requested the client to get it filled by the concerned executive.

While verifying sales transactions, Mr. Sachin carried out various audit procedures, specifically to confirm whether the recorded sales pertained to

goods ordered by valid customers, duly despatched, and invoiced during the audit period.

Mr. Sachin also noticed that one of the internal controls implemented by the company for sales transactions was segregation of duty that is the person who checks the credit limit, the person who authorises the sales order, the person who raises the sales invoices, the person who collects and records the amounts received from debtors are different. However, he noticed that this segregation of duties was often not followed in practice. He concluded that the lack of proper segregation gives rise to specific risks that need to be addressed and discussed with the company's management.

While verifying the trade receivable balance, Mr. Sachin decided to test such balance on sample basis. For deciding the sample selection, he divided the trade receivable balance into 4 groups as follows:

- (a) balance is in excess of ₹ 20,00,000.
- (b) balances in the range of ₹ 12,50,001 to ₹ 20,00,000.
- (c) balances in the range of rupees ₹ 7,50,001 to ₹ 12,50,000.
- (d) balances equal to ₹ 7,50,000 and below.

From the above groups, Mr. Sachin picked up different percentage of items to be examined in detail according to his professional judgment.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which audit procedure did CA Ekum perform at the time of starting the audit work of the company?
 - (a) Reperformance.
 - (b) Analytical Procedure.
 - (c) Inquiry.
 - (d) Recalculation.

2. Whether the view of Mr. Sachin with respect to recognition of cost of PPE correct?
 - (a) View of Mr. Sachin is correct.
 - (b) View of Mr. Sachin is partially correct as the purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates will not be included in the cost of PPE.
 - (c) View of Mr. Sachin is partially correct as the cost of introducing a new product or service and administration and other general overhead costs will not be included in the cost of PPE.
 - (d) View of Mr. Sachin is partially correct as any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management will not be included in the cost of PPE.
3. Which method is followed by Mr. Sachin for evaluating the internal control for the sales transactions?
 - (a) Check list.
 - (b) Narrative record.
 - (c) Internal Control Questionnaire.
 - (d) Flow Chart.
4. Which specific assertions did Mr. Sachin intend to verify while performing various audit procedures for sales transactions?
 - (a) Occurrence.
 - (b) Completeness.
 - (c) Measurement.
 - (d) Presentation & Disclosure.
5. Mr. Sachin concluded that a specific risk is present that needs to be addressed and discussed with the management of the company. Which kind of risk is Mr. Sachin referring to?
 - (a) Detection Risk.
 - (b) Audit Risk.

- (c) Inherent Risk.
 - (d) Control Risk.
6. Which sample selection method is used by Mr. Sachin to select sample of trade receivable balance for examination?
- (a) Haphazard Sampling.
 - (b) Monetary unit sampling.
 - (c) Stratified Sampling.
 - (d) Interval Sampling.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** Analytical Procedure.

Reason:

The term analytical procedures mean evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. One of the examples of analytical procedures is comparing the entity's financial information with the information pertaining to prior periods and other companies in similar industry.

2. **Option (c)** The view of Mr. Sachin is partially correct as the cost of introducing a new product or service and administration and other general overhead costs will not be included in the cost of PPE.

Reason:

Examples of costs that are not costs of an item of property, plant and equipment are:

- (i) costs of opening a new facility or business, such as, inauguration costs;
- (ii) costs of introducing a new product or service (including costs of advertising and promotional activities);
- (iii) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and administration and other general overhead costs.

3. **Option (c)** Internal Control Questionnaire.

Reason:

Internal Control Questionnaire is a comprehensive series of questions concerning internal control. This is the most widely used form for collecting information about the existence, operation and efficiency of internal control in an organisation. With a proper questionnaire, all internal control evaluation can be completed at one time or in sections.

4. **Option (a)** Occurrence.

Reason:

While verifying occurrence assertion, auditor verifies whether transactions recognised in the financial statements have occurred and relate to the entity.

5. **Option (d)** Control Risk.

Reason:

Control risk is a risk that internal control existing and operating in an entity would not be efficient enough to stop from happening, or find and then rectify in an appropriate time, any material misstatement relating to a transaction, balance of an account or disclosure required to be made in the financial statements of that entity. Segregation of duties is one of the internal controls implemented by the company with respect to the sales transactions.

6. **Option (c)** Stratified Sampling.

Reason:

Stratified Sampling method involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and if proportionate items are selected from each of these strata. The number of groups into which the whole population has to be divided is determined on the basis of auditor judgment.

CASE SCENARIO 12

CA J is nearing completion of audit of Cheap Cost Private Limited, a manufacturing company for the year 2023-24. The draft financial statements of the company show a profit before tax of ₹ 5 crores. Materiality for financial statements as a whole has been determined @ 5% of Profit before Tax. At the end of June 2024, he is considering following issues flagged during the course of audit which remain uncorrected:

- A fire took place in one of the premises of the company on 1st May, 2024 resulting in damages to all the inventories lying there amounting to ₹ 1 crores. The inventories of affected premises are insured with Quick Bima Limited for ₹ 50 lakhs and the company has also lodged a claim with it which is still to be settled.
- The company has debited ₹ 10 lakhs under "Machinery Account" whereas expenditure relates to normal wear and tear of high-speed automated machinery. The amount has been wrongly capitalised under "Machinery account". (Ignore depreciation effect).
- The company has not properly accounted for the necessary elements of cost in arriving at work in progress. Further, estimates regarding various stages of production have not been made properly. All such factors have resulted in overstatement of work in progress inventories by ₹ 20 lakhs.

No other issues except as stated above merit attention. Besides, written representation letter has also been obtained on matters concerning management's responsibilities regarding fulfilment of responsibilities for preparation of financial statements and providing access to all information to CA J. However, the written representation provided to CA J begins in the below stated manner:

"This representation letter is provided in connection with your audit of the financial statements of Cheap Cost Private Limited for the year ended March 31, 2024, for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the applicable accounting standards in India.

We confirm that (to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves)"

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which of the following statements is most appropriate as regards to the fire incident?
 - (a) The auditor should ask management to adjust financial statements for period under audit and book a loss of ₹ 50 lakhs in its Statement of Profit and Loss.
 - (b) The auditor should ask management to adjust financial statements for period under audit and book a loss of ₹ 1 crores in its Statement of Profit and Loss.
 - (c) The auditor should ask management to disclose it in notes to accounts.
 - (d) The auditor has no responsibility regarding described fire incident.
2. Identify the correct option regarding materiality of uncorrected misstatements relating to wrong capitalisation under "Machinery Account" and overstatement of inventories of work in progress.
 - (a) The uncorrected misstatements are not material in context of audit of financial statements as a whole as these are below materiality level determined by auditor.
 - (b) The uncorrected misstatements are material in context of audit of financial statements as a whole and their effect on opinion should be considered by auditor.
 - (c) The uncorrected misstatements are not material in context of audit of financial statements as a whole as these are in nature of management's judgment.
 - (d) The uncorrected misstatements are material in context of audit of financial statements as a whole and auditor should correct these.

3. The auditor has performed certain audit procedures described in case scenario relating to inventories of work in progress. Such procedures are related to verification of _____ assertion.
 - (a) Completeness.
 - (b) Valuation.
 - (c) Existence.
 - (d) Rights and obligations.
4. Which of the following statements is correct in respect to manner of providing written representations by management?
 - (a) The extract of written representations provided in case scenario is proper.
 - (b) The use of words "having made such enquiries" is not permitted.
 - (c) The use of words "to the best of our knowledge and belief" is not permitted.
 - (d) The use of both kind of words "having made such enquiries" and "to the best of our knowledge and belief" is not permitted.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (c)** The auditor should ask management to disclose it in notes to accounts.

Reason:

As per SA 560, "Subsequent Events", events occurring between the date of the financial statements and the date of the auditor's report and facts that become known to the auditor after the date of the auditor's report are known as subsequent events. Such events include those events that provide evidence of conditions that arose after the date of the financial statements and may significantly impact the company's financial position, the auditor should ensure that the event is adequately disclosed in the notes to accounts in the financial statements.

2. **Option (b)** The uncorrected misstatements are material in context of audit of financial statements as a whole and their effect on opinion should be considered by auditor.

Reason:

As per SA 450, "Evaluation of Misstatements Identified during the Audit", uncorrected misstatements refer to those misstatements that the auditor has accumulated during the audit and that have not been corrected. The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate.

In the given case, the misstatement of ₹ 10 lakh is material in aggregate with misstatement related to overstatement of work in progress (₹ 20 lakh) as both together are more than 5% of PBT (i.e., ₹ 25 lakhs). Further, the misstatement of ₹ 40 lakh is material individually and is required to be considered separately.

3. Option (b) Valuation.**Reason:**

As per the Valuation Assertion, the auditor should ensure that inventories have been VALUED appropriately and as per generally accepted accounting policies and practices. For WIP, the auditor should ascertain:

- how the various stages of production/ value additions are measured and in case estimates are made, understand the basis for such estimates and
- what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity.

4. Option (a) The extract of written representations provided in case scenario is proper.**Reason:**

In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief.

CASE SCENARIO 13

MPM & Associates, a firm of Chartered Accountants, have received offer letter from PST Bank for carrying out statutory audit of their Chandigarh branch for the financial year 2023-24. The offer letter, inter alia, requests audit firm to give an undertaking in writing that the firm is not disqualified under Section 141(3)(d)(ii) of the Companies Act, 2013. Such a provision relates to the disqualification of a person as auditor of a company if he, his relative or partner is indebted to the company subject to certain prescribed conditions. Before accepting the said audit, the firm checks out whether it complies with law requirements. However, there is a difference of opinion among firm personnel whether such an undertaking can be given in the case of banks.

The offer letter also contains the following declaration to be signed by the auditors in case they choose to accept the appointment:

"We declare that we will not communicate or allow to be communicated to any person, not legally entitled thereto, any information relating to the affairs of PST Bank or to the affairs of the person having any dealing with the Bank, nor will we allow any such person to inspect or have access to any books or documents belonging to or in possession of the Bank relating to the business of any person having any dealing with the Bank."

The audit firm has also received a document kit provided by Statutory Central Auditors of Bank. It relates to scope of audit, areas of special consideration while performing audit and requires an audit firm to confirm certain matters like adherence to RBI Master Circulars for income recognition, asset classification & provisioning and adequacy of checking of books of accounts based on sample etc. to them by way of a letter.

The document kit received also requires MPM & Associates to consider adverse comments made by stock auditors of borrowers enjoying cash credit facilities in their reports for purpose of reporting. It also contains specific instructions to check foreign letters of credit (FLCs) issued during the year in compliance with sanction terms of the respective borrowers and to verify income recognised in respect of FLCs.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which of the following statements is likely to be most appropriate regarding required undertaking in accordance with the Companies Act, 2013?
 - (a) The referred provision mainly addresses self-interest threats to independence of auditors. The audit firm can give such an undertaking after verifying if it complies with such requirements.
 - (b) The referred provision mainly addresses self-review threats to independence of auditors. The audit firm can give such an undertaking after verifying if it complies with such requirements.
 - (c) The referred provision mainly addresses self-interest threats to independence of auditors. However, the audit firm can't give such an undertaking as such provisions are applicable to companies and not to banks.
 - (d) The referred provision mainly addresses self-review threats to independence of auditors. However, the audit firm can't give such an undertaking as such provisions are applicable to companies and not to banks.
2. The declaration relating to non-communication of information related to affairs of Bank is related to adherence to which fundamental principle governing professional ethics?
 - (a) Objectivity.
 - (b) Confidentiality.
 - (c) Independence.
 - (d) Professional Competence and due care.
3. MPM & Associates are required to report on adverse comments made by stock auditors of borrowers of branch enjoying cash credit facilities. Which of the following statement is most appropriate in this regard?
 - (a) Stock auditors make comments in their reports on valuation of security and calculation of drawing power.

- (b) Stock auditors make comments in their reports on valuation of security only. However, no comments are made on calculation of drawing power.
 - (c) Stock auditors make comments in their reports on valuation of security, documentation made by bank in respect of sanctioned credit facilities, leakage of revenue and calculation of drawing power only.
 - (d) Stock auditors make comments in their reports on calculation of drawing power only.
4. Keeping in view the matter of foreign letters of credits (FLCs) described in case scenario, consider following statements: -
- 1. Foreign letter of credit issued by branch is a non-funded loan.
 - 2. Branch earns interest on issuance of foreign letter of credit which is credited in interest earned account of profit and loss account of branch.
 - 3. The bank which receives foreign letter of credit is known as beneficiary bank.

Which of following statement(s) is/are true?

- (a) Only statement 1 is correct.
- (b) Only statements 1 and 3 are correct.
- (c) Only statements 1 and 2 are correct.
- (d) Only statements 2 and 3 are correct.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (a)** The referred provision mainly addresses self-interest threats to independence of auditors. The audit firm can give such an undertaking after verifying if it complies with such requirements.

Reason:

Self-interest threats to independence occur when an auditor takes loan from a client. The provisions in the Companies Act, 2013 address self-

interest threats. Besides, the provisions of the Companies Act, 2013 are also applicable to banks so far as these are not inconsistent with provisions of the Banking Regulation Act, 1949. The audit firm can give such an undertaking.

2. Option (b) Confidentiality.

Reason:

Confidentiality principle requires a professional accountant to respect the confidentiality of information acquired as a result of professional or business relationships.

3. Option (a) Stock auditors make comments in their reports on valuation of security and calculation of drawing power.

Reason:

Stock auditors are required to make comments in their reports on valuation of security and calculation of drawing power.

4. Option (a) Only statement 1 is correct.

Reason:

Letter of credit is a non-funded facility. Bank earns commission/charges on it which are credited in "other income" in Profit and loss account. The bank receiving letter of credit is known as Advising bank. Therefore, only Statement 1 is correct.

CASE SCENARIO 14

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

- (i) Central Government as part of 'Make in India' initiative. However, the guarantee was not invoked, and the advances were overdue by 95 days. These advances were classified as standard assets and were regarded as NPA for income recognition purpose.
- (ii) State Government as part of power generation initiative. However, the guarantee was not invoked, and the advances were overdue by 80 days. These advances were also classified as standard assets and were regarded as NPA for income recognition purpose.

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

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

Also, the outstanding balance in one of the Loan accounts was ₹ 25 Lakh and the realisable value of the security as assessed by the bank / approved valuers was ₹ 2.25 Lakh. Bank identified the same as erosion in the value of

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

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. With respect to the overdraft facility sanctioned to Times Ltd., the account would be termed as out of order if:
 - (i) The outstanding balance remains continuously in excess of ₹ 75 Lakh.
 - (ii) The outstanding balance remains continuously in excess of ₹ 50 Lakh.
 - (iii) The outstanding balance in the account is less than ₹ 75 Lakh but there are no credits or payments deposited into the account continuously for 90 days as on balance sheet date.
 - (iv) The outstanding balance is less than ₹ 50 Lakh.Choose the correct option from below:
 - (a) (i), (ii) and (iii).
 - (b) (i), (iii) and (iv).
 - (c) (ii),(iii) and (iv).
 - (d) (iii) and (iv).
2. Which of the treatment by the bank on the provisioning and income recognition is correct in case of bank guarantee given by the Central Government and State Government?
 - (a) Both (i) and (ii) are correct.
 - (b) Only (ii) is correct.

- (c) Only (i) is correct.
 - (d) Both (i) and (ii) are incorrect.
3. In the given case, drawing power of the borrower XYZ Limited should be:
- (a) ₹ 86.25 Lakh.
 - (b) ₹ 76.35 Lakh.
 - (c) ₹ 96.25 Lakh.
 - (d) ₹ 85.45 Lakh.
4. The bank has identified an erosion in the value of security and made provision for doubtful assets. Whether the treatment by bank for the doubtful asset is correct?
- (a) Yes. The security should be classified under doubtful category. It may be either written off or fully provided by the bank.
 - (b) No. The existence of such security should be ignored, and the asset should straight away be classified as loss asset. It may be either written off or fully provided by the bank.
 - (c) Yes. The security should be classified under doubtful category and provisioning should be made as applicable for doubtful assets.
 - (d) No. The existence of the security should be ignored, and the asset should straight away be classified as loss asset. Provisioning should be made for doubtful assets.
5. The Statutory Central Auditors of a bank must furnish, in addition to the main audit report, various other audit reports. From the options, choose the audit reports that M/s. Vishwacharya and Associates shall furnish:
- (i) Long Form Audit Report.
 - (ii) Report on compliance with SLR Requirements.
 - (iii) Report on Treasury Operations – as per RBI guidelines.
 - (iv) Report on compliance as per Ghosh committee recommendations.
 - (v) Report on adverse credit - lending ratio in the rural areas.
- Choose the correct answer:
- (a) (i), (ii), (iii), (iv) and (v).

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

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (a)** (i), (ii) and (iii).

Reason:

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, these accounts should be treated as 'out of order'.

2. **Option (c)** Only (i) is correct.

Reason:

In case of Central Government guaranteed advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets but regarded as NPA for Income Recognition purpose. The situation would be different if the advance is guaranteed by State Government, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

3. **Option (a)** ₹ 86.25 Lakh.

Reason:

Particulars	Amount (₹ In lakhs)
Value of stocks (as on 31.12.2023)	130.00
Less: Value of damaged stocks	(7.00)

	123.00
Less: Creditors for goods (as on 31.12.2023)	(60.00)
Value of paid stocks	63.00
Less: Margin @25%	(15.75)
Drawing power (A)	47.25
Value of Debtors (as on 31.12.2023)	75.00
Less: Debtors exceeding 90 days	(10.00)
	65.00
Less: Margin @ 40%	(26.00)
Drawing power (B)	39.00
Drawing power (A+B)	86.25

4. **Option (b)** No. The existence of such security should be ignored, and the asset should straight away be classified as loss asset. It may be either written off or fully provided by the bank.

Reason:

- (i) Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50 per cent of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straight-away classified under doubtful category and provisioning should be made as applicable to doubtful assets.
- (ii) If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10 per cent of the outstanding in the borrowal accounts, the existence of security should be ignored, and the asset should be straight-away classified as loss asset. It may be either written off or fully provided for by the bank.

5. **Option (b)** Only (i), (ii), (iii) and (iv).

Reason:

The Statutory Central Auditors are not required to furnish Report on adverse credit - lending ratio in the rural areas along with the main audit report.

CASE SCENARIO 15

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

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

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

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

- (ii) While designing a sample for verifying revenues of company as part of tests of details, engagement partner has determined "tolerable misstatement" for ₹ 5 Lakh in order to address the risk that aggregate of individual immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements. One of the newly joined engagement team members has little conceptual understanding of "tolerable misstatement" determined by engagement partner. He also has no idea of the effect of change in tolerable misstatement on sample size.

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

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. The auditors of company are in process of establishing audit strategy. Which of the following is not a relevant factor in establishing overall audit strategy in the given case scenario?
 - (a) Consideration of 5 branches which are audited by independent auditors.
 - (b) Consideration of wholly owned subsidiary company audited by another audit firm.
 - (c) Expected time of holding AGM in accordance with provisions of the Companies Act, 2013.
 - (d) Nature, timing and extent of planned procedures for cash and cash equivalents.
2. For Priority limited, which benchmark would the engagement partner most likely to use for setting materiality for the financial statements as a whole?
 - (a) A percentage of Revenue.
 - (b) A percentage of Total assets.
 - (c) A percentage of Profit before tax.
 - (d) A percentage of Total liabilities (excluding equity).
3. In the given case scenario, assume that the engagement partner has decided to increase tolerable misstatement to ₹ 10 Lakh while designing sample described. Select the correct statement.
 - (a) It would lead to decrease in sample size.
 - (b) It would lead to an increase in sample size.

- (c) It would have no effect on sample size.
 - (d) It is not possible to draw inference on sample size due to increase in tolerable misstatement.
4. While performing procedures on designed sample, the engagement team identified certain misstatements in selected sample and projected these to the entire population of revenues. According to the requirements of the Standards on Auditing, which statement is correct in this regard?
- (a) Anomalous misstatement is auditor's best estimate of misstatement in population.
 - (b) The projected misstatement plus anomalous misstatement, if any, is best estimate of misstatement in population.
 - (c) When projected misstatement exceeds tolerable misstatement, sample provides a reasonable basis for conclusion about tested population.
 - (d) When projected misstatement plus anomalous statement, if any, exceeds tolerable misstatement, sample provides a reasonable basis for conclusion about tested population.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (d)** Nature, timing and extent of planned procedures for cash and cash equivalents.

Reason:

Planned procedures for cash and cash equivalents are not a factor to be considered for establishing audit strategy. These form part of developing audit plan.

2. **Option (c)** A percentage of Profit before tax.

Reason:

As per SA 320, PBT is often used as a benchmark for profit making entities.

3. **Option (a)** It would lead to decrease in sample size.

Reason:

Increase in tolerable misstatement would lead to decrease in sample size as lower the tolerable misstatement, the larger the sample size needs to be.

4. **Option (b)** The projected misstatement plus anomalous misstatement, if any, is best estimate of misstatement in population.

Reason:

While performing procedures on designed sample the projected misstatement plus anomalous misstatement, if any, is the best estimate of misstatement in population. The effect of anomaly still needs to be considered in addition to projection of non-anomalous misstatements.

CASE SCENARIO 16

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

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

It is also noticed that a sum of ₹ 50 Lakh is reflected in Trust's financial statements in the name of Gamma Instrument and Equipment in schedule of creditors. The said amount has been outstanding for the last two years. The auditors sent confirmation requests to the said supplier and seek management's co-operation in this regard. However, management of the Trust informs the auditor regarding a certain dispute going on with the supplier of equipment due to some quality issues. It is further informed that the dispute is near settlement, and it would not be proper to send confirmation requests as it can affect the negotiation process.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. As regards exchange of engagement letter between Trust management and auditors is concerned, which of the following statements is likely to be true?
 - (a) Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It includes reference to the expected form and content of the report to be issued by them and a statement that

there may be circumstances in which such report may differ from its expected form and content.

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

- (c) The auditor should withdraw from engagement as Trust management's refusal is a limitation on scope of independent audit.
- (d) The auditor should disclaim opinion in auditor's report.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (a)** Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It includes reference to the expected form and content of the report to be issued by them and a statement that there may be circumstances in which such report may differ from its expected form and content.

Reason:

An engagement letter is sent by auditor to client. In terms of the requirements of SA 210, it includes reference to expected form and content of report to be issued by them and a statement that there may be circumstances in which such report may differ from its expected form and content.

2. **Option (b)** Auditors have identified misstatement concerning "Rights and Obligations" assertion made by Trust management.

Reason:

With respect to Rights and Obligations assertions, the auditor should verify that the entity holds or controls the rights to assets of the entity.

3. **Option (b)** The auditor should seek audit evidence as to the validity and reasonableness of the reasons for refusal and perform alternative audit procedures.

Reason:

In terms of requirements of SA 505, the auditor should seek audit evidence as to the validity and reasonableness of the reasons for refusal and perform alternative audit procedures. The issues of opinion or withdrawal from engagement come afterwards.

CASE SCENARIO 17

Pluto Limited is engaged in the manufacturing and distribution of furniture. After Covid, as the number of people working from home has gone up, this customisable range of home office furniture has gained lot of importance. They were able to perform very well over the years and the same has been reflected in their financial statements.

During the year 2023-24, M/s Saha and Associates was reappointed as the auditor. The new engagement team has CA Saha (partner) and five article assistants. Given the large volume of transactions, the partner instructed the article assistants to review the financial statements and auditor's report from the previous year, 2022-23, to gain a thorough understanding.

While reviewing the summary page, one of the articles, Kabir noticed that a few points were under discussion with the partner before finalising the audit.

The team verified the following points with respect to employee benefit expenses:

- The employee benefit expenses recorded in the books were actually incurred during the relevant period.
- The expenses in respect of all personnel have been accounted for.
- The expenses recognised during the period are pertaining to the current accounting period.

It was also noted that dividend to equity shareholders for the year 2022-23, was declared on 15.04.2023 and was recognised as liability in the year 2022-23.

Another article Krish noticed that debtors constitute a major component of the company's financial statements. As part of the audit procedure, the auditor requested the client to obtain external confirmations from the parties. For this, a list of all the debtors were obtained and a random sampling was performed by the auditor. The client directly obtained the selected debtor confirmations from the customers on time.

Krish also observed addition in the assets amounting ₹ 50 lakhs during the year supported by sufficient audit evidence. However, upon scrutiny, it was found that some of the invoices were not in the name of the company. Further, Cash and cash equivalents were classified as balances with banks, cheques and drafts

on hand, cash on hand and earmarked balances with banks (e.g. unpaid dividend).

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which among the following assertions are discussed with respect to the employee benefit expenses?

- (i) Measurement.
- (ii) Occurrence.
- (iii) Cut-off.
- (iv) Completeness.

Choose the correct combination from below:

- (a) (i), (ii) and (iv).
 - (b) (ii), (iii) and (iv).
 - (c) (i), (iii) and (iv).
 - (d) (i), (ii) and (iii).
2. Whether disclosure of dividend under the liability head during the year 2022-23 is appropriate?
- (a) Yes, it should be recognised in the same year irrespective of the year of declaration as the amount of dividend belongs to the year 2022-23.
 - (b) No, the amount should be recognised equally between two financial years.
 - (c) No, the amount should not be recognised as a liability. It should be disclosed in the notes to accounts.
 - (d) No, the amount should neither be recognised as liability nor disclosure is required in the financial statements.
3. Krish pointed out that that the method followed to obtain debtor confirmation in the previous year was not in accordance with SA 505.

Therefore, M/s Saha & Associated should reperform the same in the correct manner. Select the most appropriate procedure among the following:

- (a) As per SA 505, confirmation should be directly obtained by the auditor. Further, for all significant account balances as on the Balance sheet date confirmations should necessarily be collected and for the smaller outstanding balances, random sampling could be performed.
 - (b) It is ok to obtain confirmation through clients as they are in constant contact with their customers. Also, many customers may not respond to auditor's external confirmation request mail. Random selection can be done for all debtors irrespective of the amount in accordance with SA 505.
 - (c) As per SA 505, confirmation should be directly obtained by the auditor. Whereas random selection can be done for all debtors irrespective of the amount.
 - (d) Either auditor or client can obtain confirmation based on time availability. However, it is necessary to obtain confirmation for all significant account balances as on the Balance sheet date and for the remaining random sampling could be performed in accordance with SA 505.
4. Which assertion has been affected in the case of fixed assets?
- (a) Existence.
 - (b) Rights and obligation.
 - (c) Completeness.
 - (d) Measurement.
5. Cash and cash equivalents were not properly classified by the client. Which of the following is incorrect disclosure of the same?
- (a) Balances with banks.
 - (b) Cheques and drafts on hand.
 - (c) Cash on hand.
 - (d) Earmarked balances with banks. (e.g.: unpaid dividend)

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** (ii), (iii) and (iv).

Reason:

In the given case, the assertions of Occurrence, Cut-off, and Completeness are being evaluated concerning employee benefit expenses. The Occurrence assertion requires the auditor to ensure that the recorded expenses were actually incurred during the relevant period itself. Additionally, the Completeness assertion ensures that all personnel-related expenses have been accounted for. Lastly, the Cut-off assertion verifies that the recognised expenses during the period are pertaining to the current accounting period.

2. **Option (c)** No. The amount should not be recognised as a liability. It should be disclosed in the notes to accounts.

Reason:

As per AS-4 (Revised) or IND AS 10, if dividends to holders of equity instruments are proposed or declared after the balance sheet date, an entity should not recognise those dividends as a liability as at the balance sheet date. It should, however, disclose the amount of dividends that were proposed or declared after the balance sheet date, but before the financial statements were approved for issue.

3. **Option (a)** As per SA 505, confirmation should be directly obtained by the auditor. Further, for all significant account balances as on the Balance sheet date confirmations should necessarily be collected and for the smaller outstanding balances, random sampling could be performed.

Reason:

To verify the existence of trade receivables at the period-end, the auditor should obtain direct confirmations from customers. Direct confirmation audit procedure involves directly contacting customers to confirm the amounts of unpaid accounts receivable as of the end of the reporting period under audit. This should necessarily be done for all significant account balances as at the period-end while certain random customers having smaller outstanding invoices should also be selected.

4. Option (b) Rights and obligation.

Reason:

As per Rights and obligations assertion the auditor is required to verify that the entity has valid legal ownership over the PPE claimed to be held and recorded in the financial statements.

5. Option (d) Earmarked balances with banks. (e.g.: unpaid dividend)

Reason:

Cash and cash equivalents shall be classified as:

- Balances with banks, Cheques, drafts on hand, Cash on hand, Others (specify nature)
- Earmarked balances with banks (for example, for unpaid dividend) shall be separately stated.

CASE SCENARIO 18

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

M/s Tripathi & Associates are willing to accept the engagement. They communicated with previous auditors before accepting the engagement. However, M/s Sreepath and Co. have failed to respond.

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

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

Mr. Ram, one of the team members, raised a doubt. He enquired regarding recourse available to incoming auditor in case management makes it clear before acceptance of engagement by auditor regarding its inability in providing support to him in respect of certain procedures expected to be performed during the audit. In this respect, specific questions were raised

relating to sending of confirmation requests to material trade payables reflecting in financial statements of a company. Trade payables pertain to material input and input services acquired and utilised by the company during the year. Lack of support by management in such a case would, in effect, signify management's refusal to allow the auditor to send confirmation requests at the outset before engagement is accepted by auditor.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. As regards the doubt of Mr. Ram described in last para of case scenario, which of the following statements is likely to be in accordance with Standards on Auditing?
 - (a) The auditor needs to inquire into management's reasons for the refusal and perform alternative audit procedures to obtain relevant and reliable audit evidence.
 - (b) The auditor needs to evaluate implications of management's refusal on auditor's assessment of risk of material misstatement and perform alternative audit procedures to obtain relevant and reliable audit evidence.
 - (c) The auditor should not accept such an engagement.
 - (d) The auditor needs to evaluate implications of management's refusal on risk of fraud and perform alternative audit procedures to obtain relevant and reliable audit evidence.
2. When CA Kishan, the partner, asked about preconditions for an audit, Mr. Arun could recollect only a few of them. Which among the following points were missed by him?
 - (i) Obtaining management responsibility on specific legal aspects governing the organisation.
 - (ii) Obtaining management responsibility on Standards on Auditing applicable to the organisation.
 - (iii) Obtaining management responsibility for the preparation of financial statements as per applicable financial reporting framework.

- (iv) Obtaining management responsibility on necessary Internal controls to enable preparation of financial statements which are free from material misstatement whether due to error or fraud.

Select the correct option

- (a) (i), (ii) and (iii).
 - (b) (ii), (iii) and (iv).
 - (c) (iii) and (iv).
 - (d) (i) and (iv).
3. Identify the incorrect factor mentioned by Mr. Kumar regarding the need for a revision of the Engagement Letter:
- (a) A significant change in ownership.
 - (b) A recent change in management.
 - (c) A change in financial reporting framework adopted in preparation of Financial Statements.
 - (d) A modest change in nature or size of the entity's business.
4. M/s Sreepath & Co. have failed to respond to incoming auditors. In this regard, choose the most appropriate option:
- (a) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of objectivity principle.
 - (b) It was ethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It does not involve violation of any fundamental principles governing professional ethics.
 - (c) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of Professional competence and due care principle.
 - (d) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is a violation of professional behaviour principle.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (c)** The auditor should not accept such an engagement.

Reason:

If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall: (a) Withdraw from the audit engagement where possible under applicable law or regulation; and (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

2. **Option (c)** (iii) and (iv).

Reason:

In order to establish whether the preconditions for an audit are present, the auditor shall:

Obtain the agreement of management that it acknowledges and understands its responsibility: (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework including where relevant their fair representation; Use by management of an acceptable financial reporting framework in the preparation of the financial statements and the agreement of management to the premise on which an audit is conducted a (ii) For such internal control as management considers necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and

3. **Option (d)** A modest change in nature or size of the entity's business.

Reason:

In case of recurring audits revision of terms audit engagement is mandated in following cases:

- (i) Any indication that the entity misunderstands the objective and scope of the audit.
- (ii) Any revised or special terms of the audit engagement.

- (iii) A recent change of senior management.
- (iv) A significant change in ownership.
- (v) A significant change in nature or size of the entity's business.
- (vi) A change in legal or regulatory requirements.
- (vii) A change in the financial reporting framework adopted in the preparation of the financial statements.
- (viii) A change in other reporting requirements.

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

Reason:

In case where previous auditor does not communicate with current auditor, one of the important fundamental principles of Professional behaviour has been violated. Since, it requires an accountant to comply with relevant laws and regulations and avoid any conduct that the accountant knows or should know might discredit the profession.

CASE SCENARIO 19

GHB Ltd., a listed company, having its registered office at New Delhi, is in the business of blending, processing, packing and selling various brands of Tea. BPP & Co. LLP, Chartered Accountants, are appointed as the statutory auditors of the company for the financial year 2023-24, CA B is the engagement partner for the assignment.

The company has a centralised warehouse near the border of Himachal Pradesh. CA B's attendance, on 31 March 2024, at the physical inventory counting in aspect of the said warehouse became impracticable on account of natural calamity in that area. It also became impossible for CA B to perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory.

The company had spent huge amount on employee benefits. Hence, CA B instructed his assistants to test the controls that the company had set around the employee benefit expenses. After being satisfied with the controls maintained by the company, he instructed his team to bifurcate the employee benefit expenses into salaries and wages, contribution to PF, expenses on ESOP/ ESPP and staff welfare expenses.

Due to time constraints, CA B is under pressure to issue a clean report in the limited time frame. He has insufficient time to properly perform or complete the relevant duties and issue appropriate audit report.

The Board of Directors want CA B to certify the debtors to be sent to the bank without checking. CA B agrees, as most of the professional income of BPP & Co. LLP comes from GHB Ltd. They have undue dependence on the fees from GHB Ltd., hence, they are concerned about losing the engagement.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Since it became impracticable for CA B, on 31 March, 2024, to attend physical inventory counting at the warehouse and also became impossible to perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and conditions of inventory, CA B shall:
 - (a) Take Management Representation regarding the existence and valuation of inventory and mention in Emphasis of Matter paragraph.
 - (b) Rely on GHB Ltd.'s perpetual inventory records as audit evidence and express unmodified opinion.
 - (c) Omit altogether the audit procedure of physical inventory counting from the audit programme because of impracticability.
 - (d) Modify the opinion in the auditor's report in accordance with SA 705 as a result of the scope limitation.
2. Which assertion concerning the bifurcation of employee expenses into various heads are being verified by CA B?
 - (a) Occurrence.
 - (b) Measurement.
 - (c) Completeness.
 - (d) Disclosures.
3. Due to tight deadlines, CA B has insufficient time to properly perform or complete the relevant duties and he has to sign off clean audit report. Which fundamental principle governing professional ethics is disregarded by him?
 - (a) Professional competence and due care.
 - (b) Professional behaviour.
 - (c) Integrity.
 - (d) Objectivity.

4. Undue dependence on the fees from GHB Ltd. creates which threat of independence for the auditors?
- (a) Intimidation Threat.
 - (b) Familiarity Threat.
 - (c) Self-interest Threat.
 - (d) Advocacy Threat.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (d)** Modify the opinion in the auditor's report in accordance with SA 705 as a result of the scope limitation.

Reason:

As per SA 501, "Audit Evidence - Specific Considerations for Selected Items", if attendance at physical inventory counting is impracticable, the auditor shall perform alternative audit procedures to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory. If it is not possible to do so, the auditor shall modify the opinion in the auditor's report in accordance with SA 705.

2. **Option (d)** Disclosures.

Reason:

A Company shall disclose by way of notes additional information regarding aggregate expenditure and income on Employee Benefits Expense (i) salaries and wages, (ii) contribution to provident and other funds, (iii) expense on Employee Stock Option Scheme (ESOP) and Employee Stock Purchase Plan (ESPP), (iv) staff welfare expenses.

3. **Option (a)** Professional competence and due care.

Reason:

A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant to attain and maintain professional knowledge and skill at the level required to ensure that a client or employing organisation receives competent professional service, based on current technical and professional standards and

relevant legislation, and act diligently and in accordance with applicable technical and professional standards.

4. Option (c) Self-interest Threat.

Reason:

Self-interest threats occur when an auditing firm, its partner or associate could benefit from a financial interest in an audit client. Examples include undue dependence on a client's fees and, hence, concerns about losing the engagement.

CASE SCENARIO 20

M/s KRISH & Company is a firm of Chartered Accountants based in Punjab, CA K, CA R, CA I, and CA SH are the partners of the firm. The firm is engaged in various audit assignments. The engagement partners, who were handling their respective assignments for the financial year 2023-24, dealt with the following issues raised during the course of their respective audits.

M/s KRISH & Co. is appointed as the joint auditor along with M/s. PK and Associates and M/s. RS and Associates for the audit of a large manufacturing company for the financial year 2023-24. CA K is in charge of this audit. They have divided their audit areas and have also identified the common audit areas, which will be applicable to all the joint auditors. While forming the opinion, CA K had a different opinion whereas the other two audit firms shared the same opinion. Both of them contended that as they were forming a majority, M/s. KRISH & Co. will have to agree with their opinion.

CA R is conducting the statutory audit of PAWAN Ltd. He observed that, during the year, the company has issued shares at premium and has transferred the amount received as premium to securities premium account. He wants to ensure that PAWAN Ltd. has utilised the amount available in the securities premium amount for the purposes permitted under the Companies Act, 2013.

The Registrar of Co-operative Societies has appointed M/s KRISH & Co. as the statutory auditor of NAND Co-operative Society for the financial year 2023-24. CA I is looking after the audit of the said registered society. During the year, in terms of Section 34 of the Cooperative Societies Act, with the sanction of the Registrar, Society contributed for charitable purposes as defined in section 2 of the Charitable Endowments Act, 1890. CA I is ensuring whether requirements, as regards contribution made, have been complied with.

All the engagement partners and the audit team of M/s KRISH & Co. have deliberations and discussions every week through google meet to review the progress of their respective assignments. During the last meeting, CA SH, the managing partner, briefed the team about the form, content, and extent

of audit documentation in terms of SA 230, while citing examples of records to be excluded as well as to be included as a part of audit documentation.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. In case of difference of opinion between the joint auditors, what course of action can M/s. KRISH & Co. take while issuing the audit report?
 - (a) They will have to agree with the opinion formed by the majority of auditors.
 - (b) They will have to agree with the opinion formed by the majority auditors, but they can mention their view in the Emphasis of Matter Paragraph.
 - (c) They can add a separate audit opinion paragraph in the common audit report.
 - (d) They can issue a separate audit report and the audit reports issued by the joint auditors shall make a reference to each other's audit report.
2. The securities premium account of PAWAN Ltd. cannot be applied for which of the following purposes?
 - (a) In writing off the debit balance in the Profit & Loss account.
 - (b) In writing off the expenses of, or the commission paid or discount allowed on any issue of equity shares of the company.
 - (c) For the purchase of its own shares or other securities under section 68.
 - (d) In paying up unissued equity shares of the company to be issued to the members of the company as fully paid bonus shares.
3. CA I, who is in charge of audit of NAND Co-operative Society, wants to ensure that the society has contributed for charitable purposes within the limits prescribed. How much is the society allowed to contribute for charitable purposes?

- (a) Contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund.
 - (b) Contribute an amount at the appropriate rate as per class of the society.
 - (c) Contribute an amount not exceeding 20% of the net profits remaining after the compulsory transfer to the reserve fund.
 - (d) Contribute annually at prescribed percentage of the profits as approved by the General body of the society.
4. Which of the following need not be included by the audit team as a part of audit documentation during handling of their respective assignments?
- (a) Significant and specific contracts and agreements.
 - (b) Draft audit engagement letter.
 - (c) Summaries of significant matters.
 - (d) Checklists.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (d)** They can issue a separate audit report and the audit reports issued by the joint auditors shall make a reference to each other's audit report.

Reason:

As per SA 299, "Joint Audit of Financial Statements", joint auditors are required to issue common audit report. However, where the joint auditors are in disagreement with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report. In such circumstances, the audit report(s) issued by the joint auditor(s) shall make a reference to each other's audit report(s).

2. **Option (a)** In writing off the debit balance in the Profit & Loss account.

Reason:

The securities premium account cannot be applied by the Company for writing off the debit balance in the Profit & Loss account.

3. **Option (a)** Contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund.

Reason:

According to section 34, a registered society may, with the sanction of the Registrar, contribute an amount not exceeding 10% of the net profits remaining after the compulsory transfer to the reserve fund for any charitable purpose as defined in section 2 of the Charitable Endowments Act, 1890.

4. **Option (b)** Draft audit engagement letter.

Reason:

Audit Documentation includes:

- Audit programmes.
- Analyses.
- Issues memoranda.
- Summaries of significant matters.
- Letters of confirmation and representation.
- Checklists.
- Correspondence (including e-mail) concerning significant matters.
- Significant and specific contracts and agreements.

Thus, Draft audit engagement letter is not included in Audit Documentation.

CASE SCENARIO 21

Mega Power Ltd. is a manufacturer of solar lanterns, which are used in remote villages where there is no reliable supply of electricity. However, due to power projects undertaken by the government, the demand for their solar lanterns has significantly declined over the past few years.

The company was in need of ₹ 2 crores for working capital and other expenses but was not able to fund this amount. Consequently, their suppliers were paid much later than usual and hence some of them withdrew the credit terms, meaning the company had to pay cash on delivery. This created a severe cash crunch, and the auditor feels that other than the cash crunch, there are several other financial indicators that cast a significant doubt on the company's ability to continue as a going concern.

The management of the company, however, assures the auditor that this is temporary, and the situation will change soon as they are planning to diversify their business. They are ready to provide written representation for the same. The auditor feels that material uncertainty still exists. The auditor wants the management to make adequate disclosure about this in the financial statements. The auditor wants to include a separate section about this in his audit report. He is also contemplating about the kind of audit report that should be issued.

The auditor has concerns about ethical values and diligence of management. He is concerned about the reliability of the representations made by the management and the audit evidence in general. The auditor is of the opinion that the written representations from management are not reliable.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Financial events or conditions that may cast significant doubt on the entity's ability to continue as a going concern does not include
 - (a) Inability to comply with the terms of loan agreements.
 - (b) Inability to pay creditors on due dates.

- (c) Shortage of important supplies.
 - (d) Substantial operating losses.
2. Which type of audit report will the auditor issue, if the use of going concern basis of accounting is appropriate, but a material uncertainty exists and adequate disclosure of the material uncertainty is made in the financial statements by the management?
- (a) Adverse opinion.
 - (b) Disclaimer of opinion.
 - (c) Unmodified opinion.
 - (d) Qualified opinion.
3. If the auditor is of the opinion that the written representations are not reliable, what type of audit opinion should be issued by him?
- (a) Disclaimer of opinion.
 - (b) Adverse opinion.
 - (c) Unmodified opinion and mention the facts in Other Matters Paragraph.
 - (d) Unmodified opinion and mention the facts in Emphasis of Matter Paragraph.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (c)** Shortage of important supplies.

Reason:

As per SA 570, "Going Concern", shortage of important supplies does not come under events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

2. **Option (c)** Unmodified opinion.

Reason:

As per SA 570, "Going Concern", the auditor shall issue unmodified opinion if the use of going concern basis of accounting is appropriate,

but a material uncertainty exists, and adequate disclosure of the material uncertainty is made in the financial statements by the management

3. Option (a) Disclaimer of opinion.

Reason:

If the auditor concludes that the written representations are not reliable, the auditor shall take appropriate actions, including determining the possible effect on the opinion in the auditor's report in accordance with SA 705, having regard to the requirement of disclaimer of opinion.

CASE SCENARIO 22

Renu & Associates have been appointed as the auditors for Kailash Ltd., a manufacturing industry, for the financial year 2023-24. During the audit, one of the Engagement Partner CA Renu noticed a significant increase in raw material consumption in comparison to previous years, despite a decrease in production volumes. This raised concerns, instigating a detailed review of the vendors supplying these raw materials. Upon inquiry, the management explained that the company had transitioned to a new vendor offering premium materials to improve product quality.

Additionally, CA Renu observed that several credit notes were issued after the end of the accounting period.

During the verification of immovable properties, she discovered that Kailash Ltd. had pledged one of its commercial properties as security for a bank loan. However, the company did not possess the original title deeds for that property.

Further, CA Renu conducted a stock audit of a borrower availing a cash credit facility of ₹ 100 lacs from a bank branch. The cash credit facility was secured against paid stocks and debtors up to 90 days, with a margin of 25% for stocks and 40% for debtors. She observed that the computed drawing power of ₹ 82.50 lacs was incorrect, based on the following information as on 31.12.2023:

Value of stocks	₹ 125 lacs
Value of stocks (fully damaged) included in above	₹ 5 lacs
Value of debtors	₹ 50 lacs
Value of debtors exceeding 90 days included in above	₹ 10 lacs
Value of creditors for goods	₹ 50 lacs

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. What audit procedure should auditor perform to check ownership of commercial property discussed in the scenario?

- (a) The auditor should request management to obtain confirmation from the bank for holding original title deeds of pledged immovable property are held as security.
 - (b) The auditor can obtain a list of immovable properties from management at Kailash Ltd., along with management's representation regarding the ownership of these properties.
 - (c) If the auditor is unable to verify the original title deeds of the pledged property, they may need to qualify the audit report accordingly.
 - (d) The auditor can assume ownership of immovable properties without obtaining a written representation from management, as long as there is a general understanding of the assets.
- 2. Which assertion is the auditor evaluating while verifying the existence of vendors and the actual receipt of goods or raw materials by the company?
 - (a) Occurrence.
 - (b) Completeness.
 - (c) Measurement.
 - (d) Existence.
- 3. What could be the possible reasons for issuing credit notes after the end of the accounting period as mentioned in the above case?
 - (a) Fictitious sales by the sales team to meet targets and cancel out those sales later with a credit note.
 - (b) Ensuring necessary corrections are reflected in the financial records for accuracy.
 - (c) When issues arise that lead to customer dissatisfaction, credit notes may be issued to resolve these disputes amicably.
 - (d) Such adjustments may be made based on negotiations or changes in market conditions that occurred post-period.

- 4 In the given case, CA Renu found that the drawing power calculated was incorrect. What should be the correct drawing power?
- (a) ₹ 75.00 lacs.
 - (b) ₹ 76.50 lacs.
 - (c) ₹ 78.00 lacs.
 - (d) ₹ 74.50 lacs.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (a)** The auditor should request management to obtain confirmation from the bank for holding original title deeds of pledged immovable property are held as security.

Reason:

The auditor should insist and verify the original title deeds for all immoveable properties held as at the balance sheet date. In case the entity has given such immoveable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security.

2. **Option (a)** Occurrence.

Reason:

While testing occurrence assertion, auditor checks whether any fictitious vendors have been booked or purchases have been recorded by reviewing the vendor selection process followed by the entity and also performing procedures to ensure existence of the vendors.

3. **Option (a)** Fictitious sales by the sales team to meet targets and cancel out those sales later with a credit note.

Reason:

Auditors should verify the credit notes issued after the accounting period. Sometimes sales team or sales personnel can make fictitious sales before

the year end to meet performance target and cancel out those sales with a post year end credit note.

4. Option (b) ₹ 76.50 lacs.

Reason:

The computation of Drawing power is as under: -

Particulars	Amount (₹ In lacs)
Value of stocks as on 31.12.23	125
Less: value of damaged stocks	(5)
	120
Less: creditors for goods as on 31.12.23	(50)
Value of Paid stocks	70.00
Less: Margin @ 25%	(17.50)
Drawing power (A)	52.50
Value of debtors as on 31.12.23	50
Less: debtors exceeding 90 days	(10)
	40
Less: Margin @ 40%	(16)
Drawing Power (B)	24
Drawing Power (A+B)	76.50

The drawing power calculated by CA P is not proper. Drawing Power comes to ₹ 76.50 lacs.

CASE SCENARIO 23

CA Neel has accepted the offer of appointment of an auditor of an entity. As business carried on by the entity is new to him, he wants to gain an understanding about the entity and its environment including its internal control. In this regard, he has performed procedures to obtain audit evidence about design and implementation of relevant controls. He has performed various procedures like inquiry, inspection and observation in this regard.

He wants reasonable assurance that the accounting system is adequate and that all accounting information which should be recorded has, in fact, been recorded.

Further, during the course of audit, he has noticed as under:

- As required by the management, bank reconciliation is required to be performed monthly. However, the same is not carried out as stipulated due to time constraints faced by accountant.
- The entity has a system of procuring its raw material supplies on the basis of valid purchase orders issued by the entity. However, purchase orders are not numbered in a sequence properly.
- Wage sheets are not verified by a responsible official as required by management.

Staff of the entity is responsible for bringing cash from centers in nearby areas to entity's premises from where it is deposited into entity's bank account. However, the concerned officer has not renewed insurance for cash in transit.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. The auditor has performed procedures to obtain audit evidence about design and implementation of controls. Which of the following procedures is more reliable to obtain audit evidence relating to application of a control?

-
- (a) Observing application of control.
 - (b) Inspecting documentation pertaining to control.
 - (c) Inquiry about application of control.
 - (d) Studying design of control.
2. Examination and evaluation of internal control is indispensable for CA Neel. It provides him necessary comfort relating to completeness of accounting information. However, review of internal controls of the entity will not enable him to know_____.
- (a) whether errors or frauds are likely to be located in ordinary course of operations of business.
 - (b) whether an effective internal audit department is operating.
 - (c) whether his opinion needs modification.
 - (d) whether any administrative control has bearing on his work.
3. As regards weaknesses identified by the auditor in control system, which of the following represent(s) significant deficiencies in internal control?
- (a) Not performing bank reconciliation timely and not verifying wage sheets by responsible official only.
 - (b) Not performing bank reconciliation timely and lack of proper sequence in purchase orders only.
 - (c) Not performing bank reconciliation timely, lack of proper sequence in purchase orders, not verifying wage sheets by responsible official and lack of insurance for cash in transit.
 - (d) Lack of insurance for cash in transit only.
4. Which of the following is most appropriate regarding auditor's responsibility in accordance with SA 265?
- (a) To communicate significant deficiencies in internal control to management.
 - (b) To communicate significant deficiencies in internal control along with explanation of their potential effects to management.

- (c) To communicate significant deficiencies in internal control along with explanation of their potential effects, to provide sufficient information to understand context of communication to management and express opinion on effectiveness of internal control.
- (d) To communicate significant deficiencies in internal control along with explanation of their potential effects and to provide sufficient information to understand context of communication to management.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (a)** Observing application of control.

Reason:

Observation consists of looking at a process or procedure being performed by others. Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.

2. **Option (c)** Whether his opinion needs modification.

Reason:

The review of internal controls will not enable the auditor to know whether his opinion needs modification.

3. **Option (c)** Not performing bank reconciliation timely, lack of proper sequence in purchase orders, not verifying wage sheets by responsible official and lack of insurance for cash in transit.

Reason:

The significance of a deficiency or a combination of deficiencies in internal control depends not only on whether a misstatement has actually occurred, but also on the likelihood that a misstatement could occur and the potential magnitude of the misstatement. Significant deficiencies may, therefore, exist even though the auditor has not identified misstatements during the audit.

4. **Option (d)** To communicate significant deficiencies in internal control along with explanation of their potential effects and to provide sufficient information to understand context of communication to management.

Reason:

Communication in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis giving their description, explanation of potential effects and sufficient information by the auditor to those charged with governance and management to understand context of communication.

CASE SCENARIO 24

Hill Ltd., a company engaged in the business of trekking essentials, appointed CA Gagan as the statutory auditor for the year. Due to the large volume of transactions of the company, the audit engagement team of CA Gagan realised that it would not be feasible to audit each transaction separately during the financial year under audit. Therefore, the Engagement Partner decided to apply following audit sampling techniques:

- Random number tables were used for selection of sample for power, telephone, and fuel charges.
- No structured method of sampling was used for office stationery.
- Transactions exceeding ₹ 8,000 were selected for travel expenses.
- The first 200 sales invoices from the sales book for the month of July were selected for sales.

Mr. Kush, one of the team members, compared the salary expenses incurred by the company during the current year with those of the previous five years. He noticed a significant percentage increase in the expenses. This unusual increase raised doubts in his mind. He decided to compare such an increase in salary expenses with the increase in the number of employees.

The company is having warehouse at 2 locations. CA Gagan is planning to attend the physical inventory count process. The inventory includes finished products such as trekking jackets, bags, shoes etc., and raw materials like leather, cloth, chemicals, etc. Some of the inventory is also held by a third party.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which of the sampling techniques were used for the following transactions?
 - (i) Power, telephone and fuel charges.
 - (ii) Office Stationery.

(iii) Travel expenses.

(iv) Sales.

(Answer in the given order)

- (a) Random sampling, Systematic sampling, Monetary unit sampling, Block sampling.
 - (b) Systematic sampling, Random sampling, Block sampling, Haphazard sampling.
 - (c) Random sampling, Haphazard sampling, Monetary unit sampling and Block sampling.
 - (d) Random sampling, Haphazard sampling, Monetary unit sampling and Systematic sampling.
2. Which audit procedure was Mr. Kush intended to perform by comparing salary expenses?
- (a) Test of details.
 - (b) Test of balances.
 - (c) Test of control.
 - (d) Substantive analytical procedure.
3. Which of the following is not part of CA Gagan's responsibility with respect to the inventories held by the third parties?
- (a) CA Gagan should request confirmation from the third party regarding the quantity and condition of the inventory held by them.
 - (b) CA Gagan should perform an independent valuation of the inventory based solely on the company's internal records.
 - (c) CA Gagan should request the third party to allow him to physically inspect the inventories held by them.
 - (d) CA Gagan should review the terms of the agreement between the company and the third party to understand the responsibilities related to inventory management.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (c)** Random sampling, Haphazard sampling, Monetary unit sampling and Block sampling.

Reason:

Random Sampling: Random selection ensures that all items in the population or within each stratum have a known chance of selection.

Haphazard sampling: Haphazard selection, in which the auditor selects the sample without following a structured technique.

Monetary Unit Sampling: It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

Block Sampling: This method involves selection of a block(s) of contiguous items from within the population.

2. **Option (d)** Substantive analytical procedure.

Reason:

Trend analysis is a commonly used technique of substantive analytical procedure. It is the comparison of current data with the prior period balance or with a trend in two or more prior period balances. The auditor evaluates whether the current balance of an account moves in line with the trend established with previous balances for that account, or based on an understanding of factors that may cause the account to change.

3. **Option (b)** CA Gagan should perform an independent valuation of the inventory based solely on the company's internal records.

Reason:

Performing an independent valuation of the inventory based solely on the company's internal records is not part of CA Gagan's responsibility with respect to the inventories held by the third parties.

CASE SCENARIO 25

PKH & Associates, a Chartered Accountant firm, is practicing in Mumbai since last two decades. Rahul got the opportunity to work as an article clerk with PKH & Associates. After completion of formalities of article clerk registration, Rahul is placed in the statutory audit team of the firm. CA P, the partner heading audit team, planned to take Rahul in the audit work of M/s Fox India Limited for the financial year 2023-24. Till last year, CA K was the head of the audit team for audit of M/s Fox India Limited. As it is the first assignment of Rahul, he was instructed by the partner to go through the audit file of M/s Fox India Limited for the financial year 2022-23 and familiarise himself with audit procedures and methodology to be followed for upcoming audit assignment.

On-going through the audit file of F.Y. 2022-23, Rahul found revised engagement letter, other working papers relating to MAT & Deferred tax calculations and the following extract on verification of expenses:

Name of concern M/s. Fox India Limited

Financial Year 2022-23

Prepared by D (05.05.2023)

Reviewed by F (06.05.2023)

Approved by CA K (07.05.2023)

Sr. No.	Nature of Procedure	Extent of Check	Basis of Sample	Done by
1.	Vouch few expense invoices available in record of concern	10%	Random Sampling	D
2.	Trace these invoices into the account books of the concern.	10%	Random Sampling	D
3.	Verify few invoices with the GST data of the concern	10%	Random Sampling	D

Rahul immediately drafted a revised engagement letter for the financial year 2023-24 and also specified the scope of audit to include the following statements:

Statement I: Reliability and sufficiency of financial information,

Statement II: Proper disclosure of financial information,

Statement III: Responsibility of an auditor to prepare the financial statements, and

Statement IV: Coverage of all aspects of entity relevant to the financial statements being audited.

He thought that it is mandatory to obtain engagement letter every year and handed over revised draft to CA P. CA P is surprised as to why Rahul drafted the same and explained him the situations under which it is necessary to obtain a revised engagement letter.

Before finalising the audit report of M/s. Fox India Limited for the F.Y. 2023-24, Rahul performed the following procedures regarding subsequent events:

- (i) Obtained an understanding of procedures established by the company to ensure that subsequent events are identified.
- (ii) Inquired management of the company as to whether any subsequent events have occurred which affects the financial statements as on 31.03.2024.
- (iii) Read the entity's latest subsequent interim financial statements.
- (iv) Read the minutes of meetings of M/s. Fox India Limited that have been held up to 31.03.2024.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which of the following would not form part of the explanation given by CA P to Rahul?
 - (a) A recent change of senior management.
 - (b) A significant change in nature or size of the entity's business.
 - (c) Replacement of CA K by CA P.
 - (d) A change in legal or regulatory requirements.
2. Which of the statements included by Rahul in revised draft engagement letter is incorrect?

- (a) Statement I.
 - (b) Statement II.
 - (c) Statement III.
 - (d) Statement IV.
3. How will you categorise the information pertaining to F.Y. 2022-23 in relation to extract found?
- (a) The same was a part of Audit plan.
 - (b) The same was a part of Audit programme.
 - (c) The same was a part of Audit guidelines.
 - (d) The same was a part of Audit procedures.
4. Which of the audit procedure performed (before finalising the audit report of M/s. Fox India Limited) by Rahul is not as per SA 560?
- (a) Procedure (i).
 - (b) Procedure (ii).
 - (c) Procedure (iii).
 - (d) Procedure (iv).

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (c)** Replacement of CA K by CA P.

Reason:

As per SA 210 replacement of head of audit team does not comes under factor that may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms.

2. **Option (c)** Statement III.

Reason:

Scope of audit of financial statements:

- Coverage of all aspects of entity relevant to the financial statements being audited.

- Reliability and Sufficiency of financial information.
- Proper disclosure of financial information.
- Expression of an opinion on financial statements.

3. Option (b) The same was a part of Audit programme.

Reason:

An audit programme is a detailed plan of applying the audit procedures in the given circumstances with instructions for the appropriate techniques to be adopted for accomplishing the audit objectives.

4. Option (d) Procedure (iv).

Reason:

Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.

CASE SCENARIO 26

CA F has been appointed as an auditor of a manufacturing entity. Pursuant to appointment, CA F planned to assess the risk of material misstatement. During this process, CA F observed that entity has identified various controls to mitigate the risk. The entity has implemented a control (named TARGET) whose objective is to ensure that production systems are processed to meet financial reporting objectives.

On completion of risk assessment procedure, CA F was wandering as to how he can verify the existence of related party relationships and transactions. So, he consulted one of his colleagues, CA Z, who suggested following ways to identify the same:

- (1) Information supplied by the entity to regulatory authorities.
- (2) Entity's income tax returns.
- (3) Inventory records maintained by the entity.
- (4) Life insurance policies acquired by the entity. On-going through the financial statement provided by the entity, CA F observed that the entity has significantly borrowed the amount during the financial year 2023-24. CA F wanted to ensure that all borrowing on the balance sheet represent valid claims by banks or other third parties. Accordingly, he performed the following procedures:
 - (i) Reviewed subsequent transactions after the end of the reporting period.
 - (ii) Recomputed the interest on borrowing.
 - (iii) Reviewed board minutes for approval of new lending agreements.
 - (iv) Agreed loan balance and loan payables to the loan agreement.

CA F decided to perform analytical procedures to obtain audit evidence as to overall reasonableness of purchase quantity and price. For this, CA F scrutinised raw material consumed as per manufacturing account and compared the same with previous years with closing stock. The variations observed were discussed with the management of the entity.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Control "TARGET" will be categorised in which of the following?
 - (a) Data center and network operations.
 - (b) Program Control.
 - (c) Processing control.
 - (d) Application Control
2. Which of the procedures performed by CA F is suitable for satisfaction of concern regarding borrowing?
 - (a) Procedure (i).
 - (b) Procedure (ii).
 - (c) Procedure (iii).
 - (d) Procedure (iv).
3. Do you agree with all the ways suggested by CA Z to CA F?
 - (a) No. Suggestion (i) is not correct.
 - (b) No. Suggestion (ii) is not correct.
 - (c) No. Suggestion (iii) is not correct.
 - (d) No. Suggestion (iv) is not correct.
4. CA F 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) Trend Analysis.
 - (d) Ratio Analysis.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (a)** Data center and network operations.

Reason:

The objective of controls over Data centre and network operations is to ensure that production systems are processed to meet financial reporting objectives.

2. **Option (c)** Procedure (iii).

Reason:

To ensure that all borrowing on the balance sheet represent valid claims by banks or other third parties, auditor should review board minutes for approval of new lending agreements.

3. **Option (c)** No. Suggestion (iii) is not correct.

Reason:

During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the following records or documents that may provide information about related party relationships and transactions. He will not inspect inventory records maintained by the entity for verifying the existence of related party relationships and transactions.

4. **Option (a)** Consumption Analysis.

Reason:

In Consumption Analysis, auditor should scrutinise raw material consumed as per manufacturing account and compare the same with previous years with closing stock and ask for the Reasons from the management, if any significant variations are found.

CASE SCENARIO 27

GNH & Co., Chartered Accountants, has been appointed as the statutory branch auditors of Chandigarh branch of HFC Bank, a nationalised bank. While carrying out the audit, the following key issues were identified:

Issue 1: Consortium Cash Credit Facility granted to X Ltd.: HFC Bank is a consortium member providing cash credit facilities of ₹ 50 crores to X Ltd., with HFC's share being ₹ 10 crores. Over the past two quarters, interest amounting to ₹ 1.75 crores have been debited in cash credit account of X Ltd., while credits in the account amounts to only ₹ 1.25 crores. Despite this shortfall, the account has been classified as performing asset, based on a certificate from the lead bank (UNC Bank Limited).

Issue 2: Asset Classification of SJ Ltd.: SJ Ltd.'s account has seen no recovery for the past 18 months. However, the bank has not applied NPA norms or income recognition norms to this account. The management justifies this by stating that the account is guaranteed by the Central Government and that NPA and income recognition norms are not applicable. Government has not invoked the guarantee.

Issue 3: Loan Application from ABC Traders: ABC Traders has applied for a cash credit limit from HFC Bank for supporting working capital requirements on account of business expansion. In discussions with ABC Traders, HFC Bank has requested different forms of security, depending on the nature of the assets offered, which includes immovable property (warehouse), goods in stock, accounts receivable, and insurance policies. Borrower provided the security and was sanctioned cash credit limit of ₹ 4.50 Crores.

Issue 4: Precision Engineering (one of the borrowers of the branch) has utilised the entire sanctioned cash credit limit of ₹ 300.00 Lacs. Outstanding balance as on 31 March 2024 is ₹ 308.00 Lacs. Bank classified the account as Substandard Asset. One fine day DGM (Inspection) of Bank was passing through the area in which borrower is located and observed that building occupied by the borrower is damaged and there is no machinery, stock and other assets available in the premises. Borrower was not available telephonically and no contact could be made with him. He ordered independent verification of assets and report was

submitted that no security mortgaged with bank is available. Report has been accepted by the bank authorities. Only a piece of land with realisable value ₹ 25 Lacs is available as of now. Bank made a provision in its books of accounts considering the account as Substandard Asset.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Whether the asset classification of account of X Limited is correct?
 - (a) Classification is correctly done on the basis of certificate provided by UNC Bank Limited.
 - (b) Classification is correctly done subject to confirmation from the Central statutory auditor of the bank.
 - (c) Classification is correctly done subject to confirmation from the Central statutory auditor of the bank and also other parameters specified in the RBI guidelines have been followed.
 - (d) Classification is not in order as classification has to be done on the basis of record of recovery of the HFC Bank only.
2. Is the bank's decision not to apply NPA and income recognition norms to account of SJ Ltd. valid under regulatory guidelines?
 - (a) The bank is correct to the extent of not applying the NPA norms for provisioning purposes. However, this exemption is not available in respect of income recognition norms.
 - (b) The bank is not correct for not applying the NPA norms for provisioning purposes. But this exemption is available in respect of income recognition norms.
 - (c) The bank is correct in not applying the NPA norms and income recognition norms as both are not applicable.
 - (d) The bank is not correct in not applying the NPA norms and income recognition norms as both are applicable.
3. ABC Traders offered its warehouse as security for the loan. HFC Bank created a charge on the warehouse. Which form of security has been

created and whether bank is required to get stock audit done of cash credit account of ABC Traders?

- (a) Security created is Pledge and bank is required to get stock audit done of cash credit account of ABC Traders.
 - (b) Security created is Mortgage and bank is required to get stock audit done of cash credit account of ABC Traders.
 - (c) Security created is Pledge and bank is not mandatorily required to get stock audit done of cash credit account of ABC Traders.
 - (d) Security created is Mortgage and bank is not mandatorily required to get stock audit done of cash credit account of ABC Traders.
4. Whether correct classification and provisioning norms have been applied in the account of Precision Engineering?
- (a) The account is correctly classified, but provision should be made for 100% of the unsecured portion besides making specified provision on secured portion.
 - (b) The account should have been classified as Doubtful asset and besides making required provision on secured portion, provision should have been made for 100% of the unsecured portion.
 - (c) The account should have been classified as loss asset and full provision should have been made in the books of accounts.
 - (d) The account should have been classified as Doubtful asset and full provision should have been made in the books of accounts.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (d)** Classification is not in order as classification has to be done on the basis of record of recovery of the HFC Bank only.

Reason:

Consortium advances should be based on the record of recovery of the respective individual member banks and other aspects having a bearing on the recoverability of the advances. Where the remittances by the borrower under consortium lending arrangements are pooled with one

bank and/or where the bank receiving remittances is not parting with the share of other member banks, the account should be treated as not serviced in the books of the other member banks and therefore, will be classified as an NPA.

2. **Option (a)** The bank is correct to the extent of not applying the NPA norms for provisioning purposes. However, this exemption is not available in respect of income recognition norms.

Reason:

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

3. **Option (d)** Security created is Mortgage and bank is not mandatorily required to get stock audit done of cash credit account of ABC Traders.

Reason:

A pledge involves bailment or delivery of goods by the borrower to the lending bank with the intention of creating a charge thereon as security for the advance. In case of Assets security created is Mortgage. Further, the stock audit should be carried out by the bank for all accounts having funded exposure of more than 5 crores in the given case cash credit limit is ₹ 4.50 Crores.

4. **Option (c)** The account should have been classified as loss asset and full provision should have been made in the books of accounts.

Reason:

If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10% of the outstanding in the borrower accounts, the existence of security should be ignored and the asset should be straight-away classified as loss asset. It may be either written off or fully provided for by the bank.

CASE SCENARIO 28

A government department has been allocated a budget for infrastructure development. During the audit, the auditor observed several discrepancies that raise concern regarding the management and utilisation of funds. The key findings include:

- Some payments were processed without proper approval from the competent authority.
- A large-scale project was implemented, but no assessment was made to determine whether the expected benefits were achieved or not.
- Funds were utilised from an account for which no budgetary provision had been made.
- Certain expenditures were made without adhering to prescribed financial regulations.
- There were instances of unnecessary spending that did not align with the principles of financial propriety.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which type of audit would most likely identify the issue of payments processed without proper approval from the competent authority?
 - (a) Audit against Rules & Orders.
 - (b) Audit of Sanctions.
 - (c) Audit against Provision of Funds.
 - (d) Propriety Audit.
2. Which type of audit would evaluate whether the expected benefits of a large-scale infrastructure project were achieved?
 - (a) Propriety Audit.
 - (b) Audit against Rules & Orders.

- (c) Audit of Sanctions.
 - (d) Performance Audit.
3. Out of the following, which audit would address the issue of funds being utilised from an account with no budgetary provision?
- (a) Audit against Provision of Funds.
 - (b) Audit of Sanctions.
 - (c) Performance Audit.
 - (d) Audit against Rules & Orders.
4. Which audit type would be relevant to detect expenditures made without following prescribed financial regulations?
- (a) Performance Audit.
 - (b) Audit against Rules & Orders.
 - (c) Audit against Provision of Funds.
 - (d) Audit of Sanctions.
5. What type of audit would most effectively identify instances of unnecessary spending that do not align with financial propriety?
- (a) Performance Audit.
 - (b) Audit of Sanctions.
 - (c) Propriety Audit.
 - (d) Audit against Rules & Orders.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** Audit of Sanctions.

Reason:

When payments are processed without proper approval from the competent authority, an Audit of Sanctions is required. This ensures that there is sanction, either special or general, accorded by competent authority authorising the expenditure.

2. Option (d) Performance Audit.**Reason:**

In cases where a large-scale project has been implemented without any assessment of whether the expected benefits were achieved, a Performance Audit is necessary. This type of audit ensures that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding results expected of them.

3. Option (a) Audit against Provision of Funds.**Reason:**

When funds were utilised from an account for which no budgetary provision was made, an Audit Against Provision of Funds is conducted. This ensures that there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority.

4. Option (b) Audit against Rules & Orders.**Reason:**

If expenditure is made without adhering to the prescribed financial regulations, an Audit Against Rules and Orders is applicable. This audit ensures that the expenditure incurred conforms to the relevant provisions of the statutory enactment and in accordance with the Financial Rules and Regulations framed by the competent authority.

5. Option (c) Propriety Audit**Reason:**

Instances of unnecessary spending that do not align with financial propriety fall under the scope of a Propriety Audit. It ensures that the expenditure is incurred with due regard to broad and general principles of financial propriety.

CASE SCENARIO 29

CA Sumit, working in BRS & Associates, Chartered Accountants, has been assigned to prepare the year-end financial statements for a rapidly growing tech startup, "InnoTech". The company has been under pressure to show strong financial results to attract new investors. Sumit's manager, Viraj, has instructed him to arrange some of the numbers, particularly the reported revenues and expenses, to present a more favourable picture of the company's financial health.

During the preparation of the Financial Statements, CA Sumit noticed several irregularities, such as overstated revenues and understated liabilities. Although these adjustments are not explicitly illegal, they could mislead investors and stakeholders. Sumit also knows that Viraj has developed good family terms with the CEO of InnoTech over the year.

As Sumit continues working on the financial statements, he realised that the pressure to comply with Viraj's requests could violate his fundamental principles of professional ethics. He must decide whether to sign off on the reports or to raise his concerns, risking his professional relationship with Viraj and the firm.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which of the following fundamental principles of ethics is being violated when Sumit was instructed to present a more favourable picture of the company's financial health?
 - (a) Professional competence and due care.
 - (b) Integrity.
 - (c) Objectivity.
 - (d) Professional behaviour.
2. Which type of threat arises in case of development of relationship with CEO of InnoTech?

- (a) Advocacy Threat.
 - (b) Self-interest Threat.
 - (c) Intimidation Threat.
 - (d) Familiarity Threat.
3. Which principle would Sumit violate if he disclosed financial details to a third party without the permission of the company?
- (a) Integrity.
 - (b) Professional behaviour.
 - (c) Confidentiality.
 - (d) Professional competence and due care.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** Integrity.

Reason:

A professional accountant shall comply with the principle of integrity, which requires an accountant to be straightforward and honest in all professional and business relationships. Integrity implies fair dealing and truthfulness.

2. **Option (d)** Familiarity Threat.

Reason:

Familiarity threats are self-evident and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests.

3. **Option (c)** Confidentiality.

Reason:

Confidentiality principle requires a professional accountant to respect the confidentiality of information acquired as a result of professional or business relationships.

CASE SCENARIO 30

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

The engagement partner has asked him to prepare a summary of non-funded credit facilities outstanding as on balance sheet date. The following information is appearing in branch's CBS data/records as on 31st March 2024:

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

On going through listing of housing loans to general public, CA B notices that branch has sanctioned many housing loans of small ticket size ranging between ₹ 10.00 lakhs to ₹ 20.00 lakhs. Therefore, he has assessed risk of material misstatements to be high. Consequently, he has designed procedures to perform tests of controls as well as substantive tests.

Saurabh has been further asked to go through SMA (Special Mention Accounts) jotting as on 30th November 2023. Such reports are available from system on monthly frequency. Being new to such type of assignment, he is unable to understand relevance of above audit procedure mandated by engagement partner.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Considering table given in the case scenario, which of the following combination is an appropriate example of non-funded credit facilities provided by the branch to its customers?
 - (a) Bills purchased and discounted; bills for collection.
 - (b) Bills for collection; staff housing loans; letters of credit issued.
 - (c) Bills purchased and discounted; letters of credit issued; guarantees issued (fully secured by 100% margin).
 - (d) Letters of credit issued, guarantees issued (fully secured by 100% margin).
2. CA B's decision to perform both tests of control as well as substantive tests was taken after he had assessed risk of material misstatement in financial statements to be high due to large number of small ticket size loans. Which Standard on Auditing deals with auditor's responsibility to design such tests?
 - (a) SA 500.
 - (b) SA 330.
 - (c) SA 300.
 - (d) SA 315.
3. Saurabh is unable to understand the relevance of going through SMA jotting as on 30th November 2023. Which of the following statement is most appropriate in this context?
 - (a) It would necessarily help auditor in identifying accounts with significant lending exposure.
 - (b) It would help auditor in identifying accounts which may involve downgrading from Sub-standard asset category to doubtful category.

- (c) It would help auditor in identifying accounts where substantial recoveries have been received during the year.
- (d) It would help auditor in identifying accounts which may involve downgrading from standard category to non-performing asset.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (d)** Letters of credit issued, guarantees issued (fully secured by 100% margin).

Reason:

Non-funded facilities are those which do not involve such transfer. Examples of non-funded loans are Letters of credit, Bank guarantees, etc.

2. **Option (b)** SA 330.

Reason:

SA 330, "The Auditor's Responses to Assessed Risks", states that: -

- (i) The auditor shall design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.
- (ii) The auditor shall design and perform further audit procedures whose nature, timing and extent are based on and are responsive to the assessed risks of material misstatement at the assertion level.

3. **Option (d)** It would help auditor in identifying accounts which may involve downgrading from standard category to non-performing asset.

Reason:

Special Mention Account (SMA) is an account which exhibits signs of incipient stress resulting in the borrower defaulting in timely servicing of debt obligations, though the account has not yet been classified as NPA as per the RBI guidelines. Such a classification is significant as early recognition of such accounts enables banks to initiate timely remedial actions to prevent potential slippages of such accounts into NPAs.

CASE SCENARIO 31

Wire Ltd. is a leading electronics manufacturer specialising in televisions and accessories. The company has grown rapidly over the last few years, with a significant increase in both employees and inventory. The company is currently in the process of preparing its financial statements for the F.Y. 2023-24. The company appointed CA Ravi for an independent audit to ensure compliance with Accounting Standards and Standards on Auditing. CA Ravi, the auditor will focus on key financial assertions and implement specific audit procedures for the following items.

- **Employee Benefit Expenses:**

CA Ravi will review whether employee benefit expense has been incurred during the period in respect of the personnel employed by the entity and does not include the cost of any unauthorised personnel.

- **Inventory:**

- (i) CA Ravi will check Inventory balance as at the year-end does not include any element of next financial year. All items of inventory pertaining to the relevant year shall be included regardless of the location.
- (ii) He will verify whether the entity owns or controls the inventory recorded in the financial statements i.e. the purchase invoices have been made in the name of client. Any inventory held by the entity on behalf of another entity has not been recognised as part of inventory of the entity.
- (iii) He will also check that Inventory has been recognised at the lower of cost and net realisable value in accordance with AS 2 - Inventories.
- (iv) He will also ensure that any costs that could not be reasonably allocated to the cost of production and any abnormal wastage have been excluded from the cost of inventory. An acceptable valuation basis (e.g. FIFO, Weighted average etc.) has been used to value inventory as at the period-end.

By performing these procedures, the auditor will ensure that the financial statements reflect the true and fair financial position of the company.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which assertion is the auditor testing when they verify that employee benefit expenses do not include the cost of unauthorised personnel?
 - (a) Completeness.
 - (b) Occurrence.
 - (c) Valuation.
 - (d) Existence.
2. All the items of inventory pertaining to the relevant year shall be included regardless of the location, which assertion is the auditor testing?
 - (a) Completeness.
 - (b) Accuracy.
 - (c) Rights and Obligations.
 - (d) Cut-off.
3. The auditor reviews purchase invoices have been made in the name of client. Which assertion is he primarily testing?
 - (a) Valuation.
 - (b) Rights and Obligations.
 - (c) Completeness.
 - (d) Occurrence.
4. When the auditor assesses whether inventory has been valued at the lower of cost and net realisable value, which assertion does he wants to test?
 - (a) Valuation.
 - (b) Completeness.

- (c) Existence.
- (d) Occurrence.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** Occurrence.

Reason:

As per Occurrence assertion the auditor is required to check that whether employee benefit expense has been incurred during the period in respect of the personnel employed by the entity.

2. **Option (d)** Cut-off.

Reason:

Since inventory balance as at the yearend does not include any element of next financial year. All items of inventory pertaining to the relevant year shall be included regardless of the location, here assertion tested by auditor is Cut-off.

3. **Option (b)** Rights and Obligations.

Reason:

As per Rights and Obligations assertion the auditor needs to verify that the entity owns or controls the inventory recorded in the financial statements i.e. the purchase invoices have been made in the name of client.

4. **Option (a)** Valuation.

Reason:

As per Valuation assertion the auditor assesses whether inventory has been recognised at the lower of cost and net realisable value in accordance with AS 2 - Inventories.

CASE SCENARIO 32

CA Nagar is the managing partner of Nagar & Co., a CA Firm. As part of the firm's annual review, CA Nagar assessed whether any independence threats exist in the firm for the F.Y. 2023-24. The firm has recently taken on multiple clients and engagements, and CA Nagar has noted a few observations regarding the independence of the firm's staff and partners.

CA Nagar wants to classify and evaluate the threats to the firm's independence based on the observations received from the staff and partners for the year.

Observations:

Observation 1: CA P, a partner of the firm, performed both the statutory audit and the non-audit engagement services for Green Pvt. Ltd.

Observation 2: CA L, a partner of the firm, who has done income tax audit for M/s. Future Associates where in CA L has material significant indirect financial interest.

Observation 3: Nagar & Co. accepted expensive gifts and hospitality (including a luxury dinner) from the client after completing the year end audit.

Observation 4: One of the clients, M/s. Walk Limited, threatened to replace them as auditors because the audit team insisted to make provision for expected credit loss which the company was not willing to provide.

CA Nagar needs to classify the threats to independence arising from each of the above observations in order to identify the specific risks and mitigate them.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Which threat to the firm's independence exists in the case of CA P as referred in Observation 1?
 - (a) Self-interest Threat.

- (b) Self-review Threat.
 - (c) Familiarity Threat.
 - (d) Intimidation Threat.
2. With reference to Observation 2 related to CA L, which type of threat exists?
- (a) Self-interest Threat.
 - (b) Familiarity Threat.
 - (c) Advocacy Threat.
 - (d) Intimidation Threat.
3. Which threat to independence is involved in Observation 3, wherein the audit team accepted expensive gifts and hospitality from the client?
- (a) Advocacy Threat.
 - (b) Self-interest Threat.
 - (c) Intimidation Threat.
 - (d) Familiarity Threat.
4. Identify the type of threat to independence on the basis of threat given by client M/s. Walk Limited in the Observation 4.
- (a) Intimidation Threat.
 - (b) Self-review Threat.
 - (c) Familiarity Threat.
 - (d) Advocacy Threat.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** Self-review Threat.

Reason:

When auditors perform services that are themselves subject matters of audit, it will be considered as Self-review threat.

2. Option (a) Self-interest Threat.

Reason:

Self-interest threat includes direct financial interest or materially significant indirect financial interest in a client.

3. Option (d) Familiarity Threat.

Reason:

Familiarity threats are self-evident and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests.

4. Option (a) Intimidation Threat.

Reason:

Intimidation threats occur when auditors are deterred from acting objectively with an adequate degree of professional skepticism.

CASE SCENARIO 33

Elite Fashions, a well-known retail brand with multiple outlets, has submitted its financial statements for audit to CA Riya. As part of her review, she plans to verify several key financial assertions and has outlined specific procedures for a detailed examination.

- (A) She intends to check major invoices recorded under the "Store Renovation Expenses" account to ensure proper recording and classification.
- (B) She plans to confirm that all balances under trade receivables are genuine and not overstated.
- (C) She wants to compare advertising expenses incurred this year with the previous year and analyse their relationship with total sales.
- (D) She decides to review property documents for a newly acquired showroom to confirm ownership.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. What type of audit test is CA Riya performing when verifying major invoices in the "Store Renovation Expenses" account?
 - (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 test when she wants to ensure genuineness of trade receivables.
 - (a) Occurrence.
 - (b) Cut-off.

- (c) Existence.
 - (d) Accuracy.
3. When analysing advertising expenses of the current and previous years and their relationship with total sales, which type of audit procedure is being performed by CA Riya?
- (a) Tests of Details.
 - (b) Tests of Transactions.
 - (c) Tests of Balances.
 - (d) Substantive Analytical Procedures.
4. Which audit procedure is being performed by CA Riya by reviewing property documents for the newly acquired showroom?
- (a) Observation.
 - (b) Inspection.
 - (c) External Confirmation.
 - (d) Inquiry.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (b)** Tests of Transactions.

Reason:

Tests of transactions ensure that individual transactions are correctly recorded and classified.

2. **Option (c)** Existence.

Reason:

The existence assertion ensures that recorded trade receivables actually exist and properly valued. By confirming their validity, CA Riya is checking whether the amounts shown in the financial statements represent genuine customer balances.

3. Option (d) Substantive Analytical Procedures.

Reason:

Substantive analytical procedures involve identifying trends, patterns, and relationships in financial data. By comparing advertising expenses across two years and analysing their impact on sales, CA Riya is performing an analytical review to detect any inconsistencies or unusual patterns.

4. Option (b) Inspection.

Reason:

Inspection involves examining records, documents, or tangible assets to verify their authenticity. Reviewing the property documents ensures that Elite Fashions has legal ownership of the newly acquired showroom, making this an inspection procedure.

CASE SCENARIO 34

MA & Associates, a Chartered Accountant firm is appointed as an auditor of XYZ Pvt. Ltd. Amit, partner of the firm, has recently bought stock in XYZ Pvt. Ltd. He believes that the company's goodwill will increase after the audit report is finalised, which could lead to a rise in stock price. As he reviews the company's financial statements, Amit decides to give unmodified opinion to help his investment.

During the audit of trade receivables, Amit selects a sample using a technique that ensures larger balances have a higher chance of being selected. However, this approach results in the exclusion of many smaller balances, potentially overlooking some crucial misstatements.

Meera, another Partner of Firm, is reviewing calculation of software development costs method adopted by XYZ Pvt. Ltd. Meera helped in creating this method earlier. She worries that her previous involvement in this method might affect her ability to review it.

Meanwhile, Raj, the CEO of XYZ Pvt. Ltd., has requested them to modify certain disclosures in the financial statements in a way that could mislead stakeholders. He argues that a more favourable presentation will help the company secure additional investments. Meera feels that complying with this request would compromise ethical standards and worries about potential conflicts with the client.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Amit has bought stock in XYZ Pvt. Ltd., and his investment could benefit from issuance of unmodified opinion in his audit report. This indicates existence of:
 - (a) Self-interest Threat.
 - (b) Self-review Threat.
 - (c) Advocacy Threat.
 - (d) Familiarity threat.

2. In the given case, Amit is selecting a sample to verify the trade receivables balances where larger balances have a higher chance of being included, causing smaller balances to be overlooked. This method is known as:
 - (a) Random Sampling.
 - (b) Systematic Sampling.
 - (c) Block Sampling.
 - (d) Monetary Unit Sampling.
3. Meera is reviewing a method for calculating software development costs that she helped in creating while working at XYZ Pvt. Ltd. This may involve:
 - (a) Advocacy Threat.
 - (b) Self-interest Threat.
 - (c) Familiarity Threat.
 - (d) Self-review Threat.
4. Raj, the CEO, is requesting the Meera and Amit to modify the financial statement disclosures in a misleading manner. Which fundamental principle of professional ethics would be violated if they agree to do so?
 - (a) Integrity.
 - (b) Objectivity.
 - (c) Confidentiality.
 - (d) Professional Competence and Due Care.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (a)** Self-interest Threat.

Reason:

Self-interest threat includes direct financial interest or materially significant indirect financial interest in a client.

2. **Option (d)** Monetary Unit Sampling.

Reason:

In the given case, Amit used a sampling method where larger balances have a higher chance of being selected. Monetary Unit Sampling is a value-weighted selection method where each monetary unit in the population has an equal chance of being chosen. This approach increases the likelihood of selecting high-value items but may overlook smaller balances, potentially missing some misstatements.

3. **Option (d)** Self-review Threat.

Reason:

When auditors perform services that are themselves subject matters of audit, it will be considered as Self-review threat.

4. **Option (a)** Integrity.

Reason:

If the auditors modify disclosures in a misleading manner as requested by Raj, they would violate the fundamental principle of Integrity, which requires accountants to be straightforward and honest in all professional relationships.

CASE SCENARIO 35

DS & Co., Chartered Accountants, are statutory auditors of SAR Industries Pvt. Ltd., a company engaged in manufacturing business since 2018. The company operates from rented premises, and it does not have building of its own. It had upgraded its machinery last time in 2020. Except interest in this company, promoters, directors, key managerial persons and their relatives do not have interest or ownership in any other entity. Also, the company does not enter into any business dealings with promoters, directors, key managerial persons and their relatives. The directors and key managerial persons get only reasonable remuneration from the company. Though the company has an internal control system in place, it has not appointed an internal auditor. It is also not mandatorily required to make such an appointment under the provisions of the Companies Act, 2013.

DS & Co. have accepted an audit of the above company for the year 2023-24 for the first time. Promoters and directors of the company are known to engagement partner only socially for quite some time. However, it is for the first time that any type of professional work related to this company has been accepted by them.

While formulating audit plan for the company, CA D (engagement partner) has planned certain risk assessment procedures and further audit procedures consisting of tests of controls and substantive procedures in relation to different areas.

The following is extract of financial information of the company: -

(figures in rupees crores)

S. No.	Particulars	Year 2023-24	Year 2022-23
1.	Turnover	30.00	15.00
2.	Inventories	5.00	2.00
3.	Property, plant and equipment (Gross block)	1.25	1.25
4.	Property, plant and equipment (Net block)	1.00	1.25

5.	Gross profit	6.00	3.75
6.	Trade receivables	12.50	5.00

The PPE items consist of machinery only. While planning procedures in respect of Property, Plant and Equipment, auditor has included audit procedures like inspecting and reviewing company's plan for performing physical verification of PPE, assessing depreciation method used, verifying cost of PPE items acquired during the year with purchase bills and recalculation of depreciation charged in statement of profit and loss.

Further, while performing risk assessment procedures to identify risk of material misstatements in financial statements, engagement partner has come to notice that there is considerable variation in gross profit ratio as compared to last year. During performance of substantive procedures, he has also studied data of purchases and sales of the company during the year under audit and has also compared such data with preceding year and earlier years also.

Based on the above facts, answer the following MCQs:

MULTIPLE CHOICE QUESTIONS

1. Keeping in view the description provided in the case scenario, which of the following statements is likely to be most appropriate?
 - (a) Engagement partner is known socially to promoters and directors of the company. The situation mandatorily involves advocacy threat casting a doubt on auditor's independence. Irrespective of this, detection risk in engagement is low.
 - (b) Engagement partner is known socially to promoters and directors of the company. The situation mandatorily involves familiarity threat casting a doubt on auditor's independence. Irrespective of this, detection risk in engagement is high.
 - (c) The situation reflected in the case scenario may not constitute threat to independence of auditor mandatorily. Irrespective of this, detection risk in engagement is low.

- (d) The situation reflected in the case scenario may not constitute threat to independence of auditor mandatorily. Irrespective of this, detection risk in engagement is high.
- 2. CA D has included in the audit plan certain procedures in respect of PPE items. Which of the following audit procedure included in audit plan is likely to be least relevant?
 - (a) Inspecting and reviewing company's plan for physical verification of PPE.
 - (b) Assessing depreciation method used.
 - (c) Verifying cost of PPE items acquired during the year with purchase bills.
 - (d) Recalculation of depreciation charged in statement of profit and loss.
- 3. Which of the following statements is likely to be most suitable to explain the fact relating to variation in gross profit ratio as compared to last year?
 - (a) Gross profit ratio has decreased in year 2023-24 as compared to year 2022-23. It may be due to the fact that sales prices may have been reduced by the company to procure more orders.
 - (b) Gross profit ratio has increased in year 2023-24 as compared to year 2022-23. It may be due to the reason that the cost of materials purchased by company could have decreased.
 - (c) Gross profit ratio has decreased in year 2023-24 as compared to year 2022-23. It may be due to the fact that office staff salary engaged in administrative functions and office maintenance expenditure could have increased.
 - (d) Gross profit ratio has decreased in year 2023-24 as compared to year 2022-23. It may be due to the reason that the company has not made an allowance for obsolescence in respect of inventories during the year.
- 4. CA D has also studied purchases and sales data of the company during the year and has also compared such data with the preceding year and earlier years also. It is an example of _____.

- (a) Ratio analysis forming part of substantive analytical procedures.
 - (b) Trend analysis forming part of substantive analytical procedures.
 - (c) Reasonable test forming part of substantive analytical procedures.
 - (d) Structural modelling forming part of substantive analytical procedures.
5. Considering the whole case scenario, identify which of the following combination of Standards is not proper for their likely relevance in performing and completing the above engagement?
- (a) SQC 1, SA 220, SA 501, SA 505.
 - (b) SA 550, SA 510, SA 220, SA 610.
 - (c) SA 700, SA 510, SA 220, SA 500.
 - (d) SQC 1, SA 700.

ANSWERS TO MULTIPLE CHOICE QUESTIONS

1. **Option (d)** The situation reflected in case scenario may not constitute threat to independence of auditor mandatorily. Irrespective of this, detection risk in engagement is high.

Reason:

The engagement partner's social acquaintance with the promoters does not create a familiarity threat mandatorily as it does not influence professional judgment. However, detection risk is high since it is the firm's first audit of the company, and there is a significant increase in turnover and trade receivables, indicating potential misstatements.

2. **Option (c)** Verifying cost of PPE items acquired during the year with purchase bills.

Reason:

While comparing given procedure in the questions more relevant audit procedures include inspecting and reviewing company's plan for physical verification of PPE, assessing depreciation method used, and recalculation of depreciation charged in statement of profit and loss to be included in

audit plan. Thus, verifying cost of PPE items acquired with purchase bills during the year only will be least relevant.

3. **Option (a)** Gross profit ratio has decreased in year 2023-24 as compared to year 2022-23. It may be due to the fact that sales prices may have been reduced by the company to procure more orders.

Reason:

The Gross Profit Ratio for 2022-23 is 25% $[(3.75/15) * 100]$, whereas for 2023-24, it has decreased to 20% $[(6/30) * 100]$. This indicates a decline in the gross profit ratio. A possible Reason for this decrease could be that the company lowered its selling prices to secure more orders. Further, office staff salary engaged in administrative functions and office maintenance expenditure and allowance for obsolescence in respect of inventories primarily impact net profit, not gross profit.

4. **Option (b)** Trend analysis forming part of substantive analytical procedures.

Reason:

Trend analysis is the comparison of current data with the prior period balance or with a trend in a two or more prior period balances. In other words, trend analysis implies analysing account fluctuations by comparing current year to prior year information and, also, to information derived over several years.

5. **Option (b)** SA 550, SA 510, SA 220, SA 610.

Reason:

As per given facts in the question combination of option covering SA 550, SA 510, SA 220, SA 610 are not relevant. Since the company does not engage in related party transactions SA 550, "Related Parties", is not relevant. Further, SA 610 based on Using Work of Internal Auditors is also irrelevant as the company does not have an internal auditor. Furthermore, SA 220 and SA 510 is relevant but does not fit the overall combination when paired with SA 550 and SA 510.