

# **INTERMEDIATE COURSE**

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## **PAPER – 5**

### **AUDITING AND ETHICS**

**[RELEVANT FOR MAY, 2026 EXAMINATION AND ONWARDS]**

## **BOOKLET ON CASE SCENARIOS**



**BOARD OF STUDIES (ACADEMIC)**  
**THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA**

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## BEFORE WE BEGIN.....

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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!**

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## CASE SCENARIO 1

CA Rajesh and Co. are the statutory auditors of Ram Textiles Ltd. and are making arrangements to start the audit. CA Rajesh, planned to ensure that the work of engagement team members is properly directed, supervised and reviewed so as to conduct an effective audit by the team members. CA Rajesh understood that the nature, timing and extent of the direction and supervision of engagement team members and their review, depends on various factors relating to entity and firm. He ensured that planning of the audit is made so as to cover the scope of audit. Enough care has been taken to ensure that the scope does not include the matters which fall outside the domain of his competence and at the same time to obtain reasonable assurance whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion. The auditor understood the entity and its environment, internal controls, the IT environment and the related risks. Considering the large volume of transactions, the auditor preferred to go for audit sampling with proper checks and controls. The engagement team members were made aware that appropriate risk assessment procedures be designed to suit the circumstances and to strike a balance between the different components of audit risk, so as to reduce the overall audit risk to acceptable low-level and to adopt appropriate audit procedures as required. The auditors wish to determine the sample size by the application of statistical techniques or through the exercise of professional judgment, as would be appropriate in the particular circumstances and also decided in appropriate cases, to examine the entire population of items that make up a class of transactions or account balance. Accordingly, CA Rajesh decided to use statistical sampling for verification of sales, and at the same time, verify all the sales transactions to related parties. The auditor considered various factors that determine the sample size for tests of control and observed that when circumstances are similar, the effect on sample size of factors will be similar, regardless of whether a statistical or non-statistical approach is chosen. Further, he designed and performed audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient and appropriate audit evidence and thereby enable to draw reasonable conclusions

on which to base the auditor's opinion. The engagement team members were given instructions, that apart from the appropriateness and relevance of audit evidence obtained, the need for sufficiency of audit evidence and the factors affecting auditor's judgment as to sufficiency of audit evidence, shall also be considered.

Based on the above facts, answer the following:

### MULTIPLE CHOICE QUESTIONS

1. CA Rajesh had considered all the factors affecting the supervision and review of engagement team members' work. One of the following is not a factor in deciding the nature, timing and extent of the direction and supervision of engagement team members and review of their work.
  - (a) Size and complexity of the entity
  - (b) The availability of time and trained personnel to review the work
  - (c) The capability and competence of the individual team members performing the audit work
  - (d) The area of the audit
  
2. As per the understanding of CA Rajesh, which of the below options, falls within the scope of audit of financial statements?
  - (a) Reliability and sufficiency of financial information.
  - (b) Responsibility of preparation and presentation of financial information.
  - (c) Expertise in authentication of documents.
  - (d) Duties outside scope of competence of auditor.
  
3. Suggest the audit team members of CA Rajesh and Co. to match the apt combination from the following information regarding risk and their description:

Type of Risk	Description
1. Sampling Risk	a. Sample was not representative of the population.

2. Audit Risk	b. Risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated.
3. Not an Audit Risk	c. Erroneous conclusion due to application of inappropriate audit procedure.
4. Non-sampling Risk	d. Risk that the auditor might express an opinion that the financial statements are materially misstated, when they are not.

- (a) 1-a, 2-b, 3-c, 4-d
- (b) 1-c, 2-a, 3-b, 4-d
- (c) 1-b, 2-d, 3-a, 4-c
- (d) 1-a, 2-b, 3-d, 4-c
4. CA Rajesh decided to go for sampling for verification of controls, transactions and for applying substantive procedures. In this regard, select a statement from the below options, which is not apt:
- (a) It is possible to make 100% examination of test of controls.
- (b) 100% examination may be made of a population constituting a small number of large value items.
- (c) 100% examination is appropriate when there is a significant risk, and other means do not provide sufficient appropriate audit evidence.
- (d) The repetitive nature of calculation or other process performed automatically by an information system, makes a 100% examination cost effective.
5. CA Rajesh wants to choose a sample size which enables him to make a proper risk assessment of the population. In selecting the sample size, which of the below option is not correct?
- (a) The lower the risk the auditor is willing to accept, the greater the sample size needs to be.

- (b) If there is an increase in the tolerable rate of deviation, then the sample size will decrease.
  - (c) Other things being equal, the greater the reliance the auditor places on the operating effectiveness of controls in the risk assessment, the greater is the extent of the auditor's tests of controls and thus the sample size will decrease.
  - (d) When there is an increase in the expected rate of deviation of the population to be tested, then sample size will increase.
6. The auditor's judgment as to sufficiency of audit evidence is not dependent on one of the factors mentioned below. Choose one such factor from the below options:
- (a) Nature and source of audit evidence
  - (b) Risk of Material Misstatement
  - (c) Size and characteristics of population
  - (d) Materiality

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (b)** The availability of time and trained personnel to review the work

**Reason:**

SA 300 states that the nature, timing and extent of direction and supervision of engagement team members depend primarily on risk-based factors such as the size and complexity of the entity, the area of the audit, and the competence and capability of the audit team. These factors determine how closely work must be directed and supervised. In contrast, the availability of time and trained personnel is a resource-planning constraint that affects scheduling and staffing, not the level of direction or supervision required by professional standards. Therefore, it is not a determining factor for direction and supervision.

**2. Option (a)** Reliability and Sufficiency of Financial Information**Reason:**

The auditor's objective is to obtain reasonable assurance that the financial statements are free from material misstatement and to express an opinion on them. This directly involves evaluating the reliability and sufficiency of financial information. Options (b) and (d) relate to management's responsibilities or matters outside the auditor's scope. Moreover, auditing standards do not require auditors to authenticate documents. SA 200 specifically states that auditors are not responsible for determining document authenticity.

**3. Option (d)** 1-a, 2-b, 3-d, 4-c**Reason:**

Sampling risk refers to the possibility that the sample selected is not representative of the population, leading to an incorrect conclusion. Audit risk is the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated. The option describing the auditor wrongly concluding that the financial statements are misstated when they are not is not audit risk as defined in SA 200. Non-sampling risk arises from factors such as using inappropriate audit procedures or misinterpreting evidence.

**4. Option (a)** It is possible to make 100% examination of test of controls.**Reason:**

Options (b), (c) and (d) correctly identify situations where 100% examination is appropriate—such as when there are only a few high-value items, when significant risks exist with no alternative evidence available, or when automated, repetitive processes allow full-population testing. In contrast, Option (a) is not apt because tests of controls are generally performed using sampling to assess operating effectiveness. Full testing of every control instance is usually impractical and is not the standard approach prescribed by auditing standards.

5. **Option (c)** Other things being equal, the greater the reliance the auditor places on the operating effectiveness of controls in the risk assessment, the greater is the extent of the auditor's tests of controls and thus the sample size will decrease.

**Reason:**

**Options (a), (b) and (d) correctly reflect SA 530 sampling principles:** lower acceptable sampling risk increases sample size; higher tolerable deviation decreases sample size; and higher expected deviation increases sample size. Option (c) is incorrect because it contradicts the logic of control reliance. When the auditor intends to place greater reliance on the operating effectiveness of controls, the auditor must perform more extensive tests of controls to obtain sufficient evidence. More extensive testing means the sample size should increase, not decrease.

6. **Option (a)** Nature and source of audit evidence

**Reason:**

SA 500 distinguishes sufficiency (quantity) from appropriateness (quality) of audit evidence. The quantity of evidence required is driven mainly by the risk of material misstatement and materiality—higher risk or higher materiality requires more evidence. Population size and characteristics affect sample size. The nature and source of evidence affect appropriateness (reliability and relevance), not the quantity of evidence required.

**CASE SCENARIO 2**

Ravi Chopra and Associates are statutory auditors of a steel manufacturing company. The audit for the current financial year has been started. The engagement partner, as part of understanding and evaluating the internal controls of the company, chose to use Internal Control Questionnaire for collecting information about the existence, operation and efficiency of internal control in the organisation. Accordingly, the auditor handed over an Internal Control Questionnaire in respect of purchases, creditors, inventories and fixed assets, to the management.

In the process of verification of receivables of the company, the engagement partner performed certain Test of Controls and found them satisfactory. He then decided to use direct confirmation procedure and selected some of the parties for external confirmation, on the basis of his judgment. The partner decided to use both positive and negative confirmation request(s) depending on the circumstances, materiality and volume of transactions as would be appropriate for the class of transactions selected for verification. The responses received and the non-responses were carefully analysed for further audit procedures to be carried on, to corroborate evidence obtained from confirmation requests.

The engagement partner observed during the course of verification, that the company is facing tight working capital conditions and also availed additional cash credit limits on ad-hoc basis for six months, from its banker, to meet the stressed working capital requirements. The partner verified whether appropriate charges were registered within the statutory time period with the Registrar of Companies and whether necessary disclosures are made in the financial statements.

Further, during the course of audit verification, the partner identified certain events or conditions that cast doubt on the entity's ability to continue as a going concern. The engagement partner held appropriate discussions with the management and those charged with governance, to resolve the matter on appropriateness of going concern assumption. The management demonstrated their plans to the satisfaction of the auditor, to dispel the doubts raised on going concern assumption.

The audit manager during the course of audit verification came across certain subsequent events but had confusion in classifying them, so as to decide on their treatment in the financial statements. The subsequent events are to be dealt, based on whether the evidence of conditions that existed on the date of the financial statements, or events providing evidence of conditions, that arose after the date of financial statements.

In the Board meeting held during the month of April, the company discussed on the settlement of certain legal claims on the company, plans for reconstruction of business by issue of new share capital and merger proposals by interested parties. The engagement partner properly analysed all such events and ensured that they are appropriately dealt with in the financial statements.

Based on the above facts, answer the following:

### MULTIPLE CHOICE QUESTIONS

- The following are a part of Internal Control Questionnaire in respect of purchases, creditors, inventories and fixed assets. Match the apt combination from the following information regarding Related part of Internal Control Questionnaire and Description of item:

Related part of Internal Control Questionnaire	Description of item
1. Are materials inspected and counted, weighed or measured in the receiving department?	a. Creditors
2. In respect of raw material and supplies, are reconciliations made of quantities and / or values received as shown by purchase invoices, with receipt into stock records?	b. Purchases
3. Are there norms for re-order level?	c. Fixed assets
4. Is there a written procedure for periodic verification and discrepancies disclosed by such reports investigated and are the records and financial accounts corrected with appropriate authority?	d. Inventories

- 
- (a) 1-d, 2-a, 3-c, 4-b
- (b) 1-b, 2-a, 3-d, 4-c
- (c) 1-a, 2-c, 3-d, 4-b
- (d) 1-c, 2-b, 3-d, 4-a
2. In respect of the confirmations from the trade receivables, choose the statement which is not correct.
- (a) Confirmation from trade receivables should necessarily be as on the date of balance sheet.
- (b) The requested confirmation should preferably be without mentioning the balance outstanding, wherein the debtor is requested to respond with the balance outstanding as per his records.
- (c) The method of selection of trade receivables to be circulated, should not be revealed to the client, until the trial balance of the trade receivables ledger is handed over to the auditor.
- (d) The auditor employs direct confirmation procedure with the consent of the entity under audit.
3. Some of the parties to whom the confirmation requests were sent, have replied and some did not. CA Ravi Chopra analysed the responses received and discussed with his team members, the reasons for non-response and asked them to send the reminders. Choose the statement which is not correct from the following:
- (a) The failure to receive a response to a negative confirmation request, does not explicitly indicate receipt by the intended confirming party, of the confirmation request or verification of the accuracy of the information contained in the request.
- (b) Failure of a confirming party to respond to a negative confirmation request, provides significantly less persuasive audit evidence, than does a response to a positive confirmation request.
- (c) Confirming parties may be less likely to respond in the case of disagreement with a confirmation request, when the information in

the request is not in their favour and more likely to respond otherwise.

- (d) Confirming parties may be more likely to respond indicating their disagreement with a confirmation request, when the information in the request is not in their favour, and less likely to respond otherwise.
4. In respect of registration or satisfaction of charges created on Borrowings of the company, following information is to be disclosed in the financial statements. Choose the correct option.
- (a) Charges or satisfaction yet to be registered with Registrar of Companies beyond the statutory period, details thereof shall be disclosed.
- (b) Charges or satisfaction yet to be registered with Registrar of Companies beyond the statutory period, details and reasons thereof shall be disclosed.
- (c) Charges yet to be registered with Registrar of Companies beyond 12 months from the date of creation of charge, the details and reasons thereof shall be disclosed.
- (d) Charges or satisfaction of charges made by the company during the year.
5. CA Ravi Chopra had considered all the events that cast a doubt on the going concern assumption. Consider the following examples of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern:
- (1) Shortage of important supplies.
  - (2) Loss of major market share.
  - (3) Inability to pay creditor on due dates.
  - (4) Non-compliance with regulatory requirements.
  - (5) Arrears or discontinuance of dividends.
  - (6) Emergence of highly successful competitor.

- (7) Pending legal proceedings which may result in claims which the entity is unlikely to be able to satisfy.
- (8) Inability to obtain financing for essential requirements.

Choose the correct option which suits to events or conditions.

- (a) 1, 3, 4-Financing events: 2, 5, 6-operating events: 7, 8-other events
  - (b) 1, 4-Financing events: 3, 2, 5-operating events: 6, 7, 8-other events
  - (c) 1, 4-Financing events: 3, 7, 6-operating events: 2, 5, 8-other events
  - (d) 3, 5, 8-Financing events: 1, 2, 6-operating events: 4, 7-other events
6. CA Ravi Chopra considered the subsequent events which require to be dealt with in the financial statements. Select from the below options, the one which is not an event, providing evidence of conditions that arose after the date of the financial statements:
- (a) Settling a legal claim outside the court at a reduced amount, between the date of financial statements and the date of auditor's report, for which provision has already been made in financial statements.
  - (b) Issue of new share capital.
  - (c) Planned merger of the company.
  - (d) Destruction of substantial inventories due to fire between the date of the financial statements and the date of auditor's report.

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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- 1. Option (b)** 1-b, 2-a, 3-d, 4-c

**Reason:**

The internal control questionnaire items relate to different functional areas. Inspection, counting and weighing of materials in the receiving department is a purchases control, ensuring only authorised and correctly described goods enter the system. Reconciling purchase invoices with goods received helps ensure creditors are recorded only for goods actually received. Norms for reorder levels form part of inventory controls,

preventing stockouts or excess stock. A written procedure for periodic verification, investigation of discrepancies and correction of records with proper authority relates to fixed assets, ensuring accuracy and safeguarding of assets.

2. **Option (a)** Confirmation from trade receivables should necessarily be as on the date of balance sheet.

**Reason:**

The trade receivables 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. Option (b) is correct because requesting the debtor to state their own balance provides stronger evidence. Option (c) is correct, as revealing the selection method may lead to manipulation. Option (d) is also correct because direct confirmations are sent with the entity's consent.

3. **Option (c)** Confirming parties may be less likely to respond in the case of disagreement with a confirmation request, when the information in the request is not in their favour and more likely to respond otherwise.

**Reason:**

Statement (c) is illogical and contrary to observed response behaviour. If information in the request is not in their favour (i.e., debtor disputes the stated balance), confirming parties are more likely to respond to correct/contest it, not less likely. Other options are correct.

4. **Option (b)** Charges or satisfaction yet to be registered with Registrar of Companies beyond the statutory period, details and reasons thereof shall be disclosed.

**Reason:**

Where any charges or satisfaction yet to be registered with Registrar of Companies beyond the statutory period, details and reasons thereof shall be disclosed.

5. **Option (d)** Financing events: 3, 5, 8 Operating events: 1, 2, 6 Other events: 4, 7

**Reason:**

Events indicating liquidity or financial stress are financing events, such as inability to pay creditors (3), dividend arrears (5) and inability to obtain finance (8). Events arising from day-to-day business conditions are operating events, such as shortage of supplies (1), loss of major market share (2) and emergence of a strong competitor (6). Legal or regulatory matters that do not fall under operating or financing categories are other events, such as regulatory non-compliance (4) and pending legal claims (7).

6. **Option (a)** Settling a legal claim outside the court at a reduced amount, between the date of financial statements and the date of auditor's report, for which provision has already been made in financial statements.

**Reason (adjusting vs non-adjusting events):**

Adjusting events are those that occur after the balance sheet date but provide further evidence of conditions that already existed at that date; these require adjustments in the financial statements. Settling a legal claim after year-end confirms an existing liability and is therefore an adjusting event, not an event arising after the balance sheet date. Non-adjusting events relate to conditions that arise after the balance sheet date and require only disclosure, such as issue of new share capital, planned merger, or destruction of inventory by fire.

**CASE SCENARIO 3**

M/s Rama & Associates, Chartered Accountants, have been appointed as the statutory auditors of a Government company H Ltd. by the Comptroller & Auditor General of India for F.Y. 2024-25. H Ltd. is engaged in the manufacturing of metro train coaches.

CA Rama, the engagement partner, had to conduct audit of expenditure as well of receipts.

During the course of the audit, CA Rama also found that the company has constructed its new stockyard for parking its metro coaches and maintenance of its metro coaches. However, the newly constructed stockyard was not being used by the company for the designated purpose and the company continued using the rented stockyard. CA Rama considered such expenditure as infructuous and avoidable expenditure.

The engagement partner also discussed with his team regarding the areas to be covered while conducting the audit of receipts. The reporting responsibilities of the engagement team were also discussed by the engagement partner with his team.

Based on the above facts, answer the following:

**MULTIPLE CHOICE QUESTIONS**

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1. \_\_\_\_\_ is conducted to ensure that the various programmes, schemes, and projects where large financial expenditure have been incurred are run economically and are yielding results expected of them.
  - (a) Propriety Audit
  - (b) Audit against Rules and Orders
  - (c) Performance Audit
  - (d) Audit against Provision of funds
2. While conducting an audit against provision of funds, the statutory auditors, M/s Rama & Associates must check

- (a) that each item of expenditure is covered by a sanction either general or special of a competent authority.
  - (b) that the expenditure incurred has been on the purpose for which the grant and appropriation has been provided and the amount of such expenditure does not exceed the appropriation made.
  - (c) that the expenditure conforms to the relevant provision of the constitution and of the laws and rules made thereunder.
  - (d) that the expenditure is in accordance with the financial rules, regulations and orders issued by the competent authority.
3. Which type of the expenditure audit covers the scrutiny of the expenditure incurred on the construction of stockyard by the company which is considered as infructuous and avoidable by CA Rama?
- (a) Propriety Audit
  - (b) Audit against provision of funds
  - (c) Audit of sanctions
  - (d) Performance Audit

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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1. **Option (c)** Performance Audit

**Reason:**

A performance audit ensures that the various programmes, schemes and projects where large financial expenditure has been incurred are being run economically and are yielding the results expected of them.

2. **Option (b)** that the expenditure incurred has been on the purpose for which the grant and appropriation has been provided and the amount of such expenditure does not exceed the appropriation made.

**Reason:**

Audit against provision of funds aims at ascertaining that the expenditure incurred has been on the purpose for which the grant and appropriation

had been provided and that the amount of such expenditure does not exceed the appropriation made.

**3. Option (a) Propriety Audit**

**Reason:**

The expenditure on constructing a stockyard that is never used becomes infructuous and avoidable, indicating lack of financial prudence. Propriety Audit examines whether public money is spent wisely, and identifies wasteful, extravagant or avoidable expenditure, and whether actions are in the public interest.

**CASE SCENARIO 4**

M/s AB & Co., Chartered Accountants, have been appointed as the statutory auditors for Financial Year 2024-25 of PQ Ltd., which is a textile company. Mr. X, the engagement partner, assigned the task of auditing the various items of financial statements to the articled clerks. Mr. X explained to the articled clerks that financial statement purports to present something as a whole in addition to its component details. An income statement purports to present "the results of operations," whereas the balance sheet purports to present "financial position." He further clarified that the auditor's opinion is typically directed to these overall representations.

However, before formulating and providing an opinion on the overall truthfulness of these statements, the auditor must first examine the truth of various specific assertions that make up each of these statements. By evaluating these individual assertions, the auditor can then form a judgment regarding the financial statement as a whole.

To verify the assertions presented in the financial statements, the auditor must perform variety of procedures.

Articled clerks looking after different areas seek your advice as regards their different concerns.

Based on the above facts, answer the following:

**MULTIPLE CHOICE QUESTIONS**

1. Mr. B, an Articled Clerk responsible for the audit procedures concerning inventory, found that the inventory amounting to ₹ 38 lakhs, after excluding ₹ 2 lakhs of inventory that was held by PQ Ltd. as a consignee, has been recognized in the Balance Sheet. Which of the following assertions related to inventory are applicable in this situation?
  - (I) Occurrence
  - (II) Completeness
  - (III) Rights & Obligations

- (IV) Measurement
- (a) I & II above
- (b) II & III above
- (c) III & IV above
- (d) I & IV above
2. Mr. C, an Articled Clerk responsible for the audit procedures regarding the share capital, found that during the year under audit, PQ Ltd. had issued sweat equity shares amounting to ₹ 10 Lakhs. Which of the following statements regarding the issue of sweat equity shares are correct?
- (I) It can be issued to employees.
- (II) It can be issued to directors.
- (III) It can be issued at a discount.
- (IV) It should be of a class of shares already issued by PQ Ltd.
- (a) I & III above
- (b) I, II & III above
- (c) I, II & IV above
- (d) I, II, III & IV above
3. Mr. D, an Articled Clerk, was performing audit procedures related to Reserves and Surplus in PQ Ltd. tell him that which statement are correct in respect of Reserves and Surplus?
- (I) Reserves are the amounts appropriated out of profits for commitment.
- (II) Securities premium is a capital reserve.
- (III) A debit balance in the statement of profit and loss account shall be shown as a negative figure under the head 'surplus'.
- (IV) All reserves can be used to augment the working capital of the Company.

- 
- (a) I & II above
- (b) II & III above
- (c) III & IV above
- (d) II & IV above
4. Mr. E, an Articled Clerk, was not sure about which items should be considered as intangible assets in PQ Ltd. According to AS-26, which of the following items should not be recognized as intangible assets?
- (I) Internally generated Goodwill
- (II) Compact disk in the case of computer software
- (III) Copyrights
- (IV) Computer software for computer-controlled machine tools that cannot operate without that specific software, which is an integral part of the related hardware.
- (a) I & II above
- (b) II & III above
- (c) III & IV above
- (d) I & IV above
5. Mr. F, an Articled Clerk, wants to know that which of the below statement is incorrect while auditing Depreciation and Amortization expenses in PQ Ltd.?
- (a) Depreciation and amortization have been charged as per the useful life of PPE and intangible assets.
- (b) Depreciation on the revalued amount should be accounted from the revaluation reserve.
- (c) Depreciation should be charged on assets from the date of actual usage and not when they are ready to use.
- (d) Depreciation and amortization should be computed prospectively whenever there is any change in useful life of PPE and intangible assets.

**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (b)** II & III above

**Reason:**

Inventory of ₹ 38 lakhs was recognised after excluding ₹ 2 lakhs of consignment stock, which does not belong to PQ Ltd. This relates to the Rights & Obligations assertion, since only inventory owned by the entity should be recorded. It also relates to the Completeness assertion, as the auditor must ensure that all inventory that should be included is recorded, and items not belonging to the entity are excluded. Measurement is not the main issue because the matter concerns ownership, not valuation. Occurrence relates to transactions and is therefore irrelevant.

2. **Option (d)** I, II, III & IV above

**Reason:**

Under Section 54, sweat equity shares may be issued to employees and directors in exchange for know-how, intellectual property or value addition. The law also allows these shares to be issued at a discount or for consideration other than cash, which distinguishes them from normal equity issues. Further, sweat equity must belong to a class of shares already issued by the company and cannot create a new class. Since all four statements—eligibility of employees, eligibility of directors, issue at discount, and requirement of existing class—are correct.

3. **Option (b)** II & III above

**Reason:**

Securities premium is treated as a capital reserve, not a revenue reserve, and its use is restricted to specific purposes under the Companies Act, making Statement (II) correct. A debit balance in the Statement of Profit & Loss represents accumulated losses and is shown as a negative figure under 'Surplus/(Deficit)', making Statement (III) correct. Statement (I) and Statement (IV) are incorrect.

**4. Option (d) I & IV above:**

**Reason:**

Under AS-26, internally generated goodwill is not recognised as an intangible asset because it cannot be measured reliably and lacks identifiability and control. Computer software integral to hardware is treated as part of the tangible asset, as it is inseparable and its cost is included in the hardware's carrying amount. Both fail key recognition tests: identifiability, control with future economic benefits, and reliable measurement of cost. Consequently, internally generated goodwill is expensed, and integral software is capitalised as part of PPE. Therefore, I & IV are not separately recognised as intangible assets, making Option (d) correct.

**5. Option (c) Depreciation should be charged on assets from the date of actual usage and not when they are ready to use.**

**Reason:**

Depreciation must be charged from the date an asset is ready for its intended use, not from the date of actual usage, making Statement (c) incorrect. Depreciation and amortisation are computed systematically over the asset's useful life (a) and revised prospectively if useful life or residual value changes (d). For revalued assets, depreciation is based on the revalued amount with adjustments between revaluation reserve and P&L (b).

**CASE SCENARIO 5**

M/s DG and Associates, Chartered Accountants, have been appointed as the statutory auditor of HT Private Limited for the financial year 2024-25. CA Mr. D, engagement partner, and a team comprising of three articled clerks has been assigned the task of conducting the audit of HT Private Limited for F.Y. 2024-25. In the initial stages of conducting an audit of HT Private Limited, CA Mr. D decided to evaluate internal control operating in the company. To gather information required for evaluation of internal control, CA Mr. D asked his team members to suggest a method which would help in gathering information so that internal control of the company can be evaluated.

First team member of the team suggested that they should follow a method, in which a series of instructions and/or questions are required to be followed and/or answered by the audit team and the answers to these instructions are usually Yes, No or Not Applicable. These instructions are framed having regard to the desirable elements of control.

The second team member of team suggested a method in which a complete and exhaustive description of the internal control system as found in operation is recorded by the auditor.

The third team member of team suggested a method in which comprehensive series of questions concerning internal control were required to be answered which would provide information about internal control.

Based on the above facts, answer the following:

**MULTIPLE CHOICE QUESTIONS**

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1. In initial stage of conducting audit of HT Private Limited, CA Mr. D decided to evaluate internal control of the company. Evaluation of internal control is very important part of
  - (a) Audit Report
  - (b) Audit Evidence
  - (c) Audit Documentation

- 
- (d) Audit Programme
2. The method suggested by first team member according to which, a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. When he completes instruction, he initials the space against the instruction. This method is called as
- (a) Flow Chart
  - (b) Check List
  - (c) Narrative Record
  - (d) Questionnaire
3. The method suggested by second team member in which a complete and exhaustive description of internal control in operation is recorded. This method is known as
- (a) Narrative Record
  - (b) Flow Chart
  - (c) Questionnaire
  - (d) Check List
4. The third team member suggested a method in which comprehensive series of questions concerning internal control is used to collect information. These questions are usually issued to the client and the client is requested to fill it. This method of gathering information so that internal control can be evaluated is called as:
- (a) Internal Control Questionnaire
  - (b) Flow Chart
  - (c) Narrative Record
  - (d) Check List

**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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**1. Option (d) Audit Programme****Reason:**

Evaluation of internal control is an essential part of the audit programme, which is the detailed plan of audit procedures. It helps the auditor decide which controls to test, the nature and extent of tests, and the substantive procedures required. Including internal control evaluation in the audit programme ensures a systematic and structured approach to the audit. While audit evidence is the result of testing, the evaluation is conducted during the execution of the audit programme, guiding the audit team on the procedures to perform. Thus, internal control evaluation is integral to planning and executing the audit, justifying Option (d).

**2. Option (b) Check List****Reason:**

Check List is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. When he completes instruction, he initials the space against the instruction. Answers to the check list instructions are usually Yes, No or Not Applicable.

**3. Option (a) Narrative Record****Reason:**

Narrative Record is a detailed, continuous written description of how the internal control system actually operates in the client's organisation. It explains processes, responsibilities, documents used, and flow of transactions in full descriptive form. This method is used when the auditor wants a complete and exhaustive understanding of internal control. Unlike flowcharts, it does not use diagrams; unlike questionnaires or checklists, it does not rely on standard questions or brief points.

**4. Option (a) Internal Control Questionnaire****Reason:**

The method suggested by the third team member describes issuing a comprehensive set of structured questions to the client, who fills in the responses. This tool is known as an Internal Control Questionnaire (ICQ) and is specifically designed to obtain detailed information about the design and operation of internal controls. ICQs help auditors assess whether key control objectives are being met by eliciting clear Yes/No/NA responses. Unlike narrative records or flowcharts prepared by the auditor, an ICQ is completed by the client, making it a direct method of gathering internal control information. Hence, Option (a) is correct.

**CASE SCENARIO 6**

CA Anuj is in practice for the past few years as proprietor of Anuj & Associates. He is very keen on documentation aspects while performing assurance engagements. He handles audits of various corporate as well as non-corporate clients with team members. The proprietorship concern also handles review engagements as well as engagements to report on prospective financial information as per needs and requirements of its clientele. Presently, it is handling audit of "Buddy Enterprises", a partnership firm, for year 2024-25 in middle of busy audit season. This business enterprise is also availing cash credit limit of ₹ 10 lacs from CDB Bank. The firm's partnership deed contains a clause stipulating audit of its financial statements by a firm of Chartered Accountants every year. However, there is no legal requirement to get financial statements of partnership firm audited. Its Profit before tax is ₹ 15 lacs.

J is junior team member forming part of audit team conducting above audit. The audit team has planned everything right from risk assessment procedures to tests of controls as well as substantive procedures. Audit plan and audit programme have been duly documented. However, during the course of audit, some information has come to notice of audit team which requires change in audit plan and could lead to revision of audit strategy. J is pondering over regarding documentation requirements in this peculiar situation.

Another team member, K has understood meaning of "sufficient appropriate" evidence while conducting audits. However, he is wondering over obtaining sufficient appropriate evidence in case of assurance engagements which may not be in nature of audit. At the initial stages, audit team has determined materiality for financial statements as whole @ 5% of Profit before tax (i.e. 5% of ₹ 15 lacs = ₹ 75000). K is also concerned about documenting materiality as part of audit documentation.

K vividly remembers that an assurance engagement involves three party relationship. However, another team member Q confronts him with meaning of three-party relationship.

In accordance with terms of sanction letter, it has been stipulated by CDB bank that partnership firm is required to submit quarterly stock statements to

bankers. During quarter ended 31<sup>st</sup> December 2024, value of stocks declared by firm to bankers is ₹ 10 lacs and margin stipulated in sanction letter is 20%.

Based upon above, answer the following questions: -

### **MULTIPLE CHOICE QUESTIONS**

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1. Considering dilemma of J described in case scenario, which of following statements is most appropriate?
  - (a) Only overall audit strategy needs to be documented by audit team.
  - (b) Only audit plan needs to be documented by audit team.
  - (c) Both overall audit strategy and audit plan need to be documented by audit team.
  - (d) Overall audit strategy, audit plan and any significant changes made during the audit engagement to the overall audit strategy or the audit plan and the reasons for such changes need to be documented by audit team.
  
2. Guide K regarding most appropriate statement concerning obtaining of "sufficient appropriate" evidence as described in case scenario.
  - (a) Sufficient appropriate evidence is to be obtained only in case of statutory audits. In the given case, there is no requirement of law to get accounts audited. Hence, there is no need to obtain sufficient appropriate evidence.
  - (b) Sufficient appropriate evidence is to be obtained in audit engagements, review engagements and engagements involving examination of prospective financial information.
  - (c) Sufficient appropriate evidence is to be obtained in audit engagements and review engagements.
  - (d) Sufficient appropriate evidence is to be obtained in all audit engagements.

3. Advise K regarding most appropriate statement regarding documenting materiality.
- (a) Materiality of ₹ 75000 needs to be documented.
  - (b) Performance materiality which is set at more than for financial statements as a whole requires to be documented along with materiality of ₹ 75000.
  - (c) Performance materiality which is set at less than for financial statements as a whole requires to be documented along with materiality of ₹ 75000.
  - (d) Performance materiality (for certain transactions) which is set at par level for financial statements as a whole requires to be documented along with materiality of ₹ 75000.
4. Which of following combinations best describes three party relationship in context of audit of partnership firm?
- (a) Anuj & Associates, management/partners of Buddy enterprises and income tax authorities
  - (b) Individual team members assisting CA Anuj, management/partners of Buddy enterprises and income tax authorities
  - (c) Anuj & Associates, management/partners of Buddy enterprises and bankers of Buddy Enterprises
  - (d) Anuj & Associates, management/partners of Buddy enterprises and intended users
5. Which of the following statements is true regarding drawing power on basis of facts given in case scenario?
- (a) DP is ₹ 10 lacs and firm can withdraw funds up to ₹ 10 lacs.
  - (b) DP is ₹ 12 lacs and firm can withdraw funds up to ₹ 12 lacs.
  - (c) DP is ₹ 8 lacs and firm can withdraw funds up to ₹ 10 lacs.
  - (d) DP is ₹ 8 lacs and firm can withdraw funds up to ₹ 8 lacs.

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**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (d)** Overall audit strategy, audit plan and any significant changes made during the audit engagement to the overall audit strategy or the audit plan and the reasons for such changes need to be documented by audit team.

**Reason:**

As per SA 300 – Planning an Audit of Financial Statements, the auditor must document:

1. Overall audit strategy,
2. Audit plan, and
3. Significant changes made during the audit to either of them along with reasons for such changes.

Since new information has emerged requiring a revision of the plan, J must document the changes and reasons. Hence option (d) is most appropriate.

2. **Option (b)** Sufficient appropriate evidence is to be obtained in audit engagements, review engagements and engagements involving examination of prospective financial information.

**Reason:**

The concept of “sufficient appropriate evidence” applies to all assurance engagements, not only statutory audits. It is required in:

- Audit engagements (reasonable assurance – high level)
- Review engagements (limited assurance – moderate level)
- Examination of prospective financial information (also assurance)

Engagements differ only in the level of assurance required, but evidence is required in all. Thus, option (b) correctly covers all relevant assurance engagements handled by Anuj & Associates.

3. **Option (c)** Performance materiality which is set at less than for financial statements as a whole requires to be documented along with materiality of ₹ 75000.

**Reason:**

As per SA 320 – Materiality, the auditor must document:

1. Materiality for financial statements as a whole → ₹ 75,000
2. Performance materiality, which is normally lower than overall materiality to reduce the risk of uncorrected misstatements.

Therefore, K must document both values, and performance materiality will always be less than overall materiality. Hence, option (c) is correct.

4. **Option (d)** (d) Anuj & Associates, management/partners of Buddy enterprises and intended users

**Reason:**

All assurance engagements (including audits) require a three-party relationship consisting of:

1. Practitioner → Anuj & Associates
2. Responsible party → Management/partners of Buddy Enterprises
3. Intended users → Persons who rely on the report (e.g., partners, bankers, etc.)

5. **Option (d)** DP is ₹8 lacs and firm can withdraw funds up to ₹ 8 lacs.

**Reason:**

Calculation:

Stock declared to bank = ₹ 10 lakhs

Bank margin = 20%

Drawing Power (DP) = Stock value × (1 – margin %)

= 10,00,000 × (1 – 0.20)

= 10,00,000 × 0.80 = ₹ 8,00,000

Thus, the firm can withdraw only up to DP = ₹ 8 lakhs.

Hence the correct option is (d).

**CASE SCENARIO 7**

CA Arun, a Chartered Accountant, is conducting the statutory audit of Preeti Textiles Ltd. for the financial year ending March 31, 2025. As part of his professional duty, he is required to express an opinion on whether the financial statements present a true and fair view of the company's financial results and state of affairs.

To form his opinion based on the conclusions drawn, CA Arun is adhering to the requirements of SA 500 – “Audit Evidence”, which requires obtaining sufficient appropriate audit evidence. He obtains and assesses relevant information during the audit. This information includes:

1. Reviewing the company's General Ledger and Journal Entries.
2. Examining supplier invoices and contracts for major purchases.
3. Scrutinizing work sheets used by finance team for calculating depreciation expense.
4. Reading minutes of the Board of Directors' meetings.
5. Inspecting documented internal control manual for sales process.

The auditor acknowledges that judgments arising from a negligent examination may lead to legal consequences and adversely affect his professional reputation. Accordingly, he conducts his examination with utmost objectivity, analytical rigor, and thoroughness.

As at 31<sup>st</sup> March 2025, Preeti Textiles Ltd. reported a trade receivables balance of ₹ 45 crore. During the course of the statutory audit, the auditor, CA Arun, decided to employ direct confirmation procedures to verify the existence and accuracy of the trade receivables.

The management requests CA Arun not to seek confirmation from two overseas customers, citing ongoing disputes and confidentiality clauses in export contracts. He evaluates this request and decides to apply alternative audit procedures, such as verifying subsequent receipts and reviewing correspondence for these balances.

While auditing travel expenses, the auditor observed several travel bills submitted by a director for foreign trips undertaken with family members during the festival period. The company had reimbursed entire amount, classifying it under "Business Promotion Expenses."

Based on above, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

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1. As per SA 500, which of the following best defines "Audit Evidence"?
  - (a) Only information contained in general ledger and journal entries.
  - (b) Only external confirmations received from trade receivables.
  - (c) The information used by the auditor in arriving at the conclusions on which the auditor's opinion is based, including both information contained in the accounting records and other information.
  - (d) Only work sheets and spreadsheets supporting cost allocations and computations.
  
2. In the scenario of Preeti Textiles Ltd., which of the following items is classified as "Information contained in the accounting records" as per SA 500?
  - (a) Minutes of the Board of Directors' meetings.
  - (b) Written confirmations from trade receivables.
  - (c) The documented internal control manual.
  - (d) Supplier invoices and the General Ledger.
  
3. Which of the following examples of audit evidence gathered by CA Arun falls under the category of "Other information that authenticates the accounting records"?
  - (a) Reviewing the company's Journal Entries.
  - (b) Obtaining written confirmations from major trade receivables.
  - (c) Scrutinizing work sheets for depreciation calculation.
  - (d) Examining contracts for major purchases.

- 
4. When the management of Preeti Textiles Ltd. requested the auditor not to seek confirmation from certain overseas customers, the auditor's most appropriate course of action should be to:
- (a) Accept the request without further consideration, since management is responsible for customer relationships.
  - (b) Refuse the request and qualify the audit report immediately.
  - (c) Evaluate whether valid grounds exist for the request. The Auditor needs to reconsider the nature, timing and extent of his audit procedures including the degree of planned reliance on management's representations.
  - (d) Proceed with confirmations only for domestic customers.
5. Which of the following audit verification procedures would be most appropriate for examining the Director's foreign travel expenses?
- (a) Auditor should verify that all bills related to foreign travel should be in the name of the company and travel related to business.
  - (b) Auditor should verify whether the expenditure qualified as revenue expenditure
  - (c) Auditor should verify that the expenditure pertains to the current audit period.
  - (d) Auditor should verify whether the expenditure had valid supporting documents

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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1. **Option (c)** The information used by the auditor in arriving at the conclusions on which the auditor's opinion is based, including both information contained in the accounting records and other information.

**Reason:**

SA 500 defines audit evidence as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. That expressly includes both information contained in the accounting records

(ledgers, journals, invoices, worksheets etc.) and other information (minutes, confirmations, etc.).

2. **Option (d)** Supplier invoices and the General Ledger.

**Reason:**

“Information contained in the accounting records” means source documents and records that form the accounting system — e.g. the General Ledger, journal entries, supplier invoices, etc. Thus, supplier invoices and the General Ledger are part of the accounting records.

The other items listed are other information such as minutes of board meetings, written confirmations, and the internal control manual.

3. **Option (b)** Obtaining written confirmations from major trade receivables.

**Reason:**

“Other information that authenticates the accounting records” refers to evidence outside the accounting records that supports/asserts the recorded balances. Examples are external confirmations, third-party correspondence, minutes of the meetings, etc. Obtaining written confirmations from major trade receivables is the example of other evidence used to corroborate recorded receivable balances.

4. **Option (c)** Evaluate whether valid grounds exist for the request. The Auditor needs to reconsider the nature, timing and extent of his audit procedures including the degree of planned reliance on management’s representations.

**Reason:**

Management’s request to restrict confirmations is a management-imposed limitation on scope. SA guidance requires the auditor to evaluate the validity of the grounds and, if confirmation is withheld, to reconsider the nature, timing and extent of audit procedures, and to perform appropriate alternative procedures (e.g. subsequent cash receipts, shipping documents, sales contracts, correspondence, credit notes). The auditor must exercise professional skepticism and judgement if the restriction is reasonable and alternative procedures provide sufficient appropriate evidence, the auditor can still form an opinion; if the

restriction is unreasonable and cannot be adequately compensated, it may lead to a qualified or disclaimer opinion. So immediate acceptance (a) or immediate qualification (b) would be premature; (d) is not appropriate practice.

5. **Option (a)** Auditor should verify that all bills related to foreign travel should be in the name of the company and travel related to business.

**Reason:**

Verifying that all foreign travel bills are in the company's name helps the auditor confirm that the expenditure was incurred on behalf of the company and not for the director's personal purposes. If the invoice is addressed to the company, it indicates that the travel was authorised, arranged, and paid for as a business activity, strengthening the link between the trip and business objectives. This check reduces the risk of personal or family leisure travel being charged to the company. It also supports proper classification as business promotion or business travel, rather than personal expense. Thus, ensuring bills are in the company's name is an important step in assessing whether the travel genuinely relates to business.

**CASE SCENARIO 8**

The Comptroller and Auditor General of India (C&AG) deputed Mr. V. Sarkar, Chief Audit Officer, to conduct propriety audit of various departments of the State Government of Punjab for the financial year 2024-25. During the course of audit, the following instances were observed:

1. While auditing a government department's festival celebration expenses, the auditor notices that the department spent ₹ 10 lakh on decorations and gifts, which appears excessive considering the scale of the event.
2. The Chief Engineer of PWD Department sanctioned repair work worth ₹ 20 lakh on his residential quarters using departmental funds, justifying it as "official convenience."
3. Health Department purchased luxury office furniture worth ₹ 75 lakh when the existing furniture was still in usable condition.
4. ₹ 3 lakh spent on community welfare donations to a private housing society in which several officers of a department resided, citing "public relations improvement."

Mr. V Sarkar noted that while all expenditures were technically sanctioned and approved under existing rules, many appeared improper, avoidable, or not in public interest. He referred to principles of financial propriety laid down in the principles of financial propriety prescribed in Government Audit Guidelines.

Based on above, answer the following:

**MULTIPLE CHOICE QUESTIONS**

1. The case of department spending ₹ 10 lakh on decorations and gifts represents which breach under the principles of financial propriety?
  - (a) Expenditure for the benefit of a particular section of the community.
  - (b) Expenditure prima facie more than the occasion demands
  - (c) Expenditure sanctioned to one's own advantage
  - (d) Expenditure not authorised under any rule

2. The Chief Engineer's sanction of repair work worth ₹ 12 lakh on his personal residential quarter using departmental funds violates which propriety principle?
  - (a) Exercise of powers for personal advantage
  - (b) Expenditure not in conformity with recognised policy
  - (c) Expenditure resulting in profit to recipients
  - (d) Expenditure lacking documentary evidence
3. Purchase of luxury office furniture when existing furniture was in usable condition primarily indicates a failure to exercise:
  - (a) Regularity audit compliance.
  - (b) Control over documentary evidence.
  - (c) Disciplinary control over subordinates
  - (d) Prudence expected in spending public money.
4. Spending ₹ 3 lakh on community welfare donations to a private housing society where several officials reside violates propriety because:
  - (a) It is not sanctioned under regularity audit
  - (b) It benefits a specific section of the community without policy backing
  - (c) It breaches limits on administrative expenses
  - (d) It lacks internal control documentation

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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1. **Option (b)** Expenditure prima facie more than the occasion demands

**Reason:**

One of the core Principles of Financial Propriety states that "public expenditure should not be prima facie more than what the occasion demands." Here, the department spent ₹10 lakh on decorations and gifts, which appears disproportionately high compared to the size and nature of the event. Even though technically sanctioned, such spending indicates

lack of moderation and breach of the principle that government funds must be used with economy and reasonableness.

2. **Option (a)** Exercise of powers for personal advantage

**Reason:**

The principles clearly state that government officers must not sanction expenditure that is directly or indirectly to their own advantage. The Chief Engineer used his official authority to approve repair work on his personal residential quarters, justifying it as "official convenience." This is a classic case of misuse of administrative and financial powers to obtain personal benefit, which is a breach of propriety and integrity obligations of a public servant.

3. **Option (d)** Prudence expected in spending public money

**Reason:**

Financial propriety requires that a government officer should exercise the same care and prudence in incurring public expenditure as a person would exercise when spending their own money. Purchasing luxury furniture worth ₹75 lakh despite existing furniture being adequate shows failure to apply prudent financial judgement. Thus, it violates the principle of prudent and economical use of public funds.

4. **Option (b)** It benefits a specific section of the community without policy backing

**Reason:**

One of the principles states that public money cannot be spent for the benefit of a particular person or section of the community unless a well-defined government policy authorises such expenditure. In the given situation:

- The donation is made to a private housing society,
- The beneficiaries include specific government officers residing there,
- There is no public purpose or policy justification.

Therefore, the expenditure is improper, not in public interest, and breaches the principle that government funds should not be used for selective benefits.

**CASE SCENARIO 9**

Great Point Ltd., a software development company, has been under pressure to meet aggressive market expectations for revenue growth. For the Financial Year ended March 31, 2025, Great Point Ltd. reported a 25% increase in net profit, mainly attributed to a substantial increase in licensing revenue from a few large contracts signed in the last quarter.

During the audit planning phase, CA R, a member of the audit team, observed that the CEO and CFO are entitled to significant performance bonuses linked directly to the company's reported net income.

The audit team focused on the large licensing contracts. They discovered that one significant contract, contributing 15% to the reported revenue, was with a newly established entity, "Alpha Systems," which appeared to be a shell company with no operational history.

Further audit procedures revealed that the contract terms allowed Alpha Systems a "right of return" on the software license for any reason within 12 months, and Great Point Ltd.'s sales team had provided a side-letter guaranteeing a full refund if the license was unused. Also, a substantial amount of development expenditure, which should have been expensed in the current period, was improperly capitalized as an intangible asset, significantly overstating the reported profit.

The auditor concluded that if inappropriate revenue recognition (due to the right of return and side-letter) and the incorrect capitalization of expenditure are not corrected, these would give rise to risks of material misstatement that are pervasive to the financial statements as a whole and may affect multiple assertions.

The preliminary risk assessment suggested a high risk of material misstatement due to management override of controls and aggressive accounting policies.

Based on above, answer the following:

**MULTIPLE CHOICE QUESTIONS**

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1. Which of the following best illustrates the concept of Audit Risk:
  - (a) The risk that Great Point Ltd.'s management intentionally booked fake expenses.
  - (b) The risk that the auditor incorrectly classifies an expense as capital expenditure.
  - (c) The risk that CA R expresses an unmodified opinion when Great Point Ltd.'s financial statements are materially misstated due to improperly recognized revenue and capitalized expense.
  - (d) The risk that a competitor sues Great Point Ltd. for patent infringement, causing an unexpected financial loss.
  
2. The risk arising from the CEO and CFO's performance bonuses, which creates pressure to overstate profits and leads to the improper capitalisation of development expenditure, is primarily an example of a risk of material misstatement at which level?
  - (a) The overall financial statement level.
  - (b) The assertion level for the Intangible Assets account balance.
  - (c) The control environment level.
  - (d) The detection risk level.
  
3. The act of classifying the development expenditure as an Intangible Asset (capital expenditure) instead of an expense (revenue expenditure) is an example of a misstatement concerning:
  - (a) Difference in disclosure.
  - (b) Selection or application of inappropriate accounting policies.
  - (c) Intentional booking of fake expenses.
  - (d) Charging of an item of capital expenditure to revenue or vice-versa.

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**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (c)** The risk that CA R expresses an unmodified opinion when Great Point Ltd.'s financial statements are materially misstated due to improperly recognized revenue and capitalized expense.

**Reason:**

In this case, improper revenue recognition (due to right-of-return and side-letter) and wrong capitalisation of expenditure create material misstatements. If the auditor fails to detect these and still issues an unmodified opinion, it represents audit risk.

2. **Option (a)** The overall financial statement level.

**Reason:**

Risks of Material Misstatement at the financial statement level arise when factors such as incentives, pressures, or management bias can affect the financial statements as a whole. Since the CEO and CFO's bonuses depend on reported net profit, there is a strong incentive to overstate earnings, leading to aggressive revenue recognition and improper capitalisation. These pressures are pervasive and influence multiple accounts and assertions. Therefore, the risk relates to the overall financial statement level.

3. **Option (d)** Charging of an item of capital expenditure to revenue or vice-versa

**Reason:**

Incorrectly capitalising development expenditure that should have been treated as a revenue expense represents a misclassification between capital and revenue expenditure. Such misstatements arise when an item that should be charged to the Profit & Loss Account is instead shown as an asset, leading to overstatement of profits and overstatement of assets.

### CASE SCENARIO 10

Samta Tools Pvt. Ltd. manufactures precision cutting tools. You are auditing the company for FY 2024–25. The company employs about 450 workers.

The auditor performs trend analysis on salary expense for the past three years:

Particulars	2022-23	2023-24	2024-25
Number of Employees	430	440	450
Salary Expense (₹ crore)	18.0	19.2	27.5
Overtime Hours	8,000	7,500	8,200

Observations by Auditor

- (i) Salary expense increased by 43.2% in 2024–25 (from 19.2 to 27.5 crore).
- (ii) Number of employees increased by only 2.3% (from 440 to 450).
- (iii) Overtime hours increased only marginally (9%).
- (iv) HR records show no major revision in pay scales.
- (v) Increase is not supported by production records.

The auditor suspects:

- Possible payments to fictitious employees,
- Incorrect accounting classification (e.g., bonuses, labour subcontracting recorded as salaries), or
- Unauthorized salary revisions.

Trend analysis is applied to identify this unusual, unexplained fluctuation.

During payroll verification, the auditor identifies several salary payments that cannot be matched to any employee in the master employee list. HR confirms that these employee IDs do not belong to any current or former employee and may have been generated due to a payroll system error. This raises concerns about the occurrence of certain salary expenses, as some payments appear to be made to non-existent or fictitious employees.

However, based on checks of attendance records, appointment files, and authorized HR approvals, the auditor verifies that all genuine employee benefit expenses relating to actual personnel have been recorded and no legitimate salary transactions have been omitted. The issue therefore relates to possible overstatement and not to completeness.

Based on above, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

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1. The auditor compares salary expense for the current year with the previous two years and notes a 43% increase. This method is an example of:
  - (a) Reasonableness test
  - (b) Trend analysis
  - (c) Ratio analysis
  - (d) Substantive test of details
2. Despite only a small increase in employees, salary expense increased significantly. What should be the auditor's next step after identifying this unusual trend?
  - (a) Conclude that the increase is justified
  - (b) Ignore it as overtime hours also increased
  - (c) Perform further audit procedures to investigate the cause
  - (d) Reduce audit work as trend analysis provides sufficient evidence
3. Which of the following situations most strongly indicates a risk of fictitious employees based on the trend analysis results?
  - (a) Salary expense increased far more than employee count
  - (b) Overtime hours increased slightly
  - (c) Production increased by 5%
  - (d) A new HR manager joined during the year

4. Which situation BEST tests the Occurrence assertion for employee benefit expenses?
- (a) Ensuring all employee benefit expenses have been recorded
  - (b) Matching payroll expense with personnel records to confirm no unauthorized persons were paid
  - (c) Checking the arithmetic accuracy of payroll calculations
  - (d) Verifying that all employee benefits are presented under the correct heading
5. Which situation BEST reflects the Completeness assertion for employee benefit expenses?
- (a) Confirming that no unauthorized employees have received salary payments
  - (b) Ensuring that every recorded employee benefit expense relates to a genuine employee and represents a valid transaction
  - (c) Ensuring salary expense is correctly classified in the financial statements
  - (d) Ensuring that employee benefit expenses for all personnel have been fully accounted for

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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**1. Option (b)** Trend analysis

**Reason:**

Trend analysis is a commonly used technique. 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.

In this case, the auditor compares salary expenses year-on-year, which is the core characteristic of trend analysis. The objective is to spot abnormal increases that may indicate risk areas requiring further investigation.

2. **Option (c)** Perform further audit procedures to investigate the cause

**Reason:**

SA 520 requires the auditor to investigate any significant and unexplained fluctuations identified through analytical procedures. A sharp increase in salary expense without a corresponding increase in employees represents an anomaly that cannot be ignored. Analytical procedures alone do not provide sufficient audit evidence when such unusual trends exist. Therefore, the auditor must perform further substantive or control testing to determine the cause. Concluding without investigation or reducing audit work would be inappropriate in the presence of risk indicators.

3. **Option (a)** Salary expense increased far more than employee count

**Reason:**

A significant increase in salary expense without a corresponding rise in the number of employees is a strong indicator of possible fictitious employees. Such a mismatch suggests that salaries may be paid to non-existent or unauthorized individuals. This is a well-recognised red flag in payroll and fraud risk assessment. A marginal increase in overtime hours is normal and does not explain a large salary jump. Similarly, production changes or appointment of a new HR manager do not, by themselves, indicate fictitious payroll entries.

4. **Option (b)** Matching payroll expense with personnel records to confirm no unauthorized persons were paid

**Reason:**

The occurrence assertion requires the auditor to confirm that recorded transactions actually occurred and pertain to the entity. Matching payroll expenses with authorized personnel records ensures that salaries were paid only to genuine and approved employees. This procedure directly detects payments made to fictitious or unauthorized persons. In the given

case, such verification is crucial due to identified payments to non-existent employee IDs.

5. **Option (d)** Ensuring that employee benefit expenses for all personnel have been fully accounted for

**Reason:**

The completeness assertion ensures that all legitimate employee benefit expenses incurred during the period have been fully recorded in the accounts. It focuses on detecting any omission of valid transactions rather than the inclusion of invalid ones. In this case, the auditor verified that expenses relating to all genuine employees were recorded, thereby satisfying completeness.

**CASE SCENARIO 11**

Madan Leasing Co. Ltd. is a non-banking leasing company that leases industrial machinery and consumer durables. During the current year, Madan Leasing entered into a lease agreement with Sulekha Engineering Pvt. Ltd. for a Textile machine valued at ₹ 10 Crore.

Facts gathered by the audit team from the lease files are:

- (i) The company's object clause in the memorandum authorises leasing of capital goods but is silent about undertaking financing activities.
- (ii) A credit appraisal file exists for Sulekha Engineering containing their past credit record, capitalisation details and proposed collateral.
- (iii) The lease agreement describes lessor, lessee, equipment and location. It states that the equipment must not be removed from the location except for repairs and contains timelines for payments and late charges. It does not expressly state who will bear the cost of returning the equipment on termination.
- (iv) The lease proposal form from Sulekha Engineering is present in the file.
- (v) The original invoice for the Textile machine is filed in the lease folder.
- (vi) There is no acceptance letter from the lessee on file confirming the equipment was received in order.
- (vii) A Board resolution authorising the execution of the lease on behalf of Sulekha Engineering is included.
- (viii) Copies of the insurance policy for the machine are not found in the lessor's records.

Based on above, answer the following:

**MULTIPLE CHOICE QUESTIONS**

1. Which audit procedure confirms whether Madan Leasing Co. is legally permitted to transact the lease of the Textile machine?

- (a) Check the object clause of the leasing company to verify permitted activities.
  - (b) Examine the lease proposal form submitted by the lessee.
  - (c) Examine the lease agreement for description of equipment and location.
  - (d) Verify that copies of insurance policies have been obtained.
2. Which missing document in the lease file creates an audit issue about whether the lessee accepted delivery in good order?
- (a) Invoice retained safely in the file.
  - (b) Board resolution authorising execution of lease.
  - (c) Acceptance letter obtained from the lessee.
  - (d) Lease proposal form submitted by the lessee.
3. Which procedure would the auditor perform to evaluate the lessee's ability to meet lease commitments?
- (a) Ensure that the invoice is retained safely.
  - (b) See that copies of the insurance policies have been obtained.
  - (c) Check whether the agreement prohibits subletting.
  - (d) Verify whether there exists a procedure to ascertain credit analysis of lessee.
4. Given the facts, which control deficiency should the auditor report as missing in Madan Leasing Co.'s records?
- (a) The invoice for the machine is not retained.
  - (b) The Board resolution authorising lease execution is absent.
  - (c) Copies of insurance policies for the leased asset are not obtained.
  - (d) The lease agreement does not describe equipment and location.

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**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (a)** Check the object clause of the leasing company to verify permitted activities

**Reason:**

An auditor must first ensure that the company is legally authorised to undertake the transaction being audited. Examining the object clause in the Memorandum of Association confirms whether leasing of capital goods is within the company's powers. Transactions outside the object clause may be ultra vires and void. Other documents such as lease proposals or insurance records do not establish legal authority. Therefore, checking the object clause is the appropriate audit procedure.

2. **Option (c)** Acceptance letter obtained from the lessee

**Reason:**

An acceptance letter from the lessee provides evidence that the leased asset was received in good condition and as per agreement terms. Its absence raises doubts about delivery, condition, and commencement of lease obligations. The invoice only proves purchase, not acceptance by the lessee. A board resolution or proposal form does not confirm physical receipt. Hence, the missing acceptance letter creates an audit concern.

3. **Option (d)** Verify whether there exists a procedure to ascertain credit analysis of lessee

**Reason:**

Evaluating the lessee's ability to meet lease commitments requires assessing creditworthiness and repayment capacity. This is achieved through a structured credit appraisal and analysis procedure. Retaining invoices or insurance policies does not address financial capability. Clauses restricting subletting relate to asset control, not credit risk. Therefore, verifying credit analysis procedures is the correct audit step.

4. **Option (c)** Copies of insurance policies for the leased asset are not obtained

**Reason:**

Leased assets remain the property of the lessor and must be adequately insured to safeguard against loss or damage. Failure to obtain and retain copies of insurance policies indicates a control deficiency in asset protection. In this case, the invoice and board resolution are present, and the lease agreement adequately describes the asset. Hence, the missing insurance documents represent the key control weakness to be reported.

**CASE SCENARIO 12**

Trimurti & Co., Chartered Accountants, are appointed as the statutory auditors of Techno Industries Ltd., a medium-sized manufacturing company engaged in producing automobile parts. The audit team is led by CA Aakriti, assisted by one qualified assistant, Mr. Pradeep, and two articled trainees.

While planning the audit, the team notes that Techno Industries Ltd. recently implemented a new Inventory Management System (IMS). The management claims that the new system allows real-time tracking of raw materials, automated reorder levels, and barcode-based issuance of materials for production.

During the preliminary review, Mr. Pradeep notices that the value of raw materials has increased by 35% compared to last year, whereas production levels increased by only 12%. He suspects possible errors in valuation or inclusion of obsolete stock. Further, the IMS allows only store managers to update inventory records. However, during walkthrough, an articled trainee observes that two production supervisors also have access to change stock quantities, without any documented authorisation.

Analytical review reveals that payments to one of the major suppliers, Alpha Metals, have doubled compared to previous year, despite no proportional increase in material purchases. To understand the functioning of the new IMS, the audit team prepares a visual diagram showing flow of material requisitions, approvals, barcode scanning, and issuance of materials to the shop floor. This helps them identify gaps in segregation of duties and authorization.

Based on above, answer the following:

**MULTIPLE CHOICE QUESTIONS**

1. The auditor noticed a 35% increase in raw material value with only a 12% rise in production. Which audit procedure is being used here?
  - (a) Test of Controls
  - (b) Substantive Analytical Procedure

- (c) Inquiry
  - (d) Test of Details
2. Unauthorized access to the Inventory Management System by production supervisors indicates which type of risk?
- (a) Control Risk
  - (b) Business Risk
  - (c) Detection Risk
  - (d) Audit Risk
3. Preparing a visual diagram showing the movement of material requisitions and barcode-based issuance represents which method of internal control evaluation?
- (a) Narrative Record
  - (b) Internal Control Questionnaire
  - (c) Checklist
  - (d) Flow Chart

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### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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

**Reason:**

The auditor compares the percentage increase in raw material value (35%) with the increase in production (12%) to identify unusual relationships. Such comparison of financial and non-financial data to spot inconsistencies is substantive analytical procedure. It helps the auditor assess the reasonableness of recorded balances and identify possible misstatements like overvaluation or obsolete inventory. This procedure is applied at the substantive stage rather than to test internal controls. Hence, option (b) is correct.

**2. Option (a) Control Risk****Reason:**

Unauthorized access to the Inventory Management System by production supervisors indicates a weakness in access controls and segregation of duties. Control risk refers to the risk that a material misstatement will not be prevented or detected and corrected by the entity's internal controls. Allowing unauthorised personnel to alter stock records increases the likelihood of errors or fraud remaining undetected. Therefore, the issue primarily reflects control risk making option (a) correct.

**3. Option (d) Flow Chart****Reason:**

A visual diagram depicting the flow of material requisitions, approvals, barcode scanning, and issuance is a flow chart. Flow charts graphically represent processes and controls, making it easier to understand system operations and identify control gaps. They are especially useful for evaluating complex systems like a new IMS. Since the auditor prepared a visual representation of procedures and document flow, option (d) is the correct answer.

**CASE SCENARIO 13**

CA Trustworthy has accepted audit of financial statements of a company viz. Precision Industries Private Limited for year 2024-25. The company's annual turnover for year 2024-25 is approximately ₹ 250 crores. As he is conducting the audit of the company for the first time, he started gaining knowledge of the business and its internal controls to identify and assess the risk of material misstatement. In this regard, he has made inquiries from certain personnel including company's in house legal counsel and various departmental heads as such inquiries can divulge information that is likely to identify and assess risks of material misstatement due to fraud or error. The company is also having internal audit department headed by Mr. A. Precisely, he has inquired from following persons to identify and assess risks of material misstatement due to fraud or error.: -

- (i) Mr. A, Head of Internal Audit Department.
- (ii) Mr. John, in-house legal counsel.
- (iii) Mr. I, IT Systems Head.

Later, while conducting audit, he observed application of few controls in IT systems. He also made extensive inquiries from middle level IT personnel about application of various controls.

Based on information received from inquiry of Mr. John, risk of material misstatement in litigation or claims involving the company was assessed by him. It was also decided later to issue letter of inquiry to Mr. F who is external legal counsel of company.

He has also gone through internal audit reports submitted to the management and decided to use internal auditor to provide direct assistance to perform following procedures labelled as P, Q, R and S.

- (P) To vouch few expenses bills.
- (Q) To trace transactions through information system.
- (R) To verify accuracy of ageing of trade receivables.

- (S) To evaluate appropriateness of management's use of going concern assumption.

During the course of audit, he has verified samples of sales invoices with entries recorded in books of accounts and sent external confirmation requests to selected trade receivables. There were 100 trade receivables outstanding as at 31<sup>st</sup> March, 2025 and it was decided to send external confirmation requests to 20 trade receivables. He had chosen one trade receivable balance randomly and thereafter every 5<sup>th</sup> balance was chosen. The responses to external confirmation requests were duly received.

Based on the above facts, answer the following:

### MULTIPLE CHOICE QUESTIONS

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1. In context of inquiries made by CA Trustworthy, which of following statements is true?
  - (a) Inquires from John and F are in nature of risk assessment procedures.
  - (b) Inquiries from A, John and I are in nature of substantive procedures.
  - (c) Inquiries from A, John and I are in nature of risk assessment procedures.
  - (d) Inquiries from John and F are in nature of substantive procedures.
2. In which of following areas, CA Trustworthy is unlikely to use internal auditor to provide direct assistance to him?
  - (a) Work as stated at P.
  - (b) Work as stated at S.
  - (c) Work as stated at Q.
  - (d) Work as stated at R.
3. With regards to audit evidence obtained during the audit which of following statements is incorrect as discussed in case scenario?
  - (a) Sales invoice and responses to inquiries from middle level IT systems personnel are examples of internal evidence.

- (b) Audit evidence obtained from inquiry of middle level IT systems personnel is more reliable than observation of application of few controls by CA Trustworthy.
  - (c) Responses to external confirmation requests are examples of external evidence.
  - (d) Internal audit reports are an example of documentary evidence.
4. While selecting samples of trade receivables described in case scenario, which method is being used?
- (a) Block sampling.
  - (b) Systematic sampling.
  - (c) Monetary unit sampling.
  - (d) Stratified sampling.
5. Choose option showing correct values of population, sampling interval and sample size respectively from description given in case scenario: -
- (a) 100, 5, 20.
  - (b) 100, 20, 5.
  - (c) 20, 5, 20.
  - (d) 20, 5, 5.

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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1. **Option (c)** Inquiries from A, John and I are in nature of risk assessment procedures

**Reason:**

As per SA 315 – Identifying and Assessing the Risks of Material Misstatement, the auditor performs risk assessment procedures to obtain an understanding of the entity and its environment. These procedures include inquiries of management and others within the entity who are likely to have information relevant to identifying risks of material misstatement due to fraud or error. In the given case, inquiries from Mr. A (Head of Internal Audit), Mr. John (in-house legal counsel) and

Mr. I (IT Systems Head) were made at the planning stage to understand internal controls, litigation risks and IT systems. Such inquiries are not performed to substantiate balances or transactions. Hence, option (c) is correct.

2. **Option (b)** Work as stated at S (Evaluation of management's use of going concern assumption)

**Reason:**

As per SA 610 (Revised), the external auditor shall not use internal auditors to provide direct assistance in areas involving significant professional judgment or high subjectivity. Evaluation of management's use of the going concern assumption requires assessment of future events, cash flows and management assumptions. Such evaluation involves critical judgment and has a pervasive impact on the financial statements. Therefore, this procedure must be performed by the statutory auditor himself. Hence, work stated at S cannot be assigned to the internal auditor and option (b) is correct.

3. **Option (b)** Audit evidence obtained from inquiry of middle level IT systems personnel is more reliable than observation of application of few controls by CA Trustworthy

**Reason:**

As per SA 500 – Audit Evidence, the reliability of audit evidence depends on its source and nature. Evidence obtained through inquiry alone is generally less reliable than evidence obtained through direct observation by the auditor. In the given case, inquiry of middle level IT personnel provides oral internal evidence, whereas observation of application of controls by CA Trustworthy provides direct audit evidence. Therefore, the statement that inquiry evidence is more reliable than observation is incorrect. Hence, option (b) is the correct answer.

4. **Option (b)** Systematic Sampling

**Reason:**

As per SA 530 – Audit Sampling, systematic sampling is a method in which the auditor selects items using a fixed sampling interval after choosing a

random starting point. In the given case, CA Trustworthy first selected one trade receivable randomly and thereafter selected every 5th balance from the population. Selection of items at regular intervals after a random start is the key feature of systematic sampling. Hence, the sampling method used is systematic sampling and option (b) is correct.

5. **Option (a)** Population – 100, Sampling Interval – 5, Sample Size – 20

**Reason:**

As per SA 530, the population represents the entire set of data from which the sample is selected. In the given case, total trade receivables outstanding are 100, which constitutes the population. External confirmation requests were sent to 20 trade receivables, representing the sample size. The sampling interval is calculated by dividing population by sample size, i.e.,  $100 \div 20 = 5$ . Hence, the correct values are Population – 100, Sampling Interval – 5 and Sample Size – 20, and option (a) is correct.

**CASE SCENARIO 14**

Raavi & Co., a firm of Chartered Accountants, has been appointed as auditor of XYZ Ltd., a prospective new client. CA Sukanya, one of the firm's partners, is responsible for handling this engagement. During a meeting with the company's officers, she discovers that Sushant, the company's CFO, is her former classmate. They had both begun their Chartered Accountancy (CA) journey together, but Sushant discontinued the program midway due to repeated examination failures and later pursued an MBA in Finance from a prestigious institution.

During the preliminary discussions, XYZ Ltd. reveals its plan to launch a new service in the weather-forecasting sector, to be offered through the company's website. Users will be able to access micro-weather information for a fee. The company requests that Raavi & Co. be *visibly associated* with the marketing of this new service.

Assuming the firm accepts the engagement, it sends a professional clearance letter to the outgoing auditor, Royal & Co., asking whether there are any professional reasons that would prevent Raavi & Co. from accepting the assignment. However, Royal & Co. does not respond to this communication.

While planning the audit, Raavi & Co. learns that XYZ Ltd. has recently acquired 100% of the shares of another company, thereby obtaining complete control over its operations. Under the applicable financial reporting framework and legal requirements, such an acquisition necessitates the preparation of consolidated financial statements, which must also be separately audited. Although Raavi & Co. becomes aware of this statutory obligation during the planning phase, the firm fails to inform or advise XYZ Ltd. about the mandatory requirement to prepare and get the consolidated financial statements audited. This lapse reflects a deficiency in providing appropriate professional guidance to the client.

Firm is also reviewing internal controls of XYZ Ltd. He verifies following things:

- Are tenders called before placing orders?
- Are the purchases made on the basis of a written order?

- Is the purchase order form standardised?

Are purchase order forms pre-numbered?

Based on the above facts, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

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1. Keeping in view request of the company to be visibly associated with company's new services, identify which type of threat is being faced by audit firm.
  - (a) Self-interest threat.
  - (b) Familiarity threat.
  - (c) Self-review threat.
  - (d) Advocacy threat.
2. The previous auditors, Royal & Co., have not replied to communication of Raavi & Co. Which fundamental principle of professional ethics is not followed by them?
  - (a) Objectivity.
  - (b) Professional behaviour.
  - (c) Professional competence and due care.
  - (d) Integrity.
3. Raavi & Co. have failed to advise the company regarding audit of consolidated financial statements. Which fundamental principle of professional ethics is being violated by Raavi & Co.?
  - (a) Professional behaviour.
  - (b) Integrity.
  - (c) Objectivity.
  - (d) Professional competence and due care.
4. Which method is Raavi & Co. using to facilitate the accumulation of the information necessary for the proper review and evaluation of internal controls?

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

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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1. **Option (d)** Advocacy threat.

**Reason:**

An advocacy threat arises when the auditor is asked to promote or publicly support a client's position, product or service. Being "visibly associated" with the company's marketing effectively asks the firm to endorse or advertise the client. That would impair the auditor's independence in appearance and could make it difficult to remain an objective evaluator of the client's financial statements.

2. **Option (b)** Professional behaviour.

**Reason:**

The principle of professional behaviour requires members to comply with relevant laws and professional standards and to cooperate with reasonable, legitimate professional enquiries from other professional accountants. When a successor auditor requests information (professional inquiry) about reasons not to accept an engagement, the predecessor has a professional obligation to respond unless there are strong, justifiable reasons (e.g., client confidentiality constraints after obtaining permission). Royal & Co.'s silence amounts to failing to act in a cooperative and responsible professional manner.

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

**Reason:**

Professional competence and due care require the auditor to possess or obtain the technical knowledge needed for the engagement, to keep informed about applicable laws and reporting requirements and to advise the client appropriately. Not informing the client about the legal

requirement to prepare/audit consolidated financial statements shows a failure to exercise due professional care and to apply the necessary technical knowledge thereby breaching this fundamental principle.

**4. Option (c) Check List.**

**Reason:**

This is a series of instructions and/or questions which a member of the auditing staff must follow and/or answer. When he completes instruction, he initials the space against the instruction. Answers to the check list instructions are usually Yes, No or Not Applicable. This is again an on-the-job requirement and instructions are framed having regard to the desirable elements of control.

**CASE SCENARIO 15**

CA Mahaveer, a partner at ANJ & Co., is conducting the statutory audit of a branch of Fair Bank for the year 2024-25. During the course of the audit, he made the following observations:

- (i) A loan of ₹ 12 lakhs was sanctioned to a farmer for cultivation of sugarcane, a crop that typically has a harvesting cycle of 10–12 months under the Kisan Credit Card (KCC) scheme. The account had no transactions since last 120 days, however, the branch continued to classify the loan as a Standard Asset as on 31st March 2025.
- (ii) The branch had taken over a term loan of ₹ 60 lakhs from another bank. However, the branch manager approved the proposal, even though such limits require sanction by the Zonal Credit Committee, as per the “Manual of Delegation of Powers” of Bank.
- (iii) It is noticed that head office of bank has flagged a saving account maintained in branch in which interest was wrongly paid at higher rate due to wrong data feeding entry. Now, situation has been rectified by debiting excess interest paid in the account. Since there was little balance in saving account, a debit balance of ₹ 1.35 lac was created in the said saving account due to above reversal. The matter was immediately informed to account holder. However, he has not turned up for payment since matter was informed to him about six months ago.
- (iv) Due to time constraints, CA Mahaveer is under pressure to issue an unmodified audit report in the limited time frame. He has insufficient time to properly perform or complete the relevant duties and issue appropriate audit report.

Based on the above facts, answer the following:

**MULTIPLE CHOICE QUESTIONS**

1. Which of the following is most appropriate regarding the sugarcane KCC loan?

- (a) The account is overdue beyond 90 days and must be classified as Sub-standard.
  - (b) The loan must be treated as NPA since no transaction has occurred for 90 days.
  - (c) Since the crop cycle exceeds 6 months, the account can still be Standard despite no transaction for 120 days.
  - (d) The account should be reported as "Doubtful".
2. Regarding the term loan takeover of ₹ 60 lakhs from another bank, which of the following is most appropriate?
- (a) It is a routine matter and auditor need not intervene.
  - (b) It reflects breach of sanctioning authority and should be reported in audit findings.
  - (c) The manager can exercise discretion up to ₹ 75 lakhs, so it is valid.
  - (d) Since the account was performing, the sanctioning irregularity is immaterial.
3. As regards debit balance of ₹ 1.35 lacs in Savings account, which of the following is correct from point of view of an auditor?
- (a) The debit balance of ₹ 1.35 lacs should be classified as NPA.
  - (b) The situation does not attract RBI norms on asset classification.
  - (c) The situation does not attract RBI norms on asset classification as no credit facility was granted.
  - (d) The bank cannot demand excess interest paid to account holder.
4. Which fundamental principle governing professional ethics is disregarded by CA Mahaveer by issuing unmodified audit report?
- (a) Professional competence and due care.
  - (b) Professional behaviour.
  - (c) Integrity.
  - (d) Objectivity.

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**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (c)** Since the crop cycle exceeds 6 months, the account can still be Standard despite no transaction for 120 days.

**Reason:**

As per RBI IRACP (Income Recognition, Asset Classification and Provisioning) guidelines, agricultural advances are classified as NPA based on crop seasons and not on the 90-day overdue norm. Sugarcane is treated as a long-duration crop in banking practice, and such advances become NPA only when the instalment remains overdue for more than one crop season. In the given case, although there were no transactions for 120 days, the crop season had not ended. Mere non-operation of the account does not attract NPA classification for agricultural advances. Hence, the loan can continue to be classified as a Standard Asset.

2. **Option (b)** It reflects breach of sanctioning authority and should be reported in audit findings.

**Reason:**

As per banking norms, loan sanctions must strictly comply with the Manual of Delegation of Powers prescribed by the bank. In the given case, the branch manager sanctioned a takeover of ₹ 60 lakhs without having the required authority, as such limits require approval of the Zonal Credit Committee. This amounts to a breach of internal control and sanctioning procedures. Even if the account is performing, such irregular sanctions are significant from an audit perspective and must be reported in the audit findings. Hence, Option (b) is correct.

3. **Option (a)** The debit balance of ₹ 1.35 lacs should be classified as NPA.

**Reason:**

A debit balance in a Savings Bank Account amounts to an unauthorised overdraft, as no credit facility is sanctioned to the account holder. In the given case, excess interest was wrongly credited and subsequently reversed, resulting in a debit balance of ₹ 1.35 lakhs. The amount has remained outstanding for more than six months and has not been regularised by the customer. As per RBI IRACP (Income Recognition, Asset

Classification and Provisioning) norms, unauthorised overdrafts outstanding for more than 90 days are required to be treated as Non-Performing Assets (NPA). Hence, Option (a) is correct.

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

**Reason:**

A Chartered Accountant is required to perform audit work with due care and adequate professional skill before forming an audit opinion. In the given case, CA Mahaveer is under severe time pressure and is unable to properly perform or complete the necessary audit procedures. Issuing an unmodified audit report without sufficient and appropriate audit evidence shows lack of diligence. Such conduct reflects failure to exercise professional competence and due care expected from an auditor. Hence, Option (a) is correct.

**CASE SCENARIO 16**

Arya Ltd. is a company engaged in the manufacture of stainless-steel household items such as hot pots, pressure cookers, bottles, and cutlery sets. The company is having its corporate office in Delhi and manufacturing plant in Ajmer, Rajasthan. To meet growing demand, Arya Ltd. planned to expand its manufacturing by setting up two new plants in Raipur district and also raised ₹ 5 crore by issuing Equity Shares of face value ₹ 10 at a premium of ₹ 5.

The company had Reserves and Surplus of ₹ 2 crore, which includes securities premium and general reserve. S.K. & Associates, statutory auditors since FY 2022–23, planned the audit and assigned roles accordingly:

- Riya, an articled assistant, was asked to perform analytical procedures on raw material inventory for obtaining evidence with respect to the overall reasonableness of purchase quantity and price of inventory. However, she collected the reports from the management for raw materials as a percentage of total stock and compared the same with the data of the previous year. She also discussed the reasons for the variations with the management.
- Shobhit, a paid CA, was assigned the physical verification of inventory. CA Shobhit was present at the physical inventory count but did not record dates or test counts, although he took some photos were taken.
- Audit documentation gaps were also observed regarding basis of materiality, and related party transactions which were discovered during the audit but not adequately documented.

Based on the above facts, answer the following:

**MULTIPLE CHOICE QUESTIONS**

1. Which of the following statements is incorrect regarding the use of the Securities Premium Account under Section 52 of the Companies Act, 2013?
  - (a) Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium

- received on those shares shall be transferred to a securities premium account.
- (b) The securities premium account can be applied by the company in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares.
  - (c) The securities premium account cannot be applied by the company in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company.
  - (d) The securities premium account can be used by the company for the purchase of its own shares or securities under section 68.
2. Which of the following should not be part of audit documentation for related party transactions?
- (a) Management representation letter in this regard.
  - (b) Related party transaction policy of the company.
  - (c) Documentation to show that such transactions are at arm's length basis.
  - (d) Documentation to show that such transactions are at close length basis.
3. Which of the following analytical procedures were performed by Ms. Riya to obtain audit evidence regarding raw material inventory?
- (a) Consumption Analysis.
  - (b) Stock Composition Analysis.
  - (c) Reasonableness test.
  - (d) Ratio analysis.

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (c)** The securities premium account cannot be applied by the company in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company.

**Reason:**

As per Section 52 of the Companies Act, 2013, where shares are issued at a premium, the amount of premium received shall be transferred to the Securities Premium Account. The Act specifically permits utilisation of this account for, inter alia, writing off expenses, commission paid or discount allowed on issue of shares or debentures. It may also be used for issuing fully paid bonus shares and for purchase of own shares under Section 68. Hence, the statement that securities premium cannot be used for writing off issue-related expenses is incorrect. Therefore, option (c) is the incorrect statement, while options (a), (b) and (d) are correct.

2. **Option (d)** Documentation to show that such transactions are at close length basis.

**Reason:**

As per SA 550 – Related Parties, the auditor is required to maintain audit documentation relating to identification of related parties, nature and terms of related party transactions, management representations, and evidence that such transactions are conducted at arm's length basis. The expression "close length basis" has no recognition under auditing standards or company law. Hence, documentation referring to transactions at close length basis is invalid.

3. **Option (b)** Stock Composition Analysis.

**Reason:**

Ms. Riya analysed raw material inventory by obtaining data of raw materials as a percentage of total stock and comparing the same with corresponding figures of the previous year. This procedure focuses on understanding the composition and relative proportion of different components of inventory. It does not examine consumption patterns or establish relationships between price and quantity. Therefore, the analytical procedure performed is Stock Composition Analysis, making option (b) the correct answer.

**CASE SCENARIO 17**

Patrika & Co., Chartered Accountants, has been appointed as the statutory auditor of AVR Retails Pvt. Ltd., a company engaged in business of electronics, for the financial year 2024–25. The firm is auditing financial statements of AVR Retails Pvt. Ltd. for the first time. During the audit, the auditor made the following observations:

- The company operates through multiple retail outlets with heavy volumes of cash and card sales.
- Store managers are allowed to approve cash discounts and product returns independently.
- Reconciliations between POS records and bank deposits are not done regularly.
- The IT system used by AVR does not log any changes to inventory records, making it difficult to track adjustments.
- The company has an internal auditor, but this auditor does not report directly to senior management.
- During internal audit, it was found that the automated system failed to charge 12% interest on overdue customer payments due to a technical glitch.
- During audit documentation, an audit assistant saved working files in unsecured folders and did not mention the reviewer's name in the file.
- After signing the audit report, a senior audit team member altered the inventory sampling sheet to reflect a different method, without recording the reason or the date of change.

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Based on the above facts, answer the following:

### MULTIPLE CHOICE QUESTIONS

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1. Which of the following is a clear non-compliance committed by the audit assistant in accordance with relevant Standard on Auditing?
  - (a) Completing documentation within 60 days of the audit report.
  - (b) Using standard templates for work papers.
  - (c) Omitting reviewer's name and saving files in unsecured folders.
  - (d) Preparing working papers electronically.
2. Which of the following is the most appropriate response for the change in the inventory testing sheet?
  - (a) Permit the change as it will improve the audit quality.
  - (b) Permit the change as the outcome is not changed.
  - (c) Such changes should not be permitted unless reason and date are recorded.
  - (d) Delete both versions and prepare a fresh sheet.
3. The internal auditor discovered that the software failed to charge 12% interest on overdue payments due to a technical glitch. Does reporting this situation fall under the scope of internal audit?
  - (a) No, as it involves customer transactions.
  - (b) Yes, as it relates to internal control failures.
  - (c) No, this is part of financial statement audit.
  - (d) Only if management asks them to review it.
4. Whether statutory auditor can rely extensively on the internal auditor's work in the given situation where internal auditor does not report to higher management and risk of material misstatement seems high.
  - (a) No, the independence and objectivity are compromised.
  - (b) Yes, internal auditor always assists external audit.

- (c) Yes, if external auditor documents reasons for reliance.
- (d) Yes, if previous experience with internal auditor is good.

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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1. **Option (c)** Omitting reviewer's name and saving files in unsecured folders.

**Reason:**

As per SA 230 – "Audit Documentation", audit working papers must be kept securely and should clearly indicate who prepared the work and who reviewed it. In the given case, the audit assistant saved files in unsecured folders and did not mention the reviewer's name. This violates the requirements relating to confidentiality, integrity, and evidence of review of audit documentation.

2. **Option (c)** Such changes should not be permitted unless reason and date are recorded.

**Reason:**

As per SA 230 – Audit Documentation, once the auditor's report has been signed, audit documentation must not be altered without proper justification. Any subsequent change must clearly record the reason for the change, the date, and the person making the change, while preserving the original documentation. In the given case, the inventory sampling method was altered after signing the audit report without recording the reason or date, making such alteration inappropriate under the Standard.

3. **Option (b)** Yes, as it relates to internal control failures.

**Reason:**

Internal audit is concerned with evaluating the adequacy and effectiveness of internal controls, including automated systems. In this case, the failure to charge 12% interest resulted from a technical glitch in the software, indicating a deficiency in system controls. Such weaknesses affect the reliability of revenue processes and IT controls. Detecting and reporting these control lapses falls squarely within the scope of internal audit functions.

4. **Option (a)** No, the independence and objectivity are compromised

**Reason:**

As per SA 610 – Using the Work of Internal Auditors, the statutory auditor must evaluate the objectivity and independence of the internal audit function, its organisational status, and the risk of material misstatement. In the given case, the internal auditor does not report to higher management or those charged with governance. Further, significant control and IT weaknesses exist in a cash-intensive business, increasing audit risk. In such circumstances, extensive reliance on internal audit work is not appropriate.

**CASE SCENARIO 18**

CA Adhya, a partner at TAK & Associates, Chartered Accountants, is conducting the statutory audit of NextGen Appliances Pvt. Ltd., a company engaged in the manufacturing and sale of consumer durables, for the year 2024-25.

During the audit, the following observations were made:

- The company conducted its year-end physical inventory count on 30th March 2025. However, due to flooding in one of its warehouse locations, the auditor was unable to visit that site, and consequently inventory valued at ₹95 lakhs at that warehouse was not physically verified
- A large debtor balance of ₹ 68 lakhs is outstanding for over 9 months. The customer has partially shut down operations and has not responded to balance confirmation requests.
- Revenue recognition is done at the point of despatch. However, CA Adhya noticed that certain despatches made on 30<sup>th</sup> March, 2025 were billed but the goods actually left the premises on 2<sup>nd</sup> April, 2025.
- The company capitalised an amount of ₹ 25 lakhs as part of machinery installation expenses which included ₹ 5 lakhs incurred on employee training and inauguration ceremony.
- A creditor balance of ₹ 20 lakhs remains not confirmed despite repeated external confirmation requests. The management contends that the amount is payable and valid.

Based on the above facts, answer the following:

**MULTIPLE CHOICE QUESTIONS**

1. What should CA Adhya do regarding the inventory at the warehouse that could not be physically verified due to flood?
  - (a) Since the inventory is below materiality threshold, ignore the same.
  - (b) Issue adverse opinion.

- (c) Perform alternative audit procedures to obtain sufficient appropriate audit evidence.
  - (d) Accept management's written representation as sufficient audit evidence.
2. What should be CA Adhya's conclusion regarding revenue recognised for sales billed on 30<sup>th</sup> March but despatched on 2<sup>nd</sup> April?
- (a) Recognise the revenue in March based on invoice date.
  - (b) Revenue should be deferred to April since ownership and control did not transfer before year-end.
  - (c) Consider it as timing difference in invoice and despatch.
  - (d) No action is required as stock is not returned.
3. While verifying capitalised expenses of machinery installation, CA Adhya notices ₹ 5 lakhs towards training and inauguration. What should she do?
- (a) Recommend for reclassification of ₹ 5 lakhs as revenue expenditure.
  - (b) Accept capitalisation as the training and inauguration was part of installation.
  - (c) Ignore as it is below materiality threshold.
  - (d) Ask management for capitalisation certificate from CFO.
4. Which of the following is not a valid alternative audit procedure in case of non-response from a debtor or creditor?
- (a) Examination of subsequent cash receipts or payments.
  - (b) Review of sales or purchase orders.
  - (c) Verification of Board resolution for the amount.
  - (d) Examination of related invoices and delivery documents.

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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1. **Option (c)** Perform alternative audit procedures to obtain sufficient appropriate audit evidence.

**Reason:**

As per SA 501 – Audit Evidence, when the auditor is unable to attend physical inventory verification due to circumstances beyond control, such as a flood, the auditor is required to perform alternative audit procedures. These procedures help in obtaining sufficient appropriate audit evidence regarding the existence and condition of inventory. Such procedures may include examination of subsequent sale records, stock movement statements, and insurance documents. The auditor cannot ignore the inventory merely because it is below materiality. Further, management representation alone is not sufficient audit evidence as per SA 580. Hence, alternative audit procedures are mandatory.

2. **Option (b)** Revenue should be deferred to April since ownership and control did not transfer before year-end.

**Reason:**

As per AS 9, revenue from sale of goods is recognised only when significant risks and rewards and control are transferred to the customer. Mere raising of an invoice does not determine revenue recognition. In the given case, although the goods were billed on 30<sup>th</sup> March, they were actually despatched on 2<sup>nd</sup> April. Hence, control and risks had not passed to the customer before the year-end. Recognising revenue in March results in a cut-off error. The auditor is required to ensure compliance with the cut-off assertion under the Standards on Auditing. Hence, recognising revenue in March is premature and revenue should be deferred to the next accounting period.

3. **Option (a)** Recommend for reclassification of ₹ 5 lakhs as revenue expenditure.

**Reason:**

As per AS 10 – Property, Plant and Equipment, only those costs which are directly attributable to bringing the asset to its intended working condition can be capitalised. Expenses such as employee training and inauguration or ceremonial expenses do not increase the future economic benefits of the asset. Such costs are incurred after the asset is ready for use and are revenue in nature. Capitalising these expenses results in

overstatement of fixed assets. Materiality cannot justify incorrect classification. Hence, ₹ 5 lakhs should be reclassified as revenue expenditure.

**4. Option (c)** Verification of Board resolution for the amount.

**Reason:**

As per SA 505 – External Confirmations, when external confirmation is not received, the auditor should perform alternative audit procedures to obtain reliable audit evidence. Such procedures include examination of subsequent receipts or payments, verification of invoices and delivery challans, and review of sales or purchase orders. These procedures provide evidence regarding existence and accuracy of balances. A Board resolution merely reflects management approval or acknowledgment. It does not establish existence, accuracy, or settlement of the balance. Hence, verification of Board resolution is not a valid alternative audit procedure.

**CASE SCENARIO 19**

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

Puneet, the CEO of ABC 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. Ashi, another Partner of Firm, feels that complying with this request would compromise ethical standards and worries about potential conflicts with the client.

Maya & Associates has also been appointed as the statutory branch auditors of Delhi branch of CIC Bank. While carrying out the audit, the following key issues were identified:

**Issue 1:** PV 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 2:** CWP Traders has applied for a cash credit limit from CIC Bank for supporting working capital requirements on account of business expansion. In discussions with CWP Traders, CIC 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.

Based on the above facts, answer the following:

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**MULTIPLE CHOICE QUESTIONS**

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1. CA Maya has bought stock in ABC Pvt. Ltd., and her investment could benefit from issuance of unmodified opinion in her audit report. This indicates existence of:
  - (a) Self-interest Threat.
  - (b) Self-review Threat.
  - (c) Advocacy Threat.
  - (d) Familiarity threat.
  
2. Puneet, the CEO, is requesting the Ashi and Maya 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.
  
3. Is the bank's decision not to apply NPA and income recognition norms to account of PV 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.
  
4. CWP Traders offered its warehouse as security for the loan. CIC 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 CWP Traders?

- (a) Security created is Pledge and bank is required to get stock audit done of cash credit account of CWP Traders.
- (b) Security created is Mortgage and bank is required to get stock audit done of cash credit account of CWP Traders.
- (c) Security created is Pledge and bank is not mandatorily required to get stock audit done of cash credit account of CWP Traders.
- (d) Security created is Mortgage and bank is not mandatorily required to get stock audit done of cash credit account of CWP Traders.

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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

**Reason:**

As per the ICAI Code of Ethics, a self-interest threat arises when a Chartered Accountant has a financial interest that may influence professional judgment. In this case, CA Maya holds shares in ABC Pvt. Ltd., which creates a direct financial interest in the client. She expects the share price to increase after issuance of an unmodified audit opinion. This personal financial benefit may bias her audit decisions and compromise independence. Her objectivity is therefore impaired due to personal gain. Hence, the situation clearly represents a self-interest threat.

**2. Option (a) Integrity**

**Reason:**

The principle of Integrity requires a Chartered Accountant to be honest, straightforward, and not associated with misleading information. In the given case, CEO Puneet requests modification of disclosures in a misleading manner. Agreeing to such a request would result in association with false or deceptive financial statements. This would compromise the auditor's honesty and truthfulness. A Chartered Accountant must present information fairly and transparently. Hence, agreeing to the request would violate the fundamental principle of Integrity.

3. **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:**

As per RBI IRAC norms, advances guaranteed by the Central Government are exempt from NPA classification and provisioning requirements until the guarantee is invoked. In the given case, PV Ltd.'s account is backed by a Central Government guarantee which has not been invoked. Hence, non-application of NPA norms for provisioning is acceptable. However, income recognition norms apply independently of the guarantee status. Since there has been no recovery for more than 90 days, interest income cannot be recognised on accrual basis. Interest can be recognised only on cash basis. Therefore, Option (a) is correct.

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

**Reason:**

A warehouse is an immovable property, and creation of a charge on immovable property constitutes a mortgage. Hence, the security created by CIC Bank is a mortgage and not a pledge. Further, as per RBI guidelines, stock audit is mandatorily required only when fund-based working capital limits are ₹ 5 crores or more. In the given case, the cash credit limit sanctioned is ₹ 4.50 crores, which is below the prescribed threshold. Therefore, the bank is not mandatorily required to conduct a stock audit. Hence, Option (d) is correct.

**CASE SCENARIO 20**

Mohan & Associates were offered the statutory audit of Simi Pvt. Ltd. for the financial year 2024–25. In line with professional requirements, the firm communicated with the outgoing auditor, Veer & Co., to inquire whether there were any professional or other reasons that would preclude them from accepting the appointment. However, Veer & Co. did not respond to this communication.

During the audit, Mr. A, a partner of Mohan & Associates, relied solely on a management representation letter to support the accounting treatment of certain tax matters under appeal. No additional audit procedures were performed to independently verify the appropriateness of management's treatment of these tax matters in the financial statements. As a result, the auditor failed to obtain sufficient and appropriate audit evidence.

As Simi Pvt. Ltd. had recently appointed a new accountant who lacked adequate knowledge of the accounting standards applicable to the company, the management requested Mr. A to assist with accounting and bookkeeping services. However, Mr. A declined the request, recognising that providing such services could impair his independence as an auditor.

Meanwhile, Mr. Raj, an investor in Simi Pvt. Ltd., placed full reliance on the audited financial statements, believing they indicated a strong financial position. He assumed that the audit guaranteed the safety of his investment, without any risk of loss.

While finalising the audit documentation, Mr. A prepared the working papers in physical form, believing that paper documentation was mandatory.

Based on the above facts, answer the following:

**MULTIPLE CHOICE QUESTIONS**

1. The previous auditors, Veer & Co. did not reply to the communication of Mohan & Associates. Which fundamental principle of professional ethics is not followed by them?
  - (a) Objectivity.

- 
- (b) Integrity.
- (c) Professional behaviour.
- (d) Professional competence and due care.
2. The auditor did not carry out any other audit procedures to justify management's treatment of the said tax matters under appeal in the financial statements. What is lacking on part of auditor in such a situation?
- (a) Professional Skepticism.
- (b) Objectivity.
- (c) Integrity.
- (d) Professional Behaviour.
3. Mr. A was requested to provide accounting & bookkeeping services to Simi Pvt. Ltd. Identify the type of threat to Independence that may be involved in acceptance of such an engagement.
- (a) Self- interest threat.
- (b) Self- review threat.
- (c) Confidentiality.
- (d) Intimidation threat.
4. Mr. Raj is confident that investment made by him is completely secure and there is no risk of any loss. Select the correct statement in this regards:
- (a) Audited Financial statements provide absolute assurance therefore money invested by Mr. Raj is absolutely safe.
- (b) Audited Financial statements provide reasonable assurance. It doesn't guarantee complete accuracy.
- (c) Neither (a) nor (b) is correct.
- (d) Both (a) and (b) are correct.
5. Mr. A was preparing the documents and audit file in physical (paper) form, believing that it is compulsory to do so. Is Mr. A's understanding, correct? Identify the correct statement regarding the form of an audit file.
- (a) Audit file should be kept in both physical & electronic form.

- (b) Audit file should be kept in physical form only.
- (c) Audit file may be kept in physical or electronic form.
- (d) Audit file should be kept in electronic form only.

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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**1. Option (c) Professional Behaviour**

**Reason:**

Professional behaviour requires a Chartered Accountant to comply with relevant laws, regulations and professional standards and to act in a manner that does not bring disrepute to the profession. As per the Code of Ethics, an outgoing auditor is expected to respond promptly and appropriately to professional communications from the incoming auditor. Failure to reply to such communication shows disregard for professional courtesy and established ethical requirements. This conduct hampers smooth auditor transition and may adversely affect audit quality. Therefore, non-response by Veer & Co. amounts to non-compliance with the principle of professional behaviour.

**2. Option (a) Professional Skepticism**

**Reason:**

Professional skepticism requires the auditor to maintain a questioning mind and to critically evaluate audit evidence obtained during the audit. An auditor should not assume that management is honest or that representations made by management are sufficient by themselves. Management representation letters are only corroborative in nature and cannot replace substantive audit procedures. By relying solely on management representation without performing further verification, the auditor failed to obtain sufficient and appropriate audit evidence. This reflects a lack of professional skepticism.

**3. Option (b) Self-review threat**

**Reason:**

A self-review threat arises when an auditor is required to evaluate or audit work that they themselves have prepared or were involved in preparing. If the auditor provides accounting or bookkeeping services to the audit

client, the financial statements would be based on the auditor's own work. While conducting the statutory audit, the auditor would then be reviewing the same accounting records prepared by them, impairing objectivity. This creates a risk that errors or misstatements may not be identified or reported. Hence, providing such services gives rise to a self-review threat.

4. **Option (b)** Audited Financial statements provide reasonable assurance. It doesn't guarantee complete accuracy.

**Reason:**

An audit is designed to provide reasonable assurance that the financial statements are free from material misstatement, whether due to fraud or error. Reasonable assurance represents a high level of assurance but does not amount to a guarantee. Due to inherent limitations of audit, such as use of sampling, judgment and internal control limitations, absolute assurance cannot be provided. Auditors do not certify the financial viability of the entity or guarantee the safety of investors' funds. Therefore, reliance on audited financial statements does not eliminate investment risk.

5. **Option (c)** Audit file may be kept in physical or electronic form.

**Reason:**

As per SA 230 – Audit Documentation, the auditor is required to prepare audit documentation that provides a sufficient and appropriate record of the basis for the auditor's report. The Standard does not prescribe any specific format for maintaining audit files. Accordingly, audit documentation may be maintained either in physical (paper) form or in electronic form. The key requirement is that the audit file should be complete, properly organised, and capable of being reviewed. There is no mandatory requirement that audit documentation must be maintained only in physical form. Hence, the auditor's belief that paper documentation is compulsory is incorrect.

**CASE SCENARIO 21**

AM & Associates, a firm of Chartered Accountants, was appointed as the Statutory Auditor of Happy Limited. CA M, the Engagement Partner, briefed the audit team on audit planning and execution.

At the commencement of the audit, CA M conducted a detailed briefing session with the audit team comprising five articled assistants. He explained that the overall audit strategy sets the scope, timing and direction of the audit, while the audit plan is developed based on the strategy and may be revised as audit circumstances change. Referring to SA 315, he emphasised that the auditor must obtain an understanding of the entity's operations, ownership and governance structure, and how it is structured and financed to identify and assess risks of material misstatement.

CA M further highlighted that the auditor's opinion is based on sufficient appropriate audit evidence, obtained through procedures such as inquiry, inspection, observation, confirmation and analytical procedures. While determining whether sufficient appropriate audit evidence has been obtained, he referred to SA 200, stating that the auditor must consider the nature of audit procedures, the balance between benefit and cost, and the need for timely financial reporting.

One of the articled assistants, Ms S, then sought clarification on the difference between risk assessment procedures and tests of controls. CA M explained that risk assessment procedures are performed to obtain an understanding of the entity and its environment, including internal control, whereas tests of controls are designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level. He further added that controls may be tested at a particular point in time or throughout the period for which reliance is intended, so as to provide an appropriate basis for the auditor's reliance on such controls.

Ms S further enquired whether audit evidence regarding the operating effectiveness of controls obtained in previous audits could be used and the period for which such reliance may be placed. In response, CA M explained that the Standards on Auditing permit reliance on prior-period audit evidence only

after assessing its continued relevance and reliability. He explained that the auditor must consider whether there have been changes in the controls, systems or operating environment, the nature and significance of the risks addressed by the controls and the results of prior testing. He also clarified that controls addressing significant risks must be tested in the current year audit and that reliance on prior-period evidence generally should not exceed three years, with some controls tested in each audit period.

CA M further added that, before using audit evidence from previous audits, the auditor must evaluate factors such as the effectiveness of other elements of internal control, including the control environment and monitoring activities, the nature of the control (manual or automated), and the consistency of its operation in prior periods. He specifically clarified that factors relating to unusual or non-routine transactions are relevant for risk identification, but not for determining whether prior-period evidence of control effectiveness may be relied upon.

Finally, CA M advised the team that the audit programme should be framed strictly within the scope of the audit engagement, keeping in view the audit objectives, statutory requirements and applicable Standards on Auditing.

Having clearly understood the engagement partner's instructions, the audit team proceeded to commence the audit of Happy Limited.

Based on above, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

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1. CA M discussed with Ms. S the points to be considered for using the audit evidence obtained in previous audits about the operating effectiveness of controls. In your opinion, which of the following points was not relevant for the discussion?
  - (a) The effectiveness of other elements of internal control, including the control environment, the entity's monitoring of controls, and the entity's risk assessment process.
  - (b) The risks arising from the characteristics of the control, including whether it is manual or automated.

- (c) The effectiveness of the control and its application by the entity, including the nature and extent of deviations in the application of the control noted in previous audits, and whether there have been personnel changes that significantly affect the application of the control.
  - (d) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.
2. While determining whether sufficient appropriate audit evidence has been obtained, the auditor, as per SA 200, is required to consider which of the following factors?
- (a) the nature of audit procedures performed only
  - (b) Nature of audit procedures, balance between benefit and cost, and timeliness of financial reporting
  - (c) balance between benefit and cost only
  - (d) balance between benefit and cost and timeliness of financial reporting

3. The relationship between overall Audit Strategy and Audit Plan can be defined as under:

Statement I:

Establishment of the overall audit strategy and the detailed audit plan are necessarily sequential processes.

Statement II:

Changes in one may result in consequential changes to the other.

Statement III:

Establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes.

Statement IV:

An audit plan can be developed, once the overall audit strategy has been established.

- (a) Statement I and Statement II are correct.
  - (b) Statement II, III and IV are correct.
  - (c) Statement II and III are correct.
  - (d) Statement I, II and IV are correct.
4. While planning the audit, as per SA 315 – Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment, the auditor is required to obtain an understanding of which of the following in order to identify and assess risks of material misstatement?
- (a) The entity's operations
  - (b) The entity's operations and its ownership and governance structure
  - (c) The entity's operations, ownership and governance structure, and how the entity is structured and financed
  - (d) The entity's operations and how the entity is structured and financed
5. CA M advised the audit team that the audit programme should be framed strictly within the scope of the audit engagement. Which of the following best describes the considerations that should guide the auditor while preparing the audit programme?
- (a) The audit programme should be framed considering the audit objectives, statutory requirements, and applicable Standards on Auditing.
  - (b) The auditor may expand the programme to cover all areas of the client's business, regardless of the audit objectives.
  - (c) The audit programme should primarily focus on internal controls, ignoring statutory compliance.
  - (d) The auditor may decide the audit programme based on convenience and availability of staff.

**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (d)** Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

**Reason:**

SA 330 allows reliance on audit evidence from previous audits after evaluating factors relating to the control environment, nature of controls, and consistency of control application. The case clearly states that unusual or non-routine transactions are relevant for risk identification, not for assessing reliance on prior control testing. Therefore, whether transactions are outside the normal course of business is not relevant for deciding use of prior-period audit evidence on operating effectiveness of controls.

2. **Option (b)** Nature of audit procedures, balance between benefit and cost, and timeliness of financial reporting

**Reason:**

As per SA 200, while exercising professional judgement to determine whether sufficient appropriate audit evidence has been obtained, the auditor is required to consider all relevant guiding factors together. These include the nature of audit procedures performed, the balance between the benefit and cost of obtaining audit evidence, and the need for timely completion of financial reporting. Considering only one or two of these factors would give an incomplete basis for judgement. The standard recognises that audit procedures must be appropriate in nature, economically justified, and performed within reporting timelines. Hence, only Option (b), which includes all three factors prescribed by SA 200, correctly reflects the requirements of the Standard.

3. **Option (b)** Statement II, III and IV are correct.

**Reason:**

SA 300 states that although the audit plan is prepared after establishing the overall audit strategy, the two are closely interrelated. It is also mentioned that they are not necessarily discrete or strictly sequential, and

changes in one may require changes in the other. Hence, Statements II, III and IV are correct. Statement I is incorrect because the process is not necessarily sequential.

4. **Option (c)** The entity's operations, ownership and governance structure, and how the entity is structured and financed

**Reason:**

SA 315 requires the auditor, during audit planning and risk assessment, to obtain a comprehensive understanding of the entity and its environment. This includes understanding the entity's operations, its ownership and governance structure, and how the entity is structured and financed. Such understanding helps the auditor identify areas where risks of material misstatement may arise. Considering only one or two aspects would result in an incomplete risk assessment. Therefore, all these elements must be considered together to comply with the requirements of SA 315.

5. **Option (a)** The audit programme should be framed considering the audit objectives, statutory requirements, and applicable Standards on Auditing.

**Reason:**

As per auditing principles, the audit programme must be designed to achieve the audit objectives efficiently. This means it should remain within the scope of the engagement and focus only on matters relevant to forming the audit opinion. The auditor must also ensure compliance with statutory requirements applicable to the client and follow the Standards on Auditing, which provide guidance on planning, procedures, and documentation. Expanding the programme beyond the scope or ignoring standards can lead to inefficiency or non-compliance, while a well-framed programme ensures that audit resources are used effectively and the objectives of the audit are properly achieved.

**CASE SCENARIO 22**

Jatin & Associates, Chartered Accountants, Chennai, were appointed as the Statutory Auditors under the Companies Act, 2013 of Sweet Aroma Private Limited, a company engaged in the business of manufacturing rice from paddy. Sweet Aroma operates only one manufacturing plant, which is located at Karnal in the State of Haryana.

As at 31<sup>st</sup> March, 2025, Jatin & Associates noted that inventory accounted for a significant 58% of total assets, making it a key audit focus. Despite the Karnal plant being far from their Chennai office and involving additional travel time and cost, the audit team decided to attend the year-end physical inventory count on 31<sup>st</sup> March, 2025 to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory.

While planning the audit of Sweet Aroma Private Limited for the financial year 2024–25, the audit team considered key factors relevant for attendance at physical inventory counting. These included the nature of inventory comprising raw paddy, semi-processed rice at three distinct milling stages, and finished rice stored in godowns. The auditors also considered the timing of the physical inventory count, stages of completion of work in progress, the perpetual inventory system maintained by the company, and assessed the risks of material misstatement and the relevant internal controls pertaining to inventory.

During the audit, Jatin & Associates attended the physical inventory counting at the Karnal plant on 31<sup>st</sup> March 2025. Prior to commencement of the count, the auditors reviewed and evaluated the written procedures issued by management for recording and controlling the results of physical inventory counting. Thereafter, they observed the manner in which management's personnel performed the count to assess compliance with those procedures. The auditors then inspected various categories of inventory, including raw paddy, work-in-progress at different milling stages, and finished rice stored in godowns. Finally, they performed test counts on selected inventory items to verify quantities and ensure the reliability of the count results.

While inspecting the inventory stored in godowns, the auditors physically verified the presence of inventory and observed its condition, including signs

of damage, moisture, or deterioration. During this inspection, they identified 67 quintals of rice tagged as "Job Work – PQR". On enquiry, management explained that M/s PQR, a proprietary concern, had supplied paddy to Sweet Aroma for custom milling. Sweet Aroma merely charged processing fees and did not bear any price or storage risk in respect of such rice. Ownership of the rice continued to remain with M/s PQR throughout the processing period.

Accordingly, the auditors evaluated the implications of such job-work inventory on audit evidence relating to existence, ownership, and condition of inventory, as well as its treatment in the financial statements of Sweet Aroma Private Limited.

Based on above, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

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

2. Below are given certain cluster of matters which are relevant in planning attendance of auditor at physical inventory counting. Which of the following clusters consists of a likely inappropriate combination?
- (a) Nature of inventory, timing of physical inventory counting and stages of completion of work in progress
  - (b) Nature of inventory, timing of physical inventory counting and valuation method of inventory
  - (c) Nature of inventory, timing of physical inventory counting, considerations regarding maintenance of a perpetual inventory system
  - (d) Risks of material misstatements related to inventory, nature of internal control pertaining to inventory, considerations regarding maintenance of a perpetual inventory system.
3. Which of the following is the most likely logical sequence of steps in relation to attendance at physical inventory counting by auditor?
- (a) Observance of performance of management's count procedures, inspection of inventory, performing test counts and evaluation of management's procedures for recording and controlling results of physical inventory counting
  - (b) Observance of performance of management's count procedures, performing test counts, inspection of inventory and evaluation of management's procedures for recording and controlling results of physical inventory counting
  - (c) Performing test counts, inspection of inventory, Observance of performance of management's count procedures and evaluation of management's procedures for recording and controlling results of physical inventory counting
  - (d) Evaluation of management's procedures for recording and controlling results of physical inventory counting, Observance of performance of management's count procedures, inspection of inventory and performing test counts

4. During attendance at physical inventory counting, the auditor inspects inventory. Following outcomes stated as I, II & III are given below of this inspection procedure: -
- Outcome I - Existence of inventory  
Outcome II - Ownership of inventory  
Outcome III - Condition of inventory
- Which of following statements is most likely true?
- (a) Outcomes I, II and III are all necessarily established after inspection.
- (b) Only Outcomes I and III are established after inspection and Outcome II is never established.
- (c) Outcomes I and III are established after inspection. However, outcome II may not be necessarily established.
- (d) Outcomes II and III are established after inspection. However, outcome I may not be necessarily established.
5. It was observed by auditors that, out of total rice physically counted on 31<sup>st</sup> March, 2025 about 67 quintals of rice belonged to M/s PQR, a proprietary concern which had sent paddy to this company's plant for extraction of rice. What would be treatment of this item in financial statements of company?
- (a) The value of 67 quintals rice would be reflected in company's financial statements as per method of valuation adopted by the company.
- (b) The value of 67 quintals rice would be reflected in company's financial statements as per method of valuation adopted by the proprietary concern.
- (c) The value of 67 quintals rice would not be reflected in company's financial statements.
- (d) The value of 67 quintals rice would be reflected in proprietary concern's financial statements as per method of valuation adopted by the company.

**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (d)** The auditor shall attend at physical inventory counting unless impracticable. However, issue of time and costs involved because of auditor's office location vis-à-vis company's plant location is not a valid basis for skipping physical inventory counting.

**Reason:**

Attendance at physical inventory counting provides the most reliable evidence about the existence and condition of inventory, as per SA 501. While practical difficulties like travel distance and cost exist, these are not valid reasons to skip attendance. The auditor should attend unless genuinely impracticable, performing alternative procedures only if attendance is truly impossible. In this case, the auditors' presence allowed them to verify inventory directly, including segregating consignment or job-work stock, thereby ensuring sufficient appropriate audit evidence.

2. **Option (b)** Nature of inventory, timing of physical inventory counting and valuation method of inventory

**Reason:**

While nature of inventory and timing of physical count are relevant factors in planning attendance, the valuation method of inventory is not directly relevant to deciding whether or how to attend the count—it affects audit procedures for valuation, not the physical verification itself. In contrast, factors like stages of completion of work in progress, perpetual inventory system, and internal controls directly influence planning for physical attendance. Hence, cluster (b) represents a likely inappropriate combination of factors for planning attendance.

3. **Option (d)** Evaluation of management's procedures for recording and controlling results of physical inventory counting, Observance of performance of management's count procedures, inspection of inventory and performing test counts.

**Reason:**

As per SA 501, the auditor should follow a logical sequence while attending physical inventory counting. First, the auditor evaluates

management's procedures for recording and controlling inventory counts to understand the framework and reliability of the process. Thereafter, the auditor observes the performance of management's count procedures to assess whether they are properly implemented. This is followed by inspection of inventory to verify existence and condition. Finally, the auditor performs test counts to corroborate the quantities recorded by management. Hence, option (d) represents the most appropriate and logical sequence of audit steps.

4. **Option (c)** Outcomes I and III are established after inspection. However, outcome II may not be necessarily established.

**Reason:**

Inspection of inventory during physical counting provides direct evidence regarding the existence of inventory and allows the auditor to assess its condition, such as damage, obsolescence, or deterioration. However, ownership (rights and obligations) cannot always be established solely through physical inspection, as inventory may be held on consignment or under job-work arrangements. As seen in the case, job-work inventory physically existed and was in good condition but did not belong to the entity. Ownership must therefore be verified through agreements and records. Hence, outcomes I and III are established, while outcome II may not necessarily be established.

5. **Option (c)** The value of 67 quintals rice would not be reflected in company's financial statements.

**Reason:**

As per the accounting principle of rights and obligations, inventory should be recognised only when the entity has ownership and bears the associated risks and rewards. In this case, the rice belonged to M/s PQR and Sweet Aroma acted merely as a job worker without assuming ownership or price risk. Mere physical possession does not justify recognition of inventory in the financial statements. Therefore, the value of 67 quintals of rice should not be reflected in the financial statements of Sweet Aroma Private Limited, making option (c) the correct answer.

**CASE SCENARIO 23**

CA Laxman, Chartered Accountant, was appointed as the statutory auditor of Best Limited for the financial year ended 31st March 2025. The company is engaged in wholesale trading and due to the nature of its operations, undertakes substantial cash transactions for purchases, expenses, and other operational payments.

While planning the audit and performing preliminary risk assessment, CA Laxman observed that the company had recorded unusually high cash payments during the year. Many of these payments were supported only by internal vouchers lacking adequate corroborative or third-party evidence. On further review of past records, similar patterns of cash expenditure were noticed over the preceding four to five years.

Further inquiry revealed that the Finance Manager, who retired in March 2025, had exercised significant and centralized control over cash payments for several years. There was inadequate segregation of duties, with authorization, recording and custody of cash largely concentrated with the same individual. These circumstances indicated weaknesses in internal control and increased the risk of material misstatement, particularly due to possible misappropriation through inflated expenditure.

During substantive audit procedures, the audit team also noted that the balance sheet as at 31<sup>st</sup> March 2025 disclosed a cash balance of ₹ 7 crores, despite the company having availed a bank loan of ₹ 2 crores during the year. The existence of such a large cash balances alongside external borrowings appeared unusual and required deeper examination of the genuineness, existence, and utilization of cash balances.

While performing detailed audit procedures, including verification of cash payments, examination of vouchers, and obtaining management representations, CA Laxman faced limitations in conclusively verifying certain transactions relating to prior years due to the absence of external supporting evidence, the passage of time, and the possibility of collusion involving past management personnel. Some audit evidence obtained was persuasive rather

than conclusive, and audit sampling had to be applied considering time and cost constraints.

Accordingly, while conducting the statutory audit in accordance with the Standards on Auditing, particularly SA 200 and related standards, CA Laxman was required to exercise professional judgment, maintain professional skepticism, obtain sufficient and appropriate audit evidence, and recognize the inherent limitations of an audit while evaluating the impact of these matters on the audit opinion.

Based on above, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

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1. While planning the audit of Best Limited, CA Laxman observes that the Finance Manager exercised significant control over cash payments for several years. Which of the following should be the most appropriate audit response in such a situation?
  - (a) Reduce audit procedures since the Finance Manager has retired
  - (b) Increase professional skepticism and modify the nature and extent of audit procedures
  - (c) Rely primarily on management explanations and written representations
  - (d) Ignore past-period transactions as they are outside the scope of the current audit
  
2. Which of the following situations most appropriately explains the presence of inflated cash payments in the books of Best Limited?
  - (a) Non-recording of certain cash sales
  - (b) Payments made against genuine and properly supported vouchers
  - (c) Payments made against overstated or inflated expenditure vouchers
  - (d) Temporary shortage of working capital

3. Which of the following statements best explains why an auditor may fail to detect certain material misstatements even after properly planning and performing the audit?
- (a) Audit failures arise only due to negligence of the auditor
  - (b) Management representations eliminate audit risk
  - (c) Audits are subject to inherent limitations resulting in unavoidable detection risk
  - (d) Compliance with Standards on Auditing ensures complete detection of misstatements

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (b)** Increase professional skepticism and modify the nature and extent of audit procedures

**Reason:**

As per SA 200, the auditor is required to exercise professional judgment and maintain professional skepticism throughout the audit. Long-term concentration of authority with a single individual increases the risk of material misstatement, including fraud. Accordingly, the auditor should respond by enhancing skepticism and modifying the nature, timing, and extent of audit procedures to obtain sufficient appropriate audit evidence. The retirement of personnel does not mitigate risks relating to past transactions, and management representations alone are not sufficient audit evidence.

2. **Option (c)** Payments made against overstated or inflated expenditure vouchers

**Reason:**

Inflated cash payments generally arise when expenditure vouchers are deliberately overstated to facilitate misappropriation of funds. Such manipulation results in excess cash outflow without any corresponding economic benefit. Non-recording of cash sales affects revenue, not

expenditure. Genuine vouchers do not lead to inflation and working capital shortage does not explain inflated payments.

3. **Option (c)** Audits are subject to inherent limitations resulting in unavoidable detection risk

**Reason:**

As explained in SA 200, every audit is subject to inherent limitations such as the use of professional judgment, audit sampling and the fact that audit evidence is generally persuasive rather than conclusive. Due to these limitations, there is an unavoidable risk that some material misstatements may not be detected. Even full compliance with the Standards on Auditing cannot eliminate this detection risk entirely.

**CASE SCENARIO 24**

Moon Group is a retail chain engaged in selling daily consumer goods directly to customers. The group operates 16 retail outlets across four cities in South India. Due to the geographical spread of operations, audits of individual outlets are carried out by different auditors, while Sumant & Co. has been appointed as the principal auditor responsible for expressing audit opinion on the group financial statements for the year ended 31 March 2025.

Moon Group also has a quarterly internal audit function, carried out by Ram & Co., an independent firm reporting to senior management.

During the statutory audit, the following matters were noted:

- (i) The group operates a customer loyalty scheme under which customers earn reward points on purchases. These points can be redeemed in future purchases. Management, supported by internal auditors and branch auditors, has treated the value of redeemed points as trade discounts in the books. However, the principal auditor believes that the accounting treatment may require further evaluation.
- (ii) During audit planning, the principal auditor noted that Moon Group has an established internal audit function carried out by Ram & Co., an independent firm reporting to senior management. The internal auditors perform regular reviews of revenue recognition, inventory controls and outlet-level transactions across the group. The principal auditor considers whether, and to what extent, the work performed by the internal auditors can be used for the purposes of the statutory audit.
- (iii) While considering the use of the internal audit function's work, the principal auditor reviewed the organisational status of Ram & Co. It was noted that the internal auditors report to senior management, do not have any operational or decision-making responsibilities within Moon Group, and their appointment and removal are overseen by those charged with governance. The principal auditor also considered whether the internal auditors' technical competence and professional expertise have any bearing on their objectivity.

Based on above, answer the following:

### MULTIPLE CHOICE QUESTIONS

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1. In relation to the accounting treatment of redeemed reward points under the loyalty scheme, which action should the principal auditor take, considering the views of management, internal auditors and branch auditors?
  - (a) Accept the treatment as trade discount since multiple auditors support management's view.
  - (b) Rely on management's judgment as accounting policies are management's responsibility.
  - (c) Independently evaluate the accounting treatment and obtain sufficient appropriate audit evidence before forming an opinion.
  - (d) Defer to the branch auditor's conclusion as the transaction originates at outlet level.
2. While using the work performed by Ram & Co., the internal auditors, what is the primary objective of the principal auditor in this engagement?
  - (a) To determine whether, and to what extent, the work of internal audit can be used for statutory audit purposes.
  - (b) To replace substantive audit procedures with internal audit procedures.
  - (c) To review only those areas not covered by internal audit.
  - (d) To obtain management explanations on internal audit observations.
3. While assessing whether the work of Ram & Co. (internal auditors) can be used, which of the following factors is NOT relevant to evaluating the objectivity of the internal audit function?
  - (a) Whether internal audit reports to senior management or those charged with governance.
  - (b) Whether internal auditors have operational responsibilities within the entity.

- (c) Whether internal auditors possess adequate technical training and professional competence.
- (d) Whether internal audit employment and removal decisions are overseen by those charged with governance.

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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1. **Option (c)** Independently evaluate the accounting treatment and obtain sufficient appropriate audit evidence before forming an opinion.

**Reason:**

As per SA 200 – Overall Objectives of the Independent Auditor, the auditor has sole responsibility for expressing an audit opinion on the financial statements. Reliance on management, internal auditors or branch auditors does not reduce this responsibility. Therefore, when there is doubt regarding the accounting treatment of reward points, the auditor must perform independent audit procedures and evaluate whether the treatment complies with the applicable financial reporting framework. The audit opinion must be based on sufficient appropriate audit evidence obtained by the auditor himself.

2. **Option (a)** To determine whether, and to what extent, the work of internal audit can be used for statutory audit purposes.

**Reason:**

As per SA 610 – Using the Work of Internal Auditors, the principal objective of the external auditor is to determine, whether and to what extent, the work of the internal audit function can be used for the purposes of the statutory audit. This includes evaluating the objectivity, competence and systematic approach of the internal audit function. The external auditor remains fully responsible for the audit opinion and therefore must assess whether the internal audit work is adequate and relevant to reduce audit procedures.

3. **Option (c)** Whether internal auditors possess adequate technical training and professional competence.

**Reason:**

As per SA 610, evaluation of objectivity of the internal audit function focuses on factors such as organisational status, freedom from conflicting responsibilities, and oversight by those charged with governance. Technical competence and professional proficiency relate to the capability of internal auditors, not their objectivity. Hence, adequacy of technical training affects competence, not independence or objectivity, making option (c) the correct answer.

**CASE SCENARIO 25**

M/s JK & Associates have been appointed as auditors of Venus Ltd. for the financial year 2024-25. The team consist of Mr. J & Mr. K both Chartered Accountants as also the engagement partners and the audit staff consisting of 2 article assistants. While starting the audit work of Venus Ltd, the engagement partners briefed the audit staff about the audit work, areas to be covered and the various auditing concepts and their application in the audit of Venus Ltd. along with applicable Standard on Auditing.

As part of this briefing, the engagement partners began by explaining the fundamental aspects of audit planning and the manner in which the audit would be structured and executed:

- (i) During the initial planning stage, Mr. K explained to the audit team that before preparing a detailed audit plan or audit programme, it is necessary to first decide the broad framework of the audit. This framework would determine the scope of the audit, the timing of audit procedures and the overall direction of audit work and would guide the preparation of more detailed audit documentation.
- (ii) While discussing audit planning, the engagement partners clarified that the process of determining the overall audit strategy and preparing the audit plan is not strictly sequential. They informed the team that both are closely inter-related and may require revision during the course of audit as new information or risks are identified.
- (iii) Mr. K further explained that, apart from determining materiality for the financial statements as a whole, the auditor is required to determine a lower threshold to plan audit procedures. This lower amount helps reduce the risk that the aggregate of uncorrected and undetected misstatements exceeds overall materiality.
- (iv) While discussing materiality benchmarks applicable to Venus Ltd., the audit team considered various bases such as profit before tax, total revenue and net assets. The engagement partner highlighted that the choice of benchmark depends upon the nature of the entity, its financial performance and the information needs of users of financial statements.

- (v) The engagement partners also briefed the audit staff about professional pronouncements issued by the Institute of Chartered Accountants of India (ICAI). They explained that guidance notes are issued to provide practical guidance to members and are generally recommendatory, whereas statements are issued with a view to securing compliance by members and are mandatory in nature.

Based on the above facts, answer the following:

### MULTIPLE CHOICE QUESTIONS

1. While planning the audit of Venus Ltd., the engagement partner explained that one of the key planning components determines the overall scope of the audit, decides the timing and direction of the audit and also guides the development of the audit plan.  
Which of the following best describes this planning component?
  - (a) Audit Programme
  - (b) Overall Audit Strategy
  - (c) Completion Memorandum
  - (d) Audit Plan
2. Which of the following best describes the amount set by the auditor at less than materiality for the financial statements as a whole, in order to reduce to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements exceeds materiality for the financial statements as a whole?
  - (a) Benchmark Materiality
  - (b) Materiality in Planning
  - (c) Performance Materiality
  - (d) Materiality.
3. Which of the following is not an appropriate benchmark that can be used in determining the materiality in the case of financial statements: -
  - (a) Total Revenue
  - (b) Profit before tax

- (c) Net Asset Value
- (d) Number of employees of the entity

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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**1. Option (b) Overall Audit Strategy**

**Reason:**

As per SA 300 (Planning an Audit of Financial Statements), the overall audit strategy sets the scope, timing and direction of the audit. It establishes the broad framework within which the audit will be conducted. The strategy guides the development of the detailed audit plan and audit programme. It helps the auditor determine resources, expertise required and key risk areas. Hence, it is the foundational planning document, not the audit plan or programme.

**2. Option (c) Performance Materiality**

**Reason:**

As per SA 320 (Materiality in Planning and Performing an Audit), performance materiality is the amount set below overall materiality to reduce audit risk. Its objective is to ensure that the aggregate of uncorrected and undetected misstatements does not exceed materiality for the financial statements as a whole. It assists in planning the nature, timing and extent of audit procedures. Hence, the definition matches performance materiality.

**3. Option (d) Number of employees of the entity**

**Reason:**

As per SA 320 – Materiality in Planning and Performing an Audit, materiality is determined using appropriate financial benchmarks that reflect the size or nature of an entity's operations. Commonly used benchmarks include profit before tax, total revenue and net assets, depending on the circumstances of the entity. These benchmarks have a direct financial significance for users of financial statements. Number of employees is a non-financial measure and does not indicate financial magnitude. Therefore, it cannot be used as a benchmark for determining materiality for financial statements as a whole.

**CASE SCENARIO 26**

Roop & Co. have been appointed as the auditors of Onda Group of Hotels. This is the first time the firm is auditing an entity in the food and beverage industry. On Day 1 of the audit, the engagement partner, along with his audit team, aimed to develop a thorough understanding of the entity and its environment in order to identify and assess the risks of material misstatement, whether due to fraud or error.

The auditor began assessing the entity's business processes and internal controls to identify areas susceptible to material misstatement:

1. Based on the auditor's understanding of the banquet hall revenue process, it was observed that invoices are raised before finance approval, advances received from customers are not vetted by the finance team, and documentation supporting revenue recognition is limited. These observations indicated weaknesses in the existing internal control framework governing revenue transactions. The auditor evaluated the nature of risk arising from such deficiencies.
2. While identifying and assessing risks of material misstatement, the engagement partner explained to the audit team the relationship between audit risk, risk of material misstatement and detection risk. He emphasized how the auditor's assessment of risks directly impacts the nature, timing and extent of audit procedures and clarified certain commonly misunderstood aspects of audit risk.
3. During the evaluation of controls over procurement of stores, the auditor noted the absence of a manually prepared Goods Receipt Note at the time of receipt of goods. However, management explained that an automated system control exists wherein a GRN is generated and approved in real time once quantity and price are entered against a specific vendor and the system does not permit back-dated entries. The auditor tested multiple controls addressing the same assertion.
4. As part of obtaining an understanding of the entity and its environment in accordance with SA 315, the audit team discussed various procedures available to identify and assess risks of material misstatement. The

engagement partner clarified that only certain procedures qualify as risk assessment procedures and distinguished them from substantive audit procedures.

5. During discussions with management, the auditor enquired about the entity's process for identifying and assessing risks of material misstatement due to fraud or error. It was noted that Onda Group of Hotels does not have a formally documented risk assessment process. The auditor considered the implications of this absence and the appropriate professional response required under the Standards on Auditing.

Based on above, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

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

- 
3. In the case of procurement of stores, the auditor has tested more than one control for the same assertion. In that given case, what should be his reliance on the control?
    - (a) Since compensating controls are identified, if tested and evaluated to be effective, the auditor can rely on the control.
    - (b) Even though compensating controls are there, since one control is ineffective, the auditor should not rely on control for this assertion and should perform extensive procedures.
    - (c) Documentation in electronic medium cannot be accepted, hence, he cannot rely only on system control.
    - (d) Even though compensating controls are there, since one control is ineffective, the auditor should not rely on control for this assertion as well as associated assertions.
  4. In the context of SA 315, which among the following is not a risk assessment procedure?
    - (a) Inquiries of management, of appropriate individuals within internal audit function and of others within the entity
    - (b) Analytical Procedures
    - (c) Observation and Inspection
    - (d) External Confirmation
  5. What should be the course of action of the auditor for the entity not having a documented risk assessment process?
    - (a) The auditor should obtain management written representations on how risks are identified
    - (b) The auditor shall discuss with management on how risks are identified, addressed and would determine whether the absence is appropriate in the circumstances or whether it represents a significant deficiency in internal control.
    - (c) The auditor should advise the management to document the same immediately and accordingly opine on the same in his audit report too.

- (d) The auditor shall discuss with management on how risks are identified by system and place reliance on the same as documentation in this context is immaterial.

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (b)** Control risk in the class of transaction

**Reason:**

Control risk refers to the risk that a misstatement will not be prevented or detected by the entity's internal controls. In the banquet hall revenue process, finance approval is obtained after invoicing, and advances are not vetted by the finance team. This indicates a weakness in internal control over revenue recognition, not an inherent susceptibility of revenue itself. Hence, the risk arises due to ineffective or absent controls over the transaction process. Therefore, it is a control risk at the class of transaction level.

2. **Option (c)** Audit risk also includes the risk that the auditor may express an opinion that the financial statements are materially misstated when they are actually not.

**Reason:**

Audit risk is defined under SA 200 as the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated. It does not include the risk of expressing a modified opinion when financial statements are actually correct. Options (a), (b) and (d) correctly describe detection risk and risk of material misstatement.

3. **Option (a)** Since compensating controls are identified, if tested and evaluated to be effective, the auditor can rely on the control.

**Reason:**

SA 315 and SA 330 allow the auditor to rely on compensating controls if they address the same assertion and are tested and found to be effective. Although manual GRN is not prepared, the system-generated GRN is created on a real-time basis and prevents back-dated entries. If such automated controls are properly tested and evaluated as effective,

reliance can be placed on them. Therefore, the auditor can rely on the control despite the absence of a manual control.

**4. Option (d) External Confirmation**

**Reason:**

As per SA 315, risk assessment procedures include inquiries, analytical procedures, and observation and inspection. External confirmation is a substantive audit procedure governed by SA 505 and is not used for understanding the entity and its environment. It is performed to obtain audit evidence rather than to assess risks.

**5. Option (b) The auditor shall discuss with management on how risks are identified, addressed and would determine whether the absence is appropriate in the circumstances or whether it represents a significant deficiency in internal control.**

**Reason:**

SA 315 requires the auditor to understand the entity's risk assessment process. If the entity does not have a documented process, the auditor should discuss with management how risks are identified and addressed in practice. The auditor must also evaluate whether the absence of documentation is appropriate for the entity's size and complexity or whether it represents a significant deficiency in internal control. Advising management or qualifying the report at this stage is not required.

**CASE SCENARIO 27**

KDR & Associates have been appointed as the auditors of Octopus Ltd. for the Financial Year 2024–25. During the course of audit, the auditor noticed a significant increase in the number of debtors, necessitating detailed verification of debtor balances and related confirmations. The auditor also observed that the company had created various provisions, including provision for taxation and provision for bad and doubtful debts, which required examination of their nature, recognition and presentation in the financial statements.

Accordingly, while carrying out audit procedures in respect of provisions, inventory, debtors and liabilities, the auditor identified certain specific audit situations, as set out below :

1. While reviewing the provisions created by Octopus Ltd., the auditor also came across certain obligations arising from past events whose outcomes depended on uncertain future events beyond the company's control. The auditor evaluated whether such obligations should be recognised in the balance sheet or disclosed by way of notes.
2. During inventory verification, the auditor noted that some inventory items owned by Octopus Ltd. were physically lying with third parties such as job workers and storage facilities. The auditor evaluated whether such inventory should form part of the closing inventory balance and whether the valuation principles were appropriately applied.
3. While verifying debtor balances, the auditor proposed to send confirmation requests to customers. However, management expressed reservations and refused to permit the auditor to send such confirmations. The auditor evaluated the implications of management's refusal on audit evidence and audit procedures.
4. While examining the liability side of the balance sheet, the auditor noted that although the structure of liabilities had not changed significantly from the previous year, it was still necessary to verify their correctness, classification and completeness. The auditor also revisited the conceptual understanding of liabilities.

5. During debtor verification, the auditor discussed the confirmation process with the audit team. Emphasis was placed on the proper handling of confirmation replies and the procedures to be followed when confirmations are not received from debtors.

Based on the above facts, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

1. While auditing the provisions and contingent items of Octopus Ltd., the auditor identifies an obligation arising from past events whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. For the purpose of audit evaluation and reporting, how should the auditor understand the nature of such an obligation?
- (a) Provision
  - (b) Reserve
  - (c) Contingent Liability
  - (d) Liability
2. Which of the following is not correct with respect to inventory held by Octopus Limited: -
- (a) All inventory units held by the company should have been recorded and recognized in the financial statements.
  - (b) Any inventory held by a third party on behalf of the company should not be included as part of the inventory balance.
  - (c) Inventory should be recognized at cost or net realizable value whichever is lower.
  - (d) Inventory balance as at the year end does not include any element of next year
3. If the management of Octopus Ltd. refuses to allow the auditor, to send the confirmation request to the debtors, the auditor should:-
- (a) Withdraw from the engagement.
  - (b) Not listen at all to any requests of the management.

- (c) Consider the management's request for refusal and assess whether such refusal is reasonable in the circumstances, and decide the nature, timing and extent of audit procedures accordingly.
  - (d) Agree to management request and proceed with audit of other items of the financial statements.
4. While verifying and reporting on liabilities of a company, which of the following statements is not true from an auditor's perspective?
- (a) Liabilities represent financial obligations of the company including owner's funds and therefore are verified together by the auditor.
  - (b) Liabilities verified by the auditor include borrowings, trade payables, other current liabilities and provisions.
  - (c) Verification of liabilities is as important for the auditor as verification of assets.
  - (d) Liabilities verified by the auditor represent obligations payable to outsiders and exclude owner's equity.

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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**1. Option (c) Contingent Liability**

**Reason:**

A contingent liability is a possible obligation arising from past events whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

As per AS 29 – Provisions, Contingent Liabilities and Contingent Assets, such liabilities are not recognised in the balance sheet but are disclosed by way of notes, unless the possibility of outflow is remote. Unlike provisions, contingent liabilities do not satisfy the criteria of present obligation with probable outflow and reliable measurement. Hence, the given description exactly matches a contingent liability.

**2. Option (b) Any inventory held by a third party on behalf of the company should not be included as part of the inventory balance.**

**Reason:**

As per AS 2 – Valuation of Inventories, inventory includes goods owned by the entity, irrespective of their physical location. Therefore, inventory lying with third parties such as consignees, job workers or warehouses must be included in the inventory balance if ownership rests with the company.

Options (a), (c) and (d) correctly state inventory principles relating to completeness, valuation at cost or NRV and exclusion of next year's elements.

3. **Option (c)** Consider the management's request for refusal and assess whether such refusal is reasonable in the circumstances, and decide the nature, timing and extent of audit procedures accordingly.

**Reason:**

As per SA 505 – External Confirmations, if management refuses to allow the auditor to send confirmation requests, the auditor shall inquire into the reasons for such refusal and assess whether the refusal is reasonable. The auditor must evaluate the implications on risk of material misstatement, especially fraud risk. If reasonable, the auditor should perform alternative audit procedures. Immediate withdrawal or blindly accepting management's request is not appropriate.

4. **Option (a)** Liabilities represent financial obligations of the company including owner's funds and therefore are verified together by the auditor.

**Reason:**

From an auditing perspective, the auditor is required to verify liabilities payable to external parties and ensure they are properly recorded, valued and disclosed. Owner's funds constitute equity, representing the residual interest of shareholders, and are not liabilities payable to outsiders. As per the financial reporting framework, liabilities and equity are separate elements of financial statements and are verified under different audit considerations. The auditor verifies borrowings, trade payables, provisions and other liabilities to ensure completeness and accuracy. Hence, the statement that liabilities include owner's funds for verification purposes is incorrect.

**CASE SCENARIO 28**

R, S, T and U are part of audit team conducting audit of financial statements of a company engaged in manufacturing of fabric for year 2024-25. As part of audit exercise, team members have planned verification of purchases, expenses, sales, other income, trade receivables and trade payables reflected in financial statements put up for audit. While designing tests of details in respect of above items, team is contemplating means of selecting items for testing that are effective in meeting for purpose of audit procedures. In this context, S has pointed out that three different means are available for selecting items for testing. However, R and T have contrarian views. They are of the view that instead of three means, only two such ways are available to auditor. Even they differ on nature of these two different ways. U has his own version and is of the view that such items can be selected only by use of audit sampling.

As regards to verification of trade receivables and trade payables, T wants to verify that these assets and liabilities exist as at balance sheet date. He has also designed properly addressed confirmation requests and suggested that responses to such requests can be sent to company's accounts department.

The team has also planned performing substantive analytical procedures in accordance with requirements of SA 520. Substantive analytical procedures are more appropriate when an account balance or relationships between items of data are predictable. Team members are puzzled whether there exists predictable relationship between sales and cost of sales, between trade receivables and cash receipts. The team is also discussing in a cordial atmosphere various factors to be considered for substantive analytical audit procedures. All team members have listed some factors in this regard as under:

- R's Listing- Availability of data, audit risk, aggregation
- S's Listing- Availability of data, inherent risk, aggregation
- T's Listing-Availability of data, audit risk, disaggregation
- U's Listing-Availability of data, inherent risk, disaggregation

The team has noticed that fabric sold by company is subject to uniform GST rate of 5%. During year 2024-25, company has paid GST of Rs. 20 lacs. One team

member has calculated that considering amount of GST paid, sales of company should be around Rs.4 crores.

Based on above, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

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1. Considering description given in case scenario regarding means of selecting items for testing, which team member's view is in accordance with Standards on Auditing?
  - (a) View of S is correct. The means available to auditor for selecting items for testing are- Selecting all items, Selecting specific items and audit sampling
  - (b) View of R is correct. The means available to auditor for selecting items for testing are- Selecting all items and audit sampling
  - (c) View of T is correct. The means available to auditor for selecting items for testing are- Selecting all items and selecting specific items
  - (d) View of U is correct. The means available to auditor for selecting items for testing consists of audit sampling only.
  
2. Which of the statements is correct regarding verification of Trade receivables and Trade Payables by T?
  - (a) T is verifying "occurrence" assertion. His approach of getting responses sent to confirmation requests is proper.
  - (b) T is verifying "existence" assertion. His approach of getting responses sent to confirmation requests is proper.
  - (c) T is verifying "existence" assertion. His approach of getting responses sent to confirmation requests is not proper.
  - (d) T is verifying "occurrence" assertion. His approach of getting responses sent to confirmation requests is not proper.

3. In context of substantive analytical relationships, choose most appropriate option regarding meaning of "predictability" and viewpoint regarding predictable relationships discussed in case scenario.
- (a) A predictable relationship is one that may reasonably be expected to exist and grow over time. Substantive analytical procedures are appropriate between sales and cost of sales.
  - (b) A predictable relationship is one that may reasonably be expected to exist and continue over time. Substantive analytical procedures are appropriate between sales and cost of sales.
  - (c) A predictable relationship is one that may reasonably be expected to exist and continue over time. Substantive analytical procedures are appropriate between sales and cost of sales; between trade receivables and cash receipts
  - (d) A predictable relationship is one that may reasonably be expected to exist and grow over time. Substantive analytical procedures are appropriate between sales and cost of sales; between trade receivables and cash receipts
4. One team member has derived sales from amount of GST paid as discussed in case scenario. Which audit procedure(s) he has performed?
- (a) Recalculation
  - (b) Analytical Procedures
  - (c) Inspection
  - (d) Observation
5. Whose listing combination is most appropriate in respect of factors to be considered for substantive analytical audit procedures?
- (a) R's Listing
  - (b) S's Listing
  - (c) T's Listing
  - (d) U's Listing

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**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (a)** View of S is correct. The means available to auditor for selecting items for testing are- Selecting all items, Selecting specific items and audit sampling

**Reason:**

When designing tests of details, the auditor shall determine means of selecting items for testing that are effective in meeting the purpose of the audit procedure. The means available to the auditor for selecting items for testing are: (a) Selecting all items (100% examination); (b) Selecting specific items; and (c) Audit sampling. The application of any one or combination of these means may be appropriate depending on the auditors' judgement to obtain audit evidence.

2. **Option (c)** T is verifying "existence" assertion. His approach of getting responses sent to confirmation requests is not proper.

**Reason:**

Existence means that assets, liabilities, and equity interests exist. Trade receivables and trade payables are in nature of assets and liabilities respectively. Therefore, T is verifying "existence" assertion.

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including designing the confirmation requests and determining that requests are properly addressed and contain return information for responses to be sent directly to the auditor. Hence, approach of getting responses sent to company's accounts department is not proper.

3. **Option (c)** A predictable relationship is one that may reasonably be expected to exist and continue over time. Substantive analytical procedures are appropriate between sales and cost of sales; between trade receivables and cash receipts

**Reason:**

As per SA 520, substantive analytical procedures are more appropriate when relationships between financial data are predictable and stable in nature. A predictable relationship is one that may reasonably be expected to exist and continue over time, based on the entity's operations and past

experience. In a manufacturing concern, a consistent relationship generally exists between sales and cost of sales due to relatively stable production processes and margins. Similarly, trade receivables are expected to convert into cash receipts in the normal course of business, establishing a predictable linkage. Since both these relationships are logical, recurring and capable of forming reliable expectations, substantive analytical procedures are appropriate in respect of both relationships mentioned in the case scenario.

**4. Option (b) Analytical Procedures**

**Reason:**

The team member has derived expected sales by establishing a plausible relationship between GST paid and sales turnover, considering the uniform GST rate of 5% applicable to fabric. By independently computing expected sales from GST paid ( $\text{₹ } 20 \text{ lakhs} \times 100 / 5$ ), the auditor develops an independent expectation of sales amounting to ₹ 4 crores. This involves evaluation of financial information through analysis of a logical and predictable relationship between tax expense and revenue. Such an evaluation is not based on inspection or recalculation of accounting records, but on analysing relationships among financial data. Therefore, the procedure performed is a substantive analytical procedure as defined under SA 520.

**5. Option (d) U's Listing**

**Reason:**

SA 520 provides that the reliability of substantive analytical procedures depends upon several factors, including the availability and reliability of data, the assessed level of inherent risk, and the degree of disaggregation of the data used. Analytical procedures are more effective when data is available from reliable sources and when inherent risk is low. Further, using more disaggregated data (for example, monthly or product-wise figures) improves predictability and precision of expectations. Hence, the combination of availability of data, inherent risk and disaggregation, as listed by U, is most appropriate in accordance with SA 520.

**CASE SCENARIO 29**

CA Lalith is the engagement partner for the statutory audit of Techie Solutions Ltd. (TSL) for the financial year ended 31st March, 2025. TSL is engaged in custom software development and executes long-term, multi-year contracts for various corporate clients. During the year, the company reported a 25% increase in revenue, primarily attributable to ongoing projects.

During audit planning and execution, the following matters were identified as significant:

1. TSL recognises revenue from long-term contracts using the percentage of completion method. The stage of completion is determined only on the basis of hours billed to clients, without considering achievement of project milestones, technical deliverables, or customer acceptance. Given the subjectivity involved, the auditor considers revenue recognition to be a significant risk area. Management has provided a written representation stating that the method adopted is appropriate and consistently applied.
2. TSL entered into a material service contract with a new supplier, Innovate Infra Services, for maintenance of its data servers. During audit procedures, the auditor discovered that the wife of TSL's CEO is a director and holds substantial equity in Innovate Infra Services. This relationship and transaction have not been disclosed in the financial statements. Management contends that since the transaction is at arm's length, no disclosure is required.
3. TSL maintains a small quantity of hardware inventory that is occasionally bundled with software solutions. Physical verification was conducted by management in January 2025. During audit procedures in April 2025, the auditor identified a 10% difference between physical stock and book records. It was further noted that, despite a documented policy requiring quarterly physical verification, the last two quarterly counts were not conducted.
4. As required by SA 580, the auditor requested a comprehensive written representation covering completeness of information, recognition, and disclosures. Management expressed reluctance and instead provided separate emails from department heads, confirming limited matters, citing time constraints.

5. In May 2025, after preparation of draft financial statements but before signing of the audit report, TSL lost a legal case that had been ongoing as at 31<sup>st</sup> March, 2025. The court ordered TSL to pay a penalty of ₹ 75 lakhs, which is material. Management proposes to disclose this only in the Directors' Report, without recognising any provision or adjustment in the financial statements.

Based on above, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

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1. Regarding revenue recognition based solely on hours billed, what should be the auditor's primary course of action?
  - (a) Accept management's written representation as sufficient audit evidence
  - (b) Design and perform additional audit procedures to obtain sufficient appropriate audit evidence
  - (c) Modify the audit report immediately
  - (d) Restrict audit work to testing billing controls
2. What is the most appropriate action by the auditor regarding the transaction with Innovate Infra Services?
  - (a) Accept management's explanation since the transaction is at arm's length
  - (b) Obtain sufficient appropriate audit evidence and require proper disclosure
  - (c) Report the matter directly to statutory authorities
  - (d) Issue a disclaimer of opinion
3. What is the most significant deficiency identified in the inventory control system?
  - (a) Physical verification was conducted before the year-end
  - (b) The 10% discrepancy between physical stock and records
  - (c) Failure to conduct quarterly physical verification as per policy

- (d) The inventory balance is not material
4. Management refuses to provide a comprehensive written representation under SA 580. What should the auditor do?
- (a) Rely on emails from department heads
  - (b) Re-evaluate management's integrity and assess impact on audit opinion
  - (c) Issue a qualified opinion immediately
  - (d) Withdraw from the engagement
5. How should the loss of the legal case be treated in the financial statements?
- (a) Disclosure only in the Directors' Report
  - (b) Disclosure in notes as a non-adjusting event
  - (c) Recognise a provision as an adjusting event
  - (d) Ignore the event for audit purposes

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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1. **Option (b)** Design and perform additional audit procedures to obtain sufficient appropriate audit evidence

**Reason:**

As per SA 500, written representations are necessary but cannot replace other audit evidence. Revenue from long-term contracts involves significant judgment and estimation, making it a high-risk area. Reliance solely on hours billed may not faithfully represent actual work completed. Therefore, under SA 330, the auditor must design and perform additional substantive procedures, such as examining project milestones, budgets, progress reports, and customer confirmations, to obtain sufficient appropriate audit evidence.

2. **Option (b)** Obtain sufficient appropriate audit evidence and require proper disclosure

**Reason:**

According to SA 550, transactions with entities in which close family members of key management personnel have control or significant influence are related party transactions, irrespective of arm's length pricing. The auditor must understand the nature, business rationale, and terms of such transactions and ensure adequate disclosure in the financial statements. Failure to disclose material related party transactions can result in material misstatement of disclosures.

3. **Option (c)** Failure to conduct quarterly physical verification as per policy

**Reason:**

As per SA 315, internal controls are designed to prevent or detect material misstatements. The non-conduct of quarterly physical verification, despite being a documented control, indicates a failure in operation of controls. The 10% discrepancy is a consequence of this failure. Such non-compliance weakens the reliability of inventory records and represents a significant deficiency in internal control.

4. **Option (b)** Re-evaluate management's integrity and assess impact on audit opinion

**Reason:**

Under SA 580, written representations form an essential part of audit evidence. Refusal to provide them constitutes a scope limitation and raises doubts regarding management's integrity and cooperation. The auditor must reassess the reliability of other audit evidence obtained and evaluate the possible effect on the audit opinion. Depending on materiality and pervasiveness, this may ultimately lead to modification of the audit report.

5. **Option (c)** Recognise a provision as an adjusting event

**Reason:**

As per SA 560, events after the reporting period that provide additional evidence of conditions existing at the balance sheet date are adjusting events. Since the legal case was ongoing as at 31<sup>st</sup> March, 2025 and the court verdict merely quantifies the obligation, the liability existed at the balance sheet date. Hence, a provision must be recognised in the financial statements.

**CASE SCENARIO 30**

XYZ Ltd. is engaged in the business of development and manufacturing of computer hardware and related components. The company designs and produces customised hardware solutions for various industrial and commercial clients. In order to enhance production efficiency, improve quality control, and support advanced manufacturing processes, XYZ Ltd. regularly invests in both tangible and intangible assets.

The following aspects relating to assets and software expenditure were examined during the audit:

1. During the audit of XYZ Ltd., the auditors observed that the company incurred substantial expenditure on repairs and maintenance of its production machinery during the year. Certain repairs went beyond routine maintenance and resulted in improved output capacity, reduced downtime, and enhanced operational efficiency of the machines. Given the volume and nature of such expenditure, the auditors identified a risk of inappropriate charging of capital expenditure to revenue. The audit team was instructed to examine whether such costs merely maintained the assets or resulted in enhancement of future economic benefits. Professional judgement was required to determine the correct classification in accordance with applicable Accounting Standards. The auditors emphasised that incorrect treatment could materially affect profit and asset valuation.
2. While reviewing additions to non-current assets, the auditors noted that XYZ Ltd. had acquired a specialised software solution, Zenith X, during the year. The software was integrated with the manufacturing systems and was intended to be used continuously over multiple production cycles. Management represented that the software plays a key role in optimising production schedules and improving manufacturing accuracy. The auditors evaluated whether the software was capable of generating identifiable future economic benefits and whether XYZ Ltd. exercised control over its use. The audit team was also required to verify that the

software was not acquired for resale or temporary use. Recognition as an intangible asset was examined in light of AS 26.

3. In the course of audit, the auditors discussed with management the procedures followed when assets become obsolete or are no longer in active use. Given the rapid technological changes in the computer hardware industry, software assets may become redundant before the end of their estimated useful lives. The auditors instructed the audit team to verify whether any such software had ceased to generate economic benefits during the year. They also emphasised the need to examine management approvals for derecognition and ensure that amortisation policies were appropriately applied. Failure to derecognise such assets could lead to overstatement of assets. Compliance with AS 26 was considered critical in this regard.
4. Considering the specialised nature of the software used by XYZ Ltd., the auditors assessed whether there were any indicators suggesting impairment during the year. Factors such as technological obsolescence, changes in production methods, or underutilisation of software were evaluated. The audit team was directed to verify whether management had performed an impairment assessment at the reporting date. Where indicators existed, the auditors required evidence supporting the determination of recoverable amount. The focus was to ensure that the carrying amount of software did not exceed its recoverable value. The audit procedures were planned in accordance with the relevant Accounting Standard on impairment.
5. During the audit, the auditors noted that XYZ Ltd. incurred significant costs on software-related activities, including feasibility studies, system design, testing, and process improvements. The audit team was advised to carefully distinguish between expenditure incurred during the research phase and that incurred during the development phase. The auditors highlighted that certain early-stage activities involved exploration of alternatives with uncertain outcomes. Such expenditure did not provide sufficient evidence of future economic benefits. The audit team was instructed to ensure that only qualifying development costs were

capitalised. Proper classification was necessary to ensure compliance with AS 26 and to prevent overstatement of intangible assets.

Based on above, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

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1. During the audit of XYZ Ltd., the auditor noted that certain repairs to production machinery resulted in improved output capacity and reduced downtime. Given the materiality of the expenditure, the auditor assessed a risk of misstatement due to incorrect classification between capital and revenue. While evaluating management's treatment of such expenditure, which of the following is the most appropriate audit conclusion and action?
  - (a) Accept management's treatment of the expenditure as revenue since it was incurred under the head "Repairs and Maintenance" in the ledger.
  - (b) Capitalise the entire expenditure automatically, as any major repair necessarily increases the useful life of the asset.
  - (c) Evaluate whether the expenditure resulted in enhancement of future economic benefits and, if so, verify that it has been capitalised by adjusting the carrying amount of the asset.
  - (d) Treat the expenditure as revenue unless it involves replacement of a separately identifiable component of the machinery.
  
2. While reviewing additions to non-current assets of XYZ Ltd., the auditor examined the capitalisation of Zenith X software acquired during the year. Management stated that the software was integrated with manufacturing systems and would be used continuously across production cycles. In order to conclude whether recognition of the software as an intangible asset is appropriate, which of the following audit findings would most strongly support the auditor's acceptance of management's treatment under AS 26?

- (a) The auditor obtains evidence that the software is integrated with the manufacturing process, is under the control of XYZ Ltd. and is expected to generate identifiable future economic benefits.
  - (b) The auditor relies primarily on management representation that the software improves production efficiency without corroborative documentation.
  - (c) The auditor notes that the software has been classified under non-current assets and amortised over a short period.
  - (d) The auditor confirms that the software was fully paid for during the year and recorded at invoice value.
3. When an intangible asset is no longer in active use by the entity, which of the following actions should the auditor verify as per AS 26?
- (a) The intangible asset continues to be recognised in the books until it is fully amortised.
  - (b) The intangible asset is deleted from the books after obtaining approval from the entity's management and amortisation is discontinued from the date of deletion.
  - (c) Amortisation is continued until the end of the financial year in which the asset was last used.
  - (d) The intangible asset is written down to a nominal value while amortisation continues.
4. Considering the specialised nature of the software used by XYZ Ltd., the auditor evaluated whether any indicators of impairment existed during the year, such as technological obsolescence, changes in production methods, or under-utilisation. Where such indicators were identified, the auditor required management to support the determination of recoverable amount with appropriate evidence. In this context, which of the following actions is most appropriate for the auditor in accordance with the applicable Accounting Standard?
- (a) Verify that the software continues to be amortised over its originally estimated useful life, irrespective of impairment indicators.

- (b) Ensure that management has compared the carrying amount of the software with its recoverable amount and recognised impairment loss, if any.
  - (c) Advise management to reduce the carrying amount of the software by a fixed percentage as a conservative measure.
  - (d) Rely on management representation that no impairment exists, as the software is still in use.
5. During the audit of XYZ Ltd., the auditor observed that significant software-related costs were incurred on feasibility studies, system design, testing, and process improvements. The audit team identified a risk that expenditure incurred during early-stage activities may have been inappropriately capitalised as internally generated intangible assets.

In order to comply with AS 26 and prevent overstatement of intangible assets, which of the following audit conclusions is most appropriate?

- (a) Capitalise all software-related expenditure once management demonstrates its intention to complete and use the software.
- (b) Defer recognition of all software-related costs until the software is fully operational.
- (c) Capitalise feasibility study and testing costs since they are necessary to bring the software into existence.
- (d) Expense off expenditure incurred during the research phase, as such costs do not provide sufficient evidence of probable future economic benefits.

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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1. **Option (c)** Evaluate whether the expenditure resulted in enhancement of future economic benefits and, if so, verify that it has been capitalised by adjusting the carrying amount of the asset.

**Reason:**

From an audit perspective, classification of repairs expenditure requires the exercise of professional judgement, as emphasised in SA 200 and

SA 315. The auditor must evaluate the substance of the transaction, not merely its nomenclature or ledger classification. Where repairs result in improved capacity, efficiency, or future economic benefits, the expenditure assumes a capital character under AS 10. The auditor's responsibility is to assess whether management's treatment is appropriate and ensure necessary adjustments are made to prevent material misstatement. Blind acceptance or automatic capitalisation would violate auditing principles.

2. **Option (a)** The auditor obtains evidence that the software is integrated with the manufacturing process, is under the control of XYZ Ltd., and is expected to generate identifiable future economic benefits.

**Reason:**

As per SA 500, management representations alone are insufficient audit evidence. The auditor must obtain corroborative evidence demonstrating control, long-term use, and probable future economic benefits, which are the core recognition criteria under AS 26. Integration of software with manufacturing operations supports its ability to generate benefits over multiple periods. Proper classification or payment does not establish asset recognition.

3. **Option (b)** The intangible asset is deleted from the books after obtaining approval from the entity's management and amortisation is discontinued from the date of deletion.

**Reason:**

As per AS 26 – Intangible Assets, an intangible asset should be derecognised when it is no longer expected to generate future economic benefits. Such derecognition must be supported by proper approval of the entity's management. Once the asset is deleted from the books, amortisation must cease from the date of deletion. Continuing amortisation or retaining the asset in the books would lead to misstatement of assets and expenses. AS 26 does not permit amortisation beyond derecognition. Therefore, the auditor should verify both deletion and cessation of amortisation.

4. **Option (b)** Ensure that management has compared the carrying amount of the software with its recoverable amount and recognised impairment loss, if any.

**Reason:**

As per AS 28 – Impairment of Assets, when indicators of impairment exist, the entity is required to estimate the recoverable amount of the asset and compare it with its carrying amount. The auditor’s responsibility is to verify that such assessment has been properly performed and supported by evidence. Continuing amortisation without impairment testing or relying solely on management representations would not comply with auditing standards. Impairment cannot be based on arbitrary reductions.

5. **Option (d)** Expense off expenditure incurred during the research phase, as such costs do not provide sufficient evidence of probable future economic benefits.

**Reason:**

The key risk identified is overstatement of intangible assets due to premature capitalisation. As per AS 26, expenditure incurred during the research phase must be expensed because future economic benefits cannot be demonstrated with reasonable certainty. In line with SA 315 and SA 500, the auditor must evaluate whether sufficient evidence exists to support capitalisation. Early-stage activities involving exploration of alternatives and uncertain outcomes fail to meet recognition criteria. Capitalising such costs would misstate assets and profits. Therefore, expensing research-phase expenditure is the most appropriate audit conclusion.

**CASE SCENARIO 31**

Sun Private Limited is a newly formed private limited company, engaged in the manufacturing of solar panels. Company has appointed M&S Associates, a Partnership Firm of Mr. Meticulous and Mr. Sincere as their First Auditors. M&S Associates accepted the assignment and Mr. Meticulous being the engagement Partner, started their Audit.

In order to understand the business performance of Sun Private Limited and to identify any unusual trends or relationships, Mr. Meticulous requested the management to provide details of other companies operating in a similar line of business. His objective was to compare key financial parameters of the company with industry standards and peer companies. Such comparison was intended to identify any significant deviations that may indicate potential risk areas requiring further audit attention, particularly at the planning stage of the audit.

While performing the comparison with similar companies, Mr. Meticulous specifically analysed the gross margin of Sun Private Limited and compared it with the gross margins of other entities in the solar panel manufacturing industry. This comparison revealed that the company's gross margin was significantly lower than the industry average. The analysis of gross margin, being a profitability ratio, helped the auditor in identifying possible misstatements in revenue recognition or cost recording.

During the course of audit, Mr. Meticulous prepared detailed audit working papers documenting the procedures performed, observations made, and conclusions drawn. When management demanded custody of the working papers, Mr. Meticulous clarified that although he may share explanations and relevant workings, the audit working papers themselves form part of the auditor's documentation. He further explained that such papers are maintained to support the auditor's opinion and are required to be retained by the audit firm in accordance with professional standards.

In view of the significant deviation observed in the gross margin, Mr. Meticulous decided to undertake a detailed examination of sales transactions. He verified delivery challans with corresponding sales invoices to ensure that all dispatched

goods were properly billed, thereby checking the completeness of sales transactions. Additionally, he examined the impact of unbilled challans on debtor balances and sought external confirmations from customers to substantiate the accuracy of receivables reflected in the financial statements.

During the detailed verification, it was observed that several delivery challans had not yet been invoiced, resulting in understatement of sales. Management subsequently employed a person to reconcile all delivery challans and identify cases where invoices were pending. Since the goods had already been dispatched and inventories were physically verified, such unbilled challans primarily affected revenue recognition and the corresponding debtor balances, without having any impact on closing inventory.

Based on above, answer the following:

### **MULTIPLE CHOICE QUESTIONS**

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1. Mr. Meticulous asked about other Companies, he was intending to perform which audit procedure?
  - (a) Analytical Procedures
  - (b) Substantive Procedures
  - (c) Random Sampling
  - (d) Statistical Sampling
2. While comparing the gross margin of Sun Private Limited with that of similar companies operating in the same industry, which specific analytical procedure was applied by Mr. Meticulous?
  - (a) Trend Analysis
  - (b) Ratio Analysis
  - (c) Statistical Modelling
  - (d) Random Sampling
3. Who has the right to retain the audit working papers of the Company in current case?
  - (a) Audit Committee

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

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### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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**1. Option (a) Analytical Procedures**

**Reason:**

As per SA 520 – Analytical Procedures, analytical procedures involve analysis of significant ratios and trends and comparison with industry data or similar entities. Mr. Meticulous requested names of similar companies specifically to compare gross margins, which is a classic application of analytical procedures. Such procedures help in identifying unusual relationships or deviations that may indicate potential misstatements. The lower gross margin compared to industry standards alerted the auditor to a possible risk area. This step was performed at the planning stage to understand the business and identify areas requiring detailed audit attention.

**2. Option (b) Ratio Analysis****Reason:**

Ratio analysis is a subset of analytical procedures under SA 520, involving evaluation of relationships between financial and non-financial data. Mr. Meticulous compared the gross margin percentage of the company with industry standards and peer companies. Gross margin is a profitability ratio, and its comparison across entities is a classic ratio analysis technique. The objective was to assess whether the company's performance is reasonable in relation to similar businesses. The deviation highlighted possible understatement of sales or overstatement of costs.

**3. Option (c) Auditor****Reason:**

As per SA 230 – Audit Documentation, audit working papers are the property of the auditor, not the client. These papers constitute evidence of audit procedures performed, conclusions reached, and professional judgment applied. While the auditor may share extracts or explanations with management, the original working papers cannot be handed over. Management has no legal right over audit documentation, even though it relates to their company. The auditor is responsible for custody, confidentiality, and retention of working papers.

**4. Option (c) Both (a) and (b)****Reason:**

When Mr. Meticulous checked delivery challans with corresponding sales invoices, he performed tests of transactions to verify whether sales transactions were properly recorded. Further, by identifying unbilled challans and seeking customer balance confirmations, he also tested account balances, particularly debtors and revenue balances. As per SA 330, auditors use a combination of tests of controls, substantive tests of transactions, and tests of balances to obtain sufficient appropriate audit evidence. The detailed checking addressed both occurrence and completeness assertions.

**5. Option (a) Gross Receipts and Debtors****Reason:**

Unbilled delivery challans indicate that goods have been dispatched but sales have not been recorded, leading to understatement of gross receipts. Once invoices are raised, corresponding debtors will also arise, impacting receivables. Since management confirmed that inventories were physically verified, dispatched goods would not form part of closing stock. Hence, the adjustment affects revenue recognition and debtor balances, not inventory. As per AS 9, revenue should be recognized when control of goods is transferred.

**CASE SCENARIO 32**

CA Sumit, an audit manager at PQR & Co., was assigned to lead an audit engagement for a company. Since this was the firm's first audit engagement with the company, he recognised the need to perform preliminary engagement activities before accepting the engagement, including evaluation of information relating to the company and its management. Accordingly, he assessed matters relevant to ethical requirements, including independence and integrity, and ensured that the terms of engagement were clearly understood before proceeding further.

After completion of these initial activities, CA Sumit focused on planning the audit, wherein he developed an overall audit strategy setting the broad scope, timing and direction of the audit. Based on his professional judgment and risk assessment, he identified risk-prone areas and incorporated specific audit procedures in the audit plan.

During the engagement, CA Sumit was conscious that the audit involved significant professional and business exposure for the firm. He recognised that any lapse in professional judgment, inadequate supervision, or failure to adhere to ethical requirements could expose the firm to litigation, adverse publicity and reputational damage, irrespective of whether the financial statements were ultimately misstated. He also understood that situations giving rise to an inappropriate audit opinion, even where the financial statements themselves may not be materially misstated, could still have serious adverse consequences on the firm's professional standing and public credibility. Accordingly, he emphasised strict compliance with professional standards, ethical requirements and proper documentation, being mindful of the auditor's business risks arising from association with the audit engagement, beyond the mere risk of material misstatement.

While constructing the audit programme, CA Sumit designed a systematic set of verification procedures to be carried out by the audit team to obtain sufficient and appropriate audit evidence efficiently. He also prepared detailed instructions for team members specifying the nature, timing and extent of procedures to be performed and the documentation standards to be followed.

While designing the audit programme, CA Sumit evaluated the company's internal control system and considered the extent to which reliance could be placed on such controls for audit purposes. Based on his professional judgment, he concluded that, in certain audit areas, substantive audit procedures would provide more efficient and reliable audit evidence compared to testing internal controls. Accordingly, he decided not to rely solely on the existing internal controls, and instead planned alternative audit procedures to obtain sufficient and appropriate audit evidence, keeping in view considerations of efficiency, reliability and audit risk.

Based on the above facts, answer the following :. (MCQs 1 to 4.)

### **MULTIPLE CHOICE QUESTIONS**

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1. What do you think would be the most facilitating purpose of performing preliminary engagement activities by CA Sumit before accepting an audit engagement ?
  - (a) To confirm whether the audit engagement aligns with the firm's financial goals.
  - (b) To evaluate compliance with ethical requirements; including independence.
  - (c) To determine the scope and direction of the audit in advance.
  - (d) To establish an overall audit strategy before starting the engagement.
  
2. Which combination of following statements best describe the non-audit risks ?
  - (i) The risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated.
  - (ii) It is a function of risk of material misstatement and detection risk.
  - (iii) Auditors' business risk such as loss from litigation, adverse publicity or other events arising in connection with the audit of financial statement.

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- (iv) Risk that the auditor might express an opinion that the financial statements are materially misstated when they are not.
- (a) (i) and (ii)
- (b) (ii) and (iii)
- (c) (i) and (iii)
- (d) (iii) and (iv)
3. How does an audit programme contribute to the efficiency of an audit?
- (a) It consists of a series of verification procedures applied to financial statements to obtain sufficient audit evidence.
- (b) It guarantees that no fraud or misstatements occur during the financial year.
- (c) It minimizes the risk of audit failure by focusing only on high-value transactions.
- (d) It replaces the need for professional judgment by standardizing the audit process.
4. During the construction of the audit program, CA Sumit decides not to rely only on the internal controls existing in the company. Which of the following conditions *is* most appropriate for an auditor for not relying on the internal controls for audit evidence?
- (a) Auditor may decide not to rely on internal controls where, based on professional judgment, substantive audit procedures are expected to provide more efficient and reliable sufficient appropriate audit evidence.
- (b) Auditor may decide not to rely on internal controls merely because sufficient audit staff are available to perform extensive substantive procedures, without considering efficiency or reliability of audit evidence.
- (c) Auditor may decide not to rely on internal controls solely because an audit plan has already been prepared, without evaluating the effectiveness of internal controls or alternative audit procedures.

- (d) Auditor may decide not to rely on internal controls when he doubts the integrity of his team.

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (b)** To evaluate compliance with ethical requirements; including independence.

**Reason:**

Preliminary engagement activities are prescribed under SA 300, which requires the auditor, at the beginning of the audit, to perform procedures relating to acceptance and continuance of client relationships in accordance with SA 220, including compliance with ethical requirements such as independence. SA 300 also requires the auditor to establish an understanding of the terms of engagement as per SA 210. These activities are undertaken before detailed audit planning and are essential to determine whether the engagement should be accepted. Establishing the overall audit strategy and audit plan is performed only after completion of these preliminary activities.

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

**Reason:**

Non-audit risk refers to the auditor's business risk, such as exposure to litigation, loss of reputation, or adverse publicity arising from association with an audit engagement, as stated in SA 200. Statement (iii) correctly describes this risk. Statement (iv) refers to the possibility of expressing an inappropriate opinion, which impacts the auditor's professional standing. Statements (i) and (ii) describe audit risk, not non-audit risk.

3. **Option (a)** It consists of a series of verification procedures applied to financial statements to obtain sufficient audit evidence.

**Reason:**

An audit programme lays down a structured set of audit procedures to be performed for obtaining sufficient and appropriate audit evidence, thereby enhancing audit efficiency. It ensures systematic coverage of audit areas, proper allocation of work among team members, and

avoidance of duplication. While it does not eliminate fraud or replace professional judgment, it acts as an effective tool for executing the audit plan in an organized manner.

- 4. Option (a)** Auditor may decide not to rely on internal controls where, based on professional judgment, substantive audit procedures are expected to provide more efficient and reliable sufficient appropriate audit evidence.

**Reason:**

As per SA 330, the auditor may decide not to rely on internal controls when it is more efficient to obtain sufficient appropriate audit evidence through substantive procedures. This decision is based on professional judgment considering cost, time, and reliability of evidence. Reliance on internal controls is not mandatory in every audit.

**CASE SCENARIO 33**

Sahaj and Associates is practising Chartered Accountant's firm rendering manifold professional services to its clients. One of its clients, Sewa Bank Ltd. is providing various credit facilities to its customers under various schemes. As a part of its routine credit review process, the engagement partner raised concern about the financial position of a customer named Raju who defaulted, some instalments of his car loan. He has one old housing loan and a recently availed personal loan but the repayments of these loans are satisfactory. The bank officials on investigation found that he had given the car to his brother for personal use, who is not paying the instalments to the bank.

During the audit, the engagement partner found certain staff advances in the books of the bank on which interest is payable by staff after the recovery of principal amount. These advances have been given by the bank in the capacity of employer.

The firm is also the statutory auditor of Pioneer Textiles Ltd. (PTL), a well-established textile manufacturing company listed on stock exchange. The financial controller of the company assured the auditors that there is no change in the share capital of the company during the year. As per the terms of audit, verification of the existence and completeness of the share capital was included in the scope of audit. Ensuring the disclosures of the same were aligned with statutory and corporate governance compliances, was also a point of concern for the auditors.

During the financial audit of PTL, engagement partner also performed materiality assessments to determine the most relevant benchmarks for financial statement users. In this particular case, the audit team was also asked to assess the financial metrics most commonly used for determining materiality and benchmarks considered less relevant for materiality thresholds.

Based on the above facts, answers the following MCQs :

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**MULTIPLE CHOICE QUESTIONS**

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1. While reviewing the advance profile of Raju, which of the following classification of financial facilities is in accordance with RBI prudential norms?
  - (a) Only the car loan should be classified as a "Non-Performing Asset"
  - (b) The personal loan, housing loan and car loan should be classified as "Non-Performing Assets".
  - (c) Both the personal loan and car loan should be classified as "Non-Performing Assets" while the old housing loan should be classified as 'standard' for being old and regular.
  - (d) All loans be treated as 'standard' as default is not done by the borrower but by his brother.
  
2. Which of the following ways would you suggest for the presentation and disclosure of the staff loan in the relevant portfolio of the bank ?
  - (a) Under sub-head 'Others' under the schedule of Loans & Advances.
  - (b) Under sub-head 'Staff Advances' under the schedule of Current Assets.
  - (c) Under sub-head 'Others' under the schedule of Other Assets.
  - (d) Under sub-head 'Employee Benefit' under the schedule of Loans & Advances.
  
3. During the statutory audit of PTL, the financial 'controller of the company claimed that no changes had occurred in shareholding or share capital during the year. Hence the auditor does not need to perform any audit procedures in this regard.

Which of the following is the most appropriate advice for the auditor' when no change in share capital is reported by the company?

  - (a) Obtain a written confirmation from the Company Secretary of the company that there were no changes in the entity's capital structure during the year.

- (b) Verify the share capital balance with the Memorandum of Association of (MOA) to ensure that it is within the authorized capital limits.
  - (c) Obtain certified copies of Last year's financial statement.
  - (d) Obtain a verbal confirmation from the Chief Financial Officer (CFO) regarding the financial reporting of share capital.
4. In determining materiality for financial statements, the engagement partner of PTL considered various benchmarks. Which of the following financial item is NOT commonly used as benchmark?
- (a) Total expenses
  - (b) Total revenue
  - (c) Gross profit
  - (d) Gross Assets

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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1. **Option (b)** The personal loan, housing loan and car loan should be classified as "Non-Performing Assets".

**Reason:**

As per RBI prudential norms, classification of advances is borrower-wise and not facility-wise. When a borrower defaults in repayment of any one credit facility, all other credit facilities granted to the same borrower must also be treated as Non-Performing Assets, irrespective of their individual performance. In this case, Raju has defaulted in repayment of the car loan instalments. Hence, even though the housing loan and personal loan are being serviced satisfactorily, they must also be classified as NPAs. The fact that the car is used by the borrower's brother is irrelevant, as liability rests with the borrower.

2. **Option (c)** Under sub-head 'Others' under the schedule of Other Assets.

**Reason:**

Staff advances given by a bank in its capacity as an employer are not part of core lending activities carried out in the ordinary course of banking

business. As per banking disclosure practices, such advances are generally classified under 'Other Assets' rather than Loans and Advances. Since these advances do not fall under standard customer lending categories, they are appropriately disclosed under the sub-head 'Others' under Other Assets. This classification ensures proper distinction between operational advances and employee-related recoverable, resulting in true and fair presentation.

3. **Option (a)** Obtain a written confirmation from the Company Secretary of the company that there were no changes in the entity's capital structure during the year.

**Reason:**

As per SA 500 and SA 580, the auditor must obtain sufficient and appropriate audit evidence, even when management states that no changes have occurred. A written confirmation from the Company Secretary, who is responsible for maintaining statutory records, provides reliable evidence regarding the absence of changes in share capital. Reliance solely on management assertion or verbal confirmation is insufficient. Verification with MOA only confirms authorized capital, not actual changes during the year.

4. **Option (d)** Gross Assets

**Reason:**

As per SA 320, commonly used benchmarks for determining materiality include profit before tax, total revenue, total expenses, or gross profit, depending on the nature of the entity. Gross assets are generally not used as a primary benchmark for materiality in profit-oriented entities, as they do not directly reflect operating performance. Asset values may remain static while significant misstatements exist in income or expenses. Therefore, gross assets are considered less relevant compared to performance-based benchmarks for determining materiality thresholds.

**CASE SCENARIO 34**

JACK & Co. is a reputed audit firm specializing in various areas of practice. In order to maintain high professional standards, the senior most partner, CA Kartikeyan plans to conduct training sessions for its audit partners and staff on relevant topics on a regular basis. The sessions are addressed by various subject experts drawn from within and outside the firm. One of the recently qualified Chartered Accountant joined the firm. CA Kartikeyan asked him to go through the summary of one of the recently held deliberations. The summary of the deliberations included the following :

- (i) CA Ankita made a presentation on different types of engagements that an auditor can take and the type of audit evidence required for the same. She placed more emphasis on the assurance engagements with examples and the type of assurance, each engagement provides. She took up the case of one of their clients, Zeal Ltd., who wanted their financial statements to be reviewed for the quarter ended June 2025.
- (ii) CA Sajag during his deliberations discussed various issues relating to audit evidence, the source and nature of audit evidence and particular circumstances under which it is received. He also threw light on the sufficiency, appropriateness and the reliability of the audit evidence to be obtained by the auditor during the course of audit.
- (iii) CA Poorvi deliberated on the concept of misstatements in the financial statements. She spoke on various instances of misstatements. She explained that a misstatement refers to a deviation between the amount, classification, presentation or disclosure of a reported financial item and that what is required for these items to be in accordance with the applicable financial reporting framework. Misstatement may also be caused due to deviation of any of these (amount, classification, presentation or disclosure) from any specific limit set by the auditor at a particular level of tolerance. Misstatements can arise from error or fraud. She also spoke on instances which cannot be regarded as misstatements in financial statements.

- (iv) CA Dhruvi deliberated on various types of Risks existing in different types of organizations and under various situations. She explained types of risks at assertion levels and the ways to design the audit procedures to handle those risks. She also explained the concept of control Risk, inherent risk and detection risks.

Based on the above facts, answer the following:

1. Which type of assurance engagement is rendered to Zeal Ltd. ?
  - (a) Reasonable assurance engagement
  - (b) Limited assurance engagement
  - (c) Moderate assurance engagement
  - (d) Assurance regarding design and operation of controls
2. Which of the following is the most appropriate statement in respect of audit evidence?
  - (a) The reliability of audit evidence obtained by auditor himself from within the entity is always highest.
  - (b) Sufficiency of audit evidence is an indicator of good quality audit evidence.
  - (c) The reliability of audit evidence is independent of its source and individual circumstances under which it is obtained.
  - (d) The reliability of audit evidence is influenced by its source and by its nature and is dependent on the individual circumstances under which it is obtained.
3. As explained by CA Poorvi, which of the following is "not" an example of misstatement ?
  - (a) Difference in accounting estimate of a financial statement item vis-a-vis its appropriateness in applicable financial reporting framework.
  - (b) Destruction of some inventories due to fire between the date of financial statements and the date of auditor's report and not provided for in the financial statements.

- (c) Selection or application of inappropriate accounting policies.
  - (d) Difference in disclosure of a financial statement item vis-a-vis its requirement in applicable financial reporting framework.
4. As discussed by CA Dhruvi, which of the following incident is an example of control risk?
- (a) A misstatement appearing in the financial statement due to misconception of an applicable Accounting Standard by the management of the company.
  - (b) Cash and bank cheque books are not properly kept in a locked safe as per the guidelines of management.
  - (c) The engagement partner failed to identify that there is a major difference between opening balances and gave an unmodified opinion in his report.
  - (d) Due to technological development, the entire product line became obsolete.

### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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**1. Option (b)** Limited assurance engagement

**Reason:**

A review of quarterly financial statements constitutes a review engagement, not a statutory audit. As per the Framework for Assurance Engagements and SA 2400/2410, review engagements provide limited assurance, expressed in a negative form (e.g., "nothing has come to our attention..."). The procedures performed are mainly inquiry and analytical procedures, which are substantially less in extent than audit procedures. Hence, the level of assurance provided is lower than reasonable assurance. Therefore, the engagement rendered to Zeal Ltd. is a limited assurance engagement.

2. **Option (d)** The reliability of audit evidence is influenced by its source and by its nature and is dependent on the individual circumstances under which it is obtained.

**Reason:**

As per SA 500 – Audit Evidence, the reliability of audit evidence depends upon its source and nature, and also on the circumstances under which it is obtained. Generally, evidence obtained from independent external sources is more reliable than internal evidence. Similarly, evidence obtained directly by the auditor is more reliable than indirect evidence. Hence, reliability is not uniform and varies based on multiple factors.

3. **Option (b)** Destruction of some inventories due to fire between the date of financial statements and the date of auditor's report and not provided for in the financial statements.

**Reason:**

Destruction of inventory due to fire after the balance sheet date is an adjusting or non-adjusting event, as per AS 4/Ind AS 10, depending on circumstances. However, such destruction does not represent a misstatement of financial statements as at the balance sheet date if conditions did not exist at that date. Misstatements relate to incorrect recognition, measurement, classification, presentation or disclosure existing at the reporting date. Hence, failure to provide for post-balance-sheet fire loss does not constitute a misstatement.

4. **Option (b)** Cash and bank cheque books are not properly kept in a locked safe as per the guidelines of management.

**Reason:**

Control risk refers to the risk that a misstatement will not be prevented, detected or corrected by the entity's internal controls. Improper safeguarding of cash and cheque books indicates a weakness in internal control system, increasing the likelihood of misappropriation or errors. This directly represents a control failure, which is the essence of control risk. Other options relate to inherent risk or detection risk.

**CASE SCENARIO 35**

M/s KDR & Associates, Chartered Accountants, were appointed as the statutory auditors of a company having its operations spread across three States in India. The company operates through multiple branches using a centralised accounting software, resulting in a very high volume of accounting data being processed across locations.

Due to the nature and scale of operations, the company records approximately 50,000 accounting entries every month, each supported by source documents such as invoices, delivery challans, payment vouchers, and electronic records. Consequently, 100% verification of transactions is impracticable in terms of time and cost. At the same time, the auditors were conscious of their responsibilities under SA 200 and SA 500 to obtain sufficient and appropriate audit evidence to reduce audit risk to an acceptably low level.

Accordingly, while formulating the overall audit strategy and detailed audit plan in accordance with SA 300, the auditors decided to apply audit sampling techniques governed by SA 530 – Audit Sampling. Their audit approach involved:

- Performing tests of controls to evaluate the operating effectiveness of internal controls, and
- Performing tests of details on selected transactions and account balances for substantive verification.

During the audit planning stage, M/s KDR & Associates performed walkthroughs of significant transaction cycles and reviewed internal audit reports for the year. The auditors observed that key controls were consistently applied across all branches through automated authorisation checks, segregation of duties, and a centralised accounting system. Based on prior experience with similar entities, satisfactory internal audit findings, and the absence of significant control deficiencies, the auditors assessed the expected rate of deviation as low. However, recognising the presence of inherent sampling risk, the auditors determined an acceptable tolerable deviation rate for reliance on controls. While designing tests of controls, the engagement

team deliberated on factors affecting sample size, particularly the relationship between expected deviation rate, tolerable deviation rate, and sampling risk.

While determining the nature, timing and extent of substantive audit procedures, the engagement team assessed the risk of material misstatement at the assertion level. Although preliminary analytical procedures and results of control testing indicated that the expected misstatement was low, the auditors noted that this was a first-time statutory audit with operations spread across multiple States. In the absence of prior year audited financial information, the auditors considered it necessary to obtain a high level of assurance that the actual misstatement in the population would not exceed tolerable misstatement. Accordingly, the engagement team deliberated on the impact of assurance requirements, tolerable misstatement and expected misstatement on the sample size for tests of details.

During the performance of tests of details on selected transactions and account balances, the auditors identified certain misstatements in the sample, including a few items that were considered anomalous in nature. In accordance with SA 530, the engagement team projected the identified misstatements to the population and combined the projected misstatement with the anomalous misstatements to estimate the total misstatement in the population. While evaluating whether the sample results provided a reasonable basis for conclusions, the auditors compared the estimated population misstatement with tolerable misstatement and also considered whether the sampling risk of actual misstatement exceeding tolerable misstatement remained acceptable.

While finalising the sample selection techniques to be used for audit sampling, the engagement team evaluated various methods such as random sampling, systematic sampling and block sampling. One option considered was selecting contiguous sequences of transactions processed during a particular period or bearing consecutive voucher numbers. However, the auditors noted that the company's accounting records were maintained in chronological and serial order, with transactions processed in batches and influenced by similar operational and control conditions within the same period. Accordingly, the engagement team deliberated on the representativeness of block sampling and its suitability for drawing valid inferences about the entire population.

While implementing audit sampling in accordance with SA 530, the engagement team adopted a systematic approach to ensure that sufficient and appropriate audit evidence was obtained. The auditors first designed the sample and selected items for testing in line with the audit objectives. Thereafter, audit procedures were performed on the selected items and any deviations or misstatements identified were investigated to understand their nature and causes. Based on the results of testing, the auditors projected the identified misstatements to the population and finally evaluated whether the sampling results provided a reasonable basis for conclusions about the population as a whole.

In above context, answer the following MCQs:

### **MULTIPLE CHOICE QUESTIONS**

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1. While planning tests of controls for M/s KDR & Associates, the audit team noted that the company has robust internal controls, automated authorisation checks, segregation of duties, and satisfactory internal audit reports. Based on prior experience and preliminary evaluation, the auditors expect low control deviations and are willing to accept a reasonable level of deviation while relying on controls.

Which of the following considerations would be most appropriate for determining the sample size for tests of controls in this audit?

- (a) Selecting a very large sample merely because the company records around 50,000 transactions per month
  - (b) Increasing the sample size substantially due to the company's multi-state operations
  - (c) Designing the sample primarily based on tolerable deviation rate and expected deviation rate, rather than population size
  - (d) Avoiding sampling and performing 100% verification due to first-time audit engagement
2. M/s KDR & Associates also plan to perform tests of details on selected transactions and balances to obtain sufficient appropriate audit evidence. During planning, the engagement team estimates that expected misstatements are low, but the auditors desire a high level of assurance due to the company's first-time audit and geographical spread.

Which of the following planning decisions would most likely increase the sample size for tests of details in the above audit?

- (a) Increasing tolerable misstatement considering strong internal controls
  - (b) Reducing the desired level of assurance because of automated accounting systems
  - (c) Increasing the desired level of assurance that actual misstatement does not exceed tolerable misstatement
  - (d) Ignoring expected misstatement since controls are operating effectively
3. Which of the following is not likely to be correct in evaluating results of audit sampling in case of tests of details?
- (a) The projected misstatement combined with anomalous misstatement is auditor's best estimate of misstatement in population.
  - (b) In case projected misstatement combined with anomalous misstatement exceeds tolerable misstatement, the sample provides a reasonable basis for conclusions about population.
  - (c) The closer the projected misstatement combined with anomalous statement is to tolerable misstatement, it is more likely that actual misstatement in the population may exceed tolerable misstatement.
  - (d) In case the projected misstatement is greater than auditor's expectation of misstatement used to determine sample size, the auditor may conclude that there is unacceptable sampling risk of actual misstatement in the population exceeding tolerable misstatement.
4. Which of the following is not likely to be correct in relation to Block Sampling and audit samples drawn upon using this technique?
- (a) Block selection involves selection of a block/blocks of contiguous items within the population.
  - (b) Most populations from which audit samples are drawn are structured in such a way that items in a sequence can be expected to have similar characteristics to each other but different

characteristics from items elsewhere in population. Hence, it is not used ordinarily in audit sampling.

- (c) Block sampling has characteristics of simplicity and economy.
  - (d) It is generally an appropriate sample selection technique when auditor intends to draw valid inferences about the entire population based upon sample.
5. Consider the below stated steps in relation to audit sampling. What is the most likely logical order of these steps to be followed by auditors of this company?

Step I - Performing audit procedures

Step II - Projecting Misstatements

Step III - Sample design and selection of items for testing

Step IV - Investigating Nature and cause of deviations

Step V - Evaluating results of audit Sampling

- (a) Step I, Step II, Step III, Step IV and Step V
- (b) Step II, Step I, Step III, Step V and Step IV
- (c) Step III, Step I, Step IV, Step II and Step V
- (d) Step I, Step II, Step III, Step V and Step IV

### **ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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1. **Option (c)** Designing the sample primarily based on tolerable deviation rate and expected deviation rate, rather than population size

**Reason:**

As per SA 530, the sample size for tests of controls is influenced mainly by tolerable deviation rate, expected deviation rate, and sampling risk, and not by population size alone. In the given case, the auditors have assessed strong internal controls and expect low deviations. Hence, sample design should focus on acceptable deviation levels rather than the sheer volume of transactions. SA 530 also clarifies that once a population is sufficiently large, its size has little effect on sample size. Therefore, relying on deviation rates is the most appropriate approach.

2. **Option (c)** Increasing the desired level of assurance that actual misstatement does not exceed tolerable misstatement

**Reason:**

As per SA 530, sample size for tests of details increases when the auditor seeks a higher level of assurance that actual misstatement does not exceed tolerable misstatement. In this case, although expected misstatement is low, the auditors desire higher assurance due to first-time audit and multi-location operations. Higher assurance requires reducing sampling risk, which can only be achieved by examining more items. Increasing tolerable misstatement would reduce sample size, not increase it. Hence, option (c) is correct.

3. **Option (b)** In case projected misstatement combined with anomalous misstatement exceeds tolerable misstatement, the sample provides a reasonable basis for conclusions about population.

**Reason:**

According to SA 530, if the projected misstatement plus anomalous misstatement exceeds tolerable misstatement, the sample does not provide a reasonable basis for concluding that the population is fairly stated. Instead, it indicates a high risk of material misstatement, requiring additional audit procedures. The other statements correctly reflect the principles of evaluating sampling results and auditor judgment.

4. **Option (d)** It is generally an appropriate sample selection technique when auditor intends to draw valid inferences about the entire population based upon sample.

**Reason:**

Block sampling involves selecting contiguous items and is simple and economical. However, audit populations are often structured such that adjacent items have similar characteristics, making block sampling unrepresentative of the entire population. Therefore, block sampling is not generally appropriate when the auditor intends to draw valid statistical inferences about the whole population.

5. **Option (c)** Step III, Step I, Step IV, Step II and Step V

**Reason:**

As per SA 530, the logical sequence of audit sampling begins with sample design and selection, followed by performing audit procedures on selected items. Thereafter, the auditor must investigate the nature and cause of deviations, then project misstatements to the population, and finally evaluate the results of audit sampling. This sequence ensures systematic execution and reliable audit conclusions.

**CASE SCENARIO 36**

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**

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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.
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.

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**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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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 37**

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**

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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

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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 38**

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**

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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

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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 39**

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 31<sup>st</sup> 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**

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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.

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**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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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 40**

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**

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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**

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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 41

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**

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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**

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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 42**

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**

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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

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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 43**

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 to 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:

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**MULTIPLE CHOICE QUESTIONS**

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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**

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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 44**

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

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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

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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 45**

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.

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### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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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 46**

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**

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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

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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 47**

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 1<sup>st</sup> 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**

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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

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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 48**

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**

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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

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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 49

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**

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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 50

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

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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 51**

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

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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 52**

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**

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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**

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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 53**

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.

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**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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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 54**

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**

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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 55**

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**

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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

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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 56**

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.

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### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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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 57

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

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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 immovable properties held as at the balance sheet date. In case the entity has given such immovable 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 immovable 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)
	<b>120</b>
Less: creditors for goods as on 31.12.23	(50)
Value of Paid stocks	<b>70.00</b>
Less: Margin @ 25%	(17.50)
Drawing power (A)	<b>52.50</b>
Value of debtors as on 31.12.23	50
Less: debtors exceeding 90 days	(10)
	<b>40</b>
Less: Margin @ 40%	(16)
Drawing Power (B)	<b>24</b>
<b>Drawing Power (A+B)</b>	<b>76.50</b>

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

**CASE SCENARIO 58**

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**

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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 59**

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**

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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 60

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**

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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

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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 61**

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**

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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.

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**ANSWERS TO MULTIPLE CHOICE QUESTIONS**

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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 62**

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**

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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**

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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 63**

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

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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 64**

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.

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### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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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 65

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 31<sup>st</sup> 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 30<sup>th</sup> 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**

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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

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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 66**

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**

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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

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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 67**

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.

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### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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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 68**

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

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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 69**

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.

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### ANSWERS TO MULTIPLE CHOICE QUESTIONS

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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 70

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

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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.