

**Mock Test Paper - Series I: March, 2024**

**Date of Paper: 14 March, 2024**

**Time of Paper: 2 P.M. to 5 P.M.**

**INTERMEDIATE GROUP – II**

**PAPER – 5: AUDITING AND ETHICS**

**Time Allowed – 3 Hours**

**Maximum Marks – 100**

**Division A- Multiple Choice Questions**

**Case Scenario 1 carries 10 Marks**

**Case Scenario 2 carries 8 Marks**

**Case Scenario 3 carries 6 Marks**

**General MCQs (3 MCQs x 2 Marks each = 6 Marks)**

**Total 30 Marks**

**Case Scenario 1**

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

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

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

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

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

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

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

- 1.1 Considering description provided in case scenario regarding accounting income as per books of accounts and taxable income under Income tax law, choose appropriate responsibility of Dhanush:
  - (a) To verify deferred tax liability likely created in financial statements in accordance with AS 22
  - (b) To verify deferred tax asset likely created in financial statements in accordance with AS 22
  - (c) To verify deferred tax asset likely created in financial statements in accordance with AS 29
  - (d) To verify deferred tax liability likely created in financial statements in accordance with AS 29
- 1.2 Keeping in view description provided in case scenario, which of following statements is likely to be correct regarding accounting treatment of cost of CDs and software acquired by company to run tests?
  - (a) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated such costs as revenue expenditure.
  - (b) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is proper.
  - (c) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as intangible asset.
  - (d) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as revenue expenditure.
- 1.3 As regards discrepancies noticed in computer systems on physical verification by management as described in case scenario, which of following statements is most appropriate?
  - (a) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it may result in modification of auditor's opinion.
  - (b) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it entails specific reporting requirement for auditor under Companies Act, 2013.

- (c) The management has properly dealt with such discrepancies. Therefore, Dhanush should not do anything further.
  - (d) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it is in nature of misstatement which needs to be communicated and documented by auditor.
- 1.4 Which of following statements meets requirements of law in respect of revenue from operations of the company?
- (a) Revenue from operations of ₹ 50 crores should be shown in Statement of Profit and loss.
  - (b) Revenue from operations of ₹ 50.10 crores should be shown in Statement of Profit and loss. However, revenue from sale of books, fees charged from students and interest on investments should be disclosed separately in notes.
  - (c) Revenue from operations of ₹ 50.10 crores should be shown in Statement of Profit and loss.
  - (d) Revenue from operations of ₹ 50 crores should be shown in Statement of Profit and loss. However, revenue from sale of books and fees charged from students should be disclosed separately in notes.
- 1.5 The company has taken useful life of desktops to be 3 years. Such a requirement is \_\_\_\_\_
- (a) prescribed under Schedule III to Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule III.
  - (b) is not prescribed under Companies Act, 2013. It depends upon manufacturing specifications of desktops.
  - (c) prescribed under Schedule II to Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule II.
  - (d) is not prescribed under Companies Act, 2013. It needs to be arrived at mandatorily by a management expert.

### Case Scenario 2

CDL Limited, a company dealing in FMCG goods, is having 50 branches in India. SKC & Associates (**referred to as company's auditor**) are appointed as statutory auditors of the company for year 2023-24. Further, company has also appointed Mr. D as branch auditor for 5 of its branches.

Since Mr. D is conducting audit of only 5 branches of company, he has not arrived at materiality level in respect of auditee branches. On the same lines, identification and assessment of risk of material misstatement has not been performed. He is of the view that determination of materiality and identifying & assessing risks of material misstatement is done for financial statements of company as a whole. He has mainly performed substantive audit procedures in respect of financial

statements of auditee branches like verification of PPE items, inventories, trade receivables, cash, bank balances and trade payables at auditee branches and maintained documentation of the same.

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

**Table 1**

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

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

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

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

company's auditor, branch audit report is sent by branch auditor to members of company.

- 2.2 After reading methodology for carrying out branch audits by Mr. D, which of following statements is likely to be most appropriate?
- (a) Separate determination of materiality and identifying & assessing risk of material misstatement is not required in respect of each of the branches. He is required to perform only substantive procedures as described in the case scenario in respect of auditee branches and maintain documentation of the same.
  - (b) Separate determination of materiality and identifying & assessing risk of material misstatement is required in respect of each of branches. However, documentation for these matters regarding branches is not required. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.
  - (c) Separate determination of materiality and identifying & assessing risk of material misstatement is required along with documentation thereof in respect of each of branches. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.
  - (d) Identifying & assessing risk of material misstatement is required along with documentation in respect of each of branches. However, materiality is required to be arrived at for financial statements of company as a whole. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.
- 2.3 Choose the correct statement regarding results of analytical procedures performed by Mr. D summarized in Table 1 in case scenario.
- (a) During year 2023-24, inventories of Branch I have moved faster in comparison to Branch II.
  - (b) During year 2023-24, inventories of Branch II have moved faster in comparison to Branch I.
  - (c) Comparison of inventory turnover ratio of Branch II over a period of years may indicate that branch's sales have likely been weak with higher inventory holdings in year 2023-24 as compared to previous years.
  - (d) Comparison of inventory turnover ratio of Branch I over a period of years may indicate that branch's sales have likely been strong with lower inventory holdings in year 2023-24 as compared to previous years.
- 2.4 Considering contents of email sent by company's auditor to Mr. D, which of following statements is likely to be in accordance with Standards on Auditing?
- (a) Company's auditor can advise Mr. D regarding certain significant accounting, auditing and reporting requirements and ask him to provide representation as to compliance with them.

- (b) Company's auditor can advise Mr. D certain significant accounting, auditing and reporting requirements. However, asking him to provide representation as to compliance with them is breach of Mr. D's independence.
- (c) Company's auditor cannot advise Mr. D certain significant accounting, auditing and reporting requirements. It is breach of Mr. D's independence.
- (d) Company's auditor can advise Mr. D regarding certain significant accounting, auditing and reporting requirements only when Mr. D makes such a request.

### Case Scenario 3

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

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

Serial number	Particulars in CBS (Core Banking solution)/records	Amount in ₹ 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 to ₹ 20 lakhs. Therefore, he has assessed risk of material misstatements to be high. As a consequence, he has designed procedures to perform tests of controls as well as substantive tests.

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

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

- 3.1 Considering table given in the case scenario, which of the following combinations is appropriate example of non-funded credit facilities provided by branch to its customers?
- (a) Bills purchased and discounted; bills for collection
  - (b) Bills for collection; staff housing loans; letters of credit issued
  - (c) Bills purchased and discounted; letters of credit issued; guarantees issued (fully secured by 100% margin)
  - (d) Letters of credit issued, guarantees issued (fully secured by 100% margin)
- 3.2 CA B's decision to perform both tests of controls as well as substantive tests was taken after he had assessed risk of material misstatement in financial statements to be high due to large number of small ticket size loans. Which Standard on Auditing deals with auditor's responsibility to design such tests?
- (a) SA 500
  - (b) SA 330
  - (c) SA 300
  - (d) SA 315
- 3.3 Saurabh is unable to understand relevance of going through SMA jotting as on 30<sup>th</sup> November, 2022. Which of following statements is most appropriate in this context?
- (a) It would necessarily help auditor in identifying accounts with significant lending exposure.
  - (b) It would help auditor in identifying accounts which may involve downgrading from Sub-standard asset category to doubtful category.
  - (c) It would help auditor in identifying accounts where substantial recoveries have been received during the year.
  - (d) It would help auditor in identifying accounts which may involve downgrading from standard category to non-performing asset.

**MCQs**

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

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

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

- (a) Audit risk in the above situation is low.
  - (b) The situation does not provide quantitative data. Therefore, it is not possible to make a precise measurement of audit risk.
  - (c) Audit risk in the above situation is high.
  - (d) The situation does not provide information affecting all components of audit risk. Therefore, inference cannot be made properly.
2. CA J is in process of planning audit for a large company engaged in business of dealing and manufacturing of pharmaceutical products. Central Drugs Standard Control Organisation (CDSCO), National regulatory Authority under Ministry of Health & Family Welfare is responsible for approval of drugs, conduct of clinical trials and laying down Standards for drugs and control over quality of imported drugs. Auditor is also considering whether to make use of audit evidence obtained in previous audit of the same company. Besides, he is also considering volume of transactions to determine whether it is efficient to rely on internal controls. As part of planning activities, he is also considering extent of substantive audit procedures to be performed. Consider following factors stated from 1 to 5:
- 1. Reporting requirements required by CDSCO, if any
  - 2. Need for specialized knowledge of pharma industry
  - 3. Expected use of audit evidence obtained in previous audit
  - 4. Volume of transactions to consider reliance on internal control
  - 5. Nature and extent of substantive audit procedures
- Choose the most appropriate factor/combination of factors which could be relevant to CA J in establishing audit strategy: -
- (a) 1, 3, 4 and 5
  - (b) 1 only
  - (c) 1, 2, 3 and 4
  - (d) 2 only
3. CA Tarini is in process of formulating audit plan for conducting audit of a company engaged in business of dealing in commodity futures. Which of following is not likely to be an appropriate audit procedure to be included in audit plan for the abovesaid company?
- (a) Verification of turnover of company
  - (b) Verification of cost of raw material consumed
  - (c) Examination of company's accounting policy for revenue recognition
  - (d) Verification of contract notes with brokers

### Division B- Descriptive Questions

1. (a) DOX Limited, a service provider company engaged in providing courier services pan-India as well as internationally, has appointed an internal auditor, Mr. G, in accordance with requirements of the Companies Act, 2013 during financial year 2023-24. The company's annual turnover during year 2022-23 and 2023-24 has been about ₹ 300 crores during each of above years. Business of the company has been profitable. Mr. G heads internal audit department of the company assessing governance activities, assisting in improving risk management activities and reviewing controls. Discuss reporting responsibility of statutory auditor of the company under the Companies Act, 2013 specifically in relation to internal audit and related matters for the year 2023-24.  

**(4 Marks)**
- (b) Up and High Private Limited has started its export business during the year 2023-24. The company was catering to domestic market only in past years. CA H, statutory auditor of the company, is of the view that the company has understated its revenue by ₹ 50.00 lacs in the year 2023-24 by not complying with requirements of AS 9 relating to revenue recognition.
  - (i) Discuss responsibilities of statutory auditor to communicate with management in the above situation in accordance with SA 450. Also explain the usefulness of such communication.
  - (ii) If management refuses to correct misstatement as communicated by the statutory auditor, how should he proceed?  

**(4 Marks)**
- (c) Prudent Enterprises Private Limited has incurred and fully spent for the first time Corporate Social Responsibility (CSR) expenditure amounting to ₹ 14.50 lacs in pursuance to provisions of section 135 of Companies Act, 2013. The expenditure was spent for women empowerment programmes through an implementing agency (not a related party). As per law provisions, it was required to spend ₹ 14.00 lacs during the year. Discuss how such information is required to be disclosed in accordance with requirements of Schedule III to the Companies Act, 2013 in financial statements of the company.  

**(3 Marks)**
- (d) CA Tripad (engagement partner) based at New Delhi is external auditor of Lap of Nature, a firm, since last three years. The firm is engaged in business of providing tourism services including holiday packages to its club members. It has also provided auditor including his team members free holiday for a week every year in one of its premium resorts in Ooty in the State of Tamil Nadu. The company has also booked free air travel for engagement team members during all these years. Discuss why Chartered Accountant is not acting ethically. How are familiarity threats created in above situation?  

**(3 Marks)**

2. (a) Mention any four financial events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as going concern. **(4 Marks)**
- (b) Adequate planning benefits the audit of financial statements in several ways. Explain. **(4 Marks)**
- (c) The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence. Give one example each for such practical and legal limitations. **(3 Marks)**
- (d) Goods and Services Tax Network (GSTN) is a not for profit, limited by shares, company. Its 50% shareholding is with Union Government and 50% with different State Governments. The company provides IT infrastructure and services to various stakeholders including governments and tax payers. The company is in operation since past few years and subsequent auditor needs to be appointed during financial year 2023-24. Who appoints statutory auditor of such a company described above in accordance with provisions of Companies Act, 2013? Can any directions be issued to statutory auditors of above company? **(3 Marks)**
3. (a) Suniti, a CA student, is part of an engagement team conducting audit of a company TIM Private Limited. According to audit programme, she is responsible for verifying purchases and PPE items appearing in books of accounts from records/bills of company. Besides, she has also been entrusted responsibility to obtain written representation from management regarding carrying out of physical verification of inventories during the year. During course of her work, she finds that:
- (i) One purchase bill amounting to ₹ 5.00 lacs pertaining to TIM Industries has been entered in books of TIM Private Limited.
- (ii) The management has refused to provide a written representation relating to physical verification of inventories during the year. She has brought it to knowledge of engagement partner who has decided to use lack of such a representation as audit evidence.
- Discuss whether each of above constitutes audit evidence. State reasoning for your answer. **(4 Marks)**
- (b) CA B is statutory auditor of Boom Payments Bank for year 2023-24. During the year, banking regulator has imposed restrictions on Bank from accepting new deposits due to non-compliance in conducting KYC in large number of accounts and violation of rules aimed at preventing money laundering. There is material uncertainty regarding probable outcome of such restrictions on ability of Bank to continue as going concern. However, for year 2023-24, auditor has concluded that use of going concern basis of accounting is appropriate. The financial

statements of Bank do not make adequate disclosure of material uncertainty due to above events in financial statements. What are implications for auditor's report for year 2023-24 in view of above?

**(4 Marks)**

- (c) Auditor shall develop an audit plan that includes description of audit procedures. Specify requirements in this regard. **(3 Marks)**
- (d) What is meant by audit documentation? What are objectives of an independent auditor in accordance with SA 230? **(3 Marks)**
4. (a) You are part of engagement team conducting audit of an entity engaged in manufacturing business. State few audit procedures you would undertake to perform to verify that recorded sales in financial statements represent goods actually sold during the period and recorded sales are not overstated. **(4 Marks)**
- (b) While performing statutory audit of Contra Industries Private Limited, a company engaged in manufacturing and assembling of LED lights, CA Varun has decided to attend physical inventory count process of the company on 30<sup>th</sup> and 31<sup>st</sup> March, 2024. The inventories are lying at three different locations - two such locations A and B are in one city and third location C is in another city. Further, company also sends inventories to some service providers for quality control and testing as such facilities are not available with the company.
- CA Varun is well-versed with this type of industry and has prepared a list of following matters which could be relevant to him in planning attendance at physical inventory count process for discharging his responsibilities in accordance with SAs: -
- Nature of inventories i.e. LED light components, parts, circuits, panels, body, WIP and finished packed LED lights
  - Materiality of inventories at different locations A, B and C
  - Stage of completion of work-in-progress
  - Maintenance of perpetual inventory system by company
  - Materiality of inventories lying with service providers
  - Timing of physical inventory counting i.e. year end
- There are two important matters which do not find place in above list. Without considering these crucial matters, it would be difficult for the auditor to properly plan his attendance at inventory count process in accordance with relevant SA. Discuss such matters. **(4 Marks)**
- (c) The auditor should decide whether relevant information is properly disclosed in the financial statements. Explain with reference to scope of audit. **(3 Marks)**

- (d) SQC 1 dwells upon engagement quality control review (EQCR) as part of system of quality control in a firm. Why is such a review required? For which type of engagements EQCR is mandatory?

What should be approach of firm for engagements for which EQCR is not mandatory? **(3 Marks)**

5. (a) WTE Private Limited is engaged in business of manufacturing a product liable to GST @ 5%. The input raw materials for manufacturing this product are liable to GST @ 12% and 18%. As a result, at the end of financial year, ITC on inputs amounting to ₹ 60 lacs is accumulated in Electronic Credit ledger and refundable to company under provisions of GST law. How would above amount of ₹ 60 lacs be reflected and classified in balance sheet of company? State few audit procedures to be performed by you for verification of abovesaid balance. **(4 Marks)**
- (b) The objective of an auditor in accordance with SA 315 is to identify and assess risks of material misstatement at financial statement level and assertion level. Which specific activities an auditor is required to perform for the purpose of identifying and assessing risks of material misstatement? **(4 Marks)**
- (c) You have been appointed as an auditor of ABC Hotel, a three star hotel, for Financial Year 2022-23. As an auditor what are the special points that need to be considered in verifying the Inventories in the nature of food and beverages? **(3 Marks)**
- (d) Professional Behaviour is one of the fundamental principles governing professional ethics. Explain its meaning. Also, give example of a situation where a Chartered Accountant fails to follow this principle. **(3 Marks)**
6. (a) CA Z is appointed as statutory auditor of BETA Private Limited for the year 2023-24. There exists an internal audit function in the company headed by its Chief Internal Auditor, CA K. Valuation of trade receivables of company is assessed as area of higher risk by statutory auditor. He wants to take direct assistance of Chief Internal Auditor in respect of above matter. Discuss along with reasons whether it would be proper for statutory auditor to: -
- (i) assign checking of accuracy of aging of trade receivables to Chief Internal Auditor?
- (ii) assign evaluation of adequacy of provision based on aging of trade receivables to Chief Internal Auditor? **(4 Marks)**
- (b) The audit of Government expenditure is one of the major components of Government audit. Briefly explain the basic standards set in relation to audit of Government expenditure. **(4 Marks)**

**OR**

- (c) Cinescreen Multiplex Ltd. is operating cinemas in different locations in Mumbai and has appointed you as an internal auditor. What are the areas that need to be verified in relation to receipts from sale of Tickets?

**(4 Marks)**

- (d) Given below is a table containing Column A and Column B. Column A contains description of certain controls in an automated environment. Complete Column B by stating appropriate type of control.

<b>Column A (Description of control in an automated environment)</b>	<b>Column B (Type of control)</b>
Reasonableness checks	?
Controls over Data centre and network operations	?
Controls over application system acquisition, development and maintenance	?
Program change controls	?

**(3 Marks)**

- (e) An engagement partner takes overall responsibility for maintaining audit quality in an audit engagement in accordance with SA 220. What are his objectives in taking and emphasizing such responsibility?

**(3 Marks)**

**Mock Test Paper - Series I: March, 2024**

**Date of Paper: 14 March, 2024**

**Time of Paper: 2 P.M. to 5 P.M.**

**INTERMEDIATE: GROUP – II**

**PAPER – 5: AUDITING AND ETHICS**

**SUGGESTED ANSWERS / HINTS**

**Division A-Multiple Choice Questions**

**Case Scenario 1**

<b>Question No.</b>	<b>Answer</b>
<b>1.1</b>	<b>(b)</b> To verify deferred tax asset likely created in financial statements in accordance with AS 22
<b>1.2</b>	<b>(b)</b> The company's accounting treatment of treating cost of CDs with software costs as intangible assets is proper.
<b>1.3</b>	<b>(b)</b> The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it entails specific reporting requirement for auditor under Companies Act, 2013.
<b>1.4</b>	<b>(d)</b> Revenue from operations of ₹ 50 crores should be shown in Statement of Profit and loss. However, revenue from sale of books and fees charged from students should be disclosed separately in notes.
<b>1.5</b>	<b>(c)</b> prescribed under Schedule II to Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule II.

**Case Scenario 2**

<b>Question No.</b>	<b>Answer</b>
<b>2.1</b>	<b>(a)</b> The accounts of a branch shall be audited either by the company's auditor or by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of Companies Act, 2013. In case branch accounts are audited by a person other than company's auditor, branch audit report is sent by branch auditor to company's auditor.
<b>2.2</b>	<b>(c)</b> Separate determination of materiality and identifying & assessing risk of material misstatement is required along with documentation thereof in respect of each of branches. He is required to perform substantive procedures as described in case study in respect of auditee branches and also maintain documentation of same.

<b>2.3</b>	<b>(a)</b> During year 2023-24, inventories of Branch I have moved faster in comparison to Branch II.
<b>2.4</b>	<b>(a)</b> Company's auditor can advise Mr. D regarding certain significant accounting, auditing and reporting requirements and ask him to provide representation as to compliance with them.

### Case Scenario 3

<b>Question No.</b>	<b>Answer</b>
<b>3.1</b>	<b>(d)</b> Letters of credit issued; guarantees issued (fully secured by 100% margin)
<b>3.2</b>	<b>(b)</b> SA 330
<b>3.3</b>	<b>(d)</b> It would help auditor in identifying accounts which may involve downgrading from standard category to non-performing asset.

### General MCQ's

1. (c)
2. (c)
3. (b)

### Division B -Descriptive Answers

1. **(a)** DOX Limited is in business of providing courier services. As name of the company and given facts suggest: -
  - It is not a small company under section 2(85) of Companies Act, 2013.
  - It is not a private company.
  - It is not a one person company.
  - It is not a banking or insurance company.
  - It is not a Section 8 company as it does not has charitable objects etc.

Therefore, it does not qualify for any exemption from applicability of CARO, 2020. Hence, reporting requirements under CARO, 2020 are applicable. While reporting under CARO, 2020, statutory auditor is required to report under clause (xiv) of paragraph 3 as under:

- (a) whether the company has an internal audit system commensurate with the size and nature of its business
  - (b) whether the reports of the internal auditors for the period under audit were considered by the statutory auditor
- (b)** The above situation is an example of misstatement relating to non-compliance with requirements of AS 9 identified during audit. In

accordance with requirements of SA 450, the auditor shall communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management, unless prohibited by law or regulation. The auditor shall request management to correct those misstatements.

Timely communication of misstatements to the appropriate level of management is important as it enables management to evaluate whether the items are misstatements, inform the auditor if it disagrees and take action as necessary. The correction by management of all misstatements, including those communicated by the auditor, enables management to maintain accurate accounting books and records and reduces the risks of material misstatement of future financial statements because of the cumulative effect of immaterial uncorrected misstatements related to prior periods.

If management refuses to correct some or all of the misstatements communicated by the auditor, the auditor shall obtain an understanding of management's reasons for not making the corrections and shall take that understanding into account when evaluating whether the financial statements as a whole are free from material misstatement.

- (c) In the given situation, following information is required to be disclosed in accordance with requirements to Schedule III to the Companies Act, 2013:

(a)	amount required to be spent by the company during the year	
	₹14.00 lacs	
(b)	amount of expenditure incurred	₹ 14.50 lacs
(c)	shortfall at the end of the year	NIL
(d)	total of previous years shortfall	NA
(e)	reason for shortfall	NA
(f)	nature of CSR activities - Women empowerment activities through implementing agency	
(g)	details of related party transactions, e.g., contribution to a trust controlled by the company in relation to CSR expenditure as per relevant Accounting Standard	NIL
(h)	where a provision is made with respect to a liability incurred by entering into a contractual obligation, the movements in the provision during the year should be shown separately	NIL

- (d) The firm is providing free hospitality to engagement team members including engagement partner. In such circumstances, fundamental principles governing professional ethics are violated. Such acts of free hospitality are capable of impairing objectivity of auditor.

The situation given in the question signifies that auditors have formed relationships with client where they may end up being too sympathetic to the client's interests. Due to free hospitality enjoyed by engagement team members, they may take a sympathetic view to issues which may have arisen during course of audit. In this way, familiarity threats are created in the situation.

**2. (a) Financial events or conditions that may cast significant doubt on the entity's ability to continue as going concern:**

- (i) Net liability or net current liability position.
- (ii) Fixed-term borrowings approaching maturity without realistic prospects of renewal or repayment; or excessive reliance on short term borrowings to finance long term assets.
- (iii) Indications of withdrawal of financial support by trade payables.
- (iv) Negative operating cash flows indicated by historical or prospective financial statements.
- (v) Adverse key financial ratios.
- (vi) Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.
- (vii) Arrears or discontinuance of dividends.
- (viii) Inability to pay trade payables on due dates.
- (ix) Inability to comply with terms of loan agreements.
- (x) Change from credit to cash-on-delivery transactions with suppliers.
- (xi) Inability to obtain financing for essential new product development or other essential investments.

**(b) Adequate planning benefits the audit of financial statements in several ways, including the following:**

- (a) Helping the auditor to devote appropriate attention to important areas of the audit.
- (b) Helping the auditor identify and resolve potential problems on a timely basis.
- (c) Helping the auditor properly organize and manage the audit engagement so that it is performed in an effective and efficient manner.
- (d) Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
- (e) Facilitating the direction and supervision of engagement team members and the review of their work.
- (f) Assisting, where applicable, in coordination of work done by auditors of components and experts.

**(c) Example of practical limitation on ability of auditor to obtain audit evidence**

An auditor does not test all transactions and balances. He forms his opinion only by testing samples. It is an example of practical limitation on auditor's ability to obtain audit evidence.

**Example of legal limitation on ability of auditor to obtain audit evidence**

Management may not provide complete information as requested by auditor. There is no way by which auditor can force management to provide complete information as may be requested by auditor. In case he is not provided with required information, he can only report. It is an example of legal limitation on auditor's ability to obtain audit evidence.

- (d)** The above company is a government company. Section 143(5) of the Companies Act, 2013 states that, in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government or Governments, or partly by the Central Government and partly by one or more State Governments, the comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) of section 139 i.e. appointment of subsequent auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statements of the company.

- 3. (a)** Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. Purchase bill of ₹ 5.00 lacs pertaining to TIM Industries has been entered in books of TIM Private Limited. Therefore, it is contradicting management's assertion relating to occurrence of such purchases. Hence, it constitutes audit evidence.

Further, the absence of information (for example, management's refusal to provide a requested representation) is used by auditor, and therefore, also constitutes audit evidence. In the given case, management has refused to provide a written representation relating to physical verification of inventories during the year. Therefore, absence of information is used by auditor and it also constitutes audit evidence.

- (b)** As described in the situation given in the question, banking regulator has imposed restrictions due to non-compliance with regulatory requirements and there is material uncertainty of such events or conditions which may cast a significant doubt on ability of Bank to continue as going concern. However, the financial statements of Bank do not make adequate disclosure of material uncertainty due to above events in financial statements.

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:

- (i) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705.
  - (ii) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the financial statements do not adequately disclose this matter.
- (c)** SA 300 states that auditor shall develop an audit plan that shall include description of-
- (i) The nature, timing and extent of planned risk assessment procedures
  - (ii) The nature, timing and extent of planned further audit procedures at assertion level
  - (iii) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.
- (d)** Audit documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. The objective of the auditor in accordance with SA 230 is to prepare documentation that provides: -
- (i) A sufficient and appropriate record of the basis for the auditor's report and
  - (ii) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.
- 4. (a)** Following audit procedures can be performed to perform to verify that recorded sales in financial statements represent goods actually sold during the period and recorded sales are not overstated.
- Check whether a single sales invoice is recorded twice or a cancelled sales invoice has been recorded.
  - Test check few invoices with their relevant entries in sales journal.
  - Obtain confirmation from few customers to ensure genuineness of sales transaction
  - Check whether any fictitious customers and sales have been recorded.
  - Verify whether any shipments were done without the consent and agreement of the customer, especially at the year end to inflate the sales figure
  - Whether unearned revenue recorded as earned.
  - Whether any substantial uncertainty exists about collectability

- Whether customer obligations are contingent on other (financing, resale, etc.).
  - Review sequence of sales invoices
  - Review journal entries for unusual transactions
  - Calculate the ratio of sales return to sales and compare it with previous year and enquire for the reasons for unusual variation.
- (b) The list given in the question does not contain following important matters: -
- Whether adequate procedures are expected to be established and proper instructions issued for physical inventory counting. The auditor has to evaluate management's instructions for recording and controlling physical inventory counting. It is important for the auditor to know beforehand how the inventory count will be conducted so as to assess its effectiveness.
  - The nature of internal control related to inventories at different locations. It is possible that inventories at one location have unsatisfactory control leading to higher risk of material misstatement related to inventories at that particular location.
- (c) The auditor should decide whether relevant information is properly disclosed in the financial statements. He should also keep in mind applicable statutory requirements in this regard.
- It is done by ensuring that financial statements properly summarize transactions and events recorded therein and by considering the judgments made by management in preparation of financial statements.
- The management responsible for preparation and presentation of financial statements makes many judgments in this process of preparing and presenting financial statements. For example, choosing of appropriate accounting policies in relation to various accounting issues like choosing method of charging depreciation on fixed assets or choosing appropriate method for valuation of inventories.
- The auditor evaluates selection and consistent application of accounting policies by management; whether such a selection is proper and whether chosen policy has been applied consistently on a period-to-period basis.
- (d) Significant judgments made in an engagement should be reviewed by an engagement quality control reviewer for taking an objective view before the report is issued. Engagement quality control review is mandatory for all audits of financial statements of **listed entities**.
- In respect of other engagements, firm should devise criteria to determine cases requiring performance of engagement quality control review.
5. (a) In the given situation, ₹ 60 lacs is accumulated in Electronic credit ledger of WTE Private Limited as finished product is liable to lower GST rate whereas input raw materials for manufacturing carry higher GST rate. It is refundable to company by virtue of provisions of GST law. The above

balance would be reflected and classified under current assets. Within current assets, it would be classified into "Other current assets".

Few audit procedures to be performed for verification of above balance are:

- In relation to balances with statutory authorities like GST input credit, prepare a reasonability analysis with respect to purchases by applying the applicable rate to the purchases and in case of any variance with the asset recorded by the entity, reasons for variance should be requested from the entity.
- Obtain copies of statutory GST returns filed on GST portal.
- In case refundable amount as on balance sheet date is still outstanding, verify whether the amount recorded as per books of account tallies with the claim made with the authorities subsequently by going to GST portal.
- In case refundable amount as on balance sheet date is received subsequently, verify it from Bank statement.

**(b)** For the purpose of identifying and assessing the risks of material misstatement, the auditor shall:

- (i) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements.
- (ii) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions.
- (iii) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test and
- (iv) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

**(c) Verification of inventories in the nature of food and beverages:** The inventories in any hotel are both readily portable and saleable particularly the food and beverage inventories. It is therefore extremely important that all movements and transfers of such inventories should be properly documented to enable control to be exercised over each individual stores' areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed. Therefore, following may be noted in this regard:

- (a) All movement and transfer of inventories must be properly documented.
- (b) Areas where inventories are kept must be kept locked and the key retained by the departmental manager.

- (c) The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.
  - (d) Many hotels use specialized professional valuers to count and value the inventories on a continuous basis throughout the year.
  - (e) The auditor should ensure that all inventories are valued at the year end and that he should himself be present at the year-end physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories.
- (d) The Principle of Professional Behaviour 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. A professional accountant shall not knowingly engage in any employment, occupation or activity that impairs or might impair the integrity, objectivity or good reputation of the profession, and as a result would be incompatible with the fundamental principles.

### Example

A Chartered Accountant has conducted audit of accounts of an entity for a particular year. ICAI has issued a letter to him relating to certain matters concerning audit. He didn't even bother to reply to the letter despite reminders. Failure to reply to professional body smacks of lack of courtesy and professional responsibility. In the given case, Chartered accountant has not followed principle of Professional Behaviour.

6. (a) In accordance with SA 610, the external auditor shall not use internal auditors to provide direct assistance to perform procedures that relate to higher assessed risks of material misstatement where the judgment required in performing the relevant audit procedures or evaluating the audit evidence gathered is more than limited.

In the given situation, valuation of trade receivables is assigned as an area of higher risk by statutory auditor. Judgment required in checking of accuracy of aging of trade receivables is limited. Therefore, external auditor can assign the checking of the accuracy of the aging to Chief Internal Auditor providing direct assistance as it involves limited judgment.

However, because the evaluation of the adequacy of the provision based on the aging would involve more than limited judgment, it would not be appropriate to assign that latter procedure to Chief Internal Auditor providing direct assistance.

- (b) **Expenditure Audit:** The audit of government expenditure is one of the major components of government audit. The basic standards set for audit of expenditure are to ensure that there is provision of funds authorized by competent authority fixing the limits within which expenditure can be incurred. These standards are—
- (i) 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. Such an audit is called as the audit against 'rules and orders'.

- (ii) that there is sanction, either special or general, accorded by competent authority authorising the expenditure. Such an audit is called as the audit of sanctions.
- (iii) that there is a provision of funds out of which expenditure can be incurred and the same has been authorised by competent authority. Such an audit is called as audit against provision of funds.
- (iv) that the expenditure is incurred with due regard to broad and general principles of financial propriety. Such an audit is also called as propriety audit.
- (v) 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. Such an audit is termed as the performance audit.

### OR

**(c)** The special steps involved in the audit of receipts from sale of tickets are stated below-

- (i) Verify that entrance to the cinema-hall during show is only through printed tickets;
- (ii) Verify that they are serially numbered and bound into books. In case bookings are made online, verify the system for online booking;
- (iii) Verify that the number of tickets issued for each show and class, are different though the numbers of the same class for the show on the same day, each week, run serially;
- (iv) Verify that for advance booking a separate series of tickets is issued;
- (v) Verify that the inventory of tickets is kept in the custody of a responsible official.
- (vi) Confirm that at the end of show, a statement of tickets sold is prepared and cash collected is agreed with it.
- (vii) Verify that a record is kept of the 'free passes' and that these are issued under proper authority.
- (viii) Reconcile the amount of Tax collected with the total number of tickets issued for each class.
- (ix) Vouch the entries in the Cash Book in respect of cash collected on sale of tickets for different shows on a reference to Daily Statements which have been test checked as aforementioned with record of tickets issued for the different shows held.

(d)

<b>Column A (Description of control in an automated environment)</b>	<b>Column B (Type of control)</b>
Reasonableness checks	Application controls
Controls over Data centre and network operations	General IT controls
Controls over application system acquisition, development and maintenance	General IT controls
Program change controls	General IT controls

(e) Leadership responsibility of an engagement partner is to take responsibility for the overall quality on each audit engagement. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise-

(a) The importance to audit quality of:

- (i) Performing work that complies with professional regulatory and legal requirements
- (ii) Complying with the firm's quality control policies and procedures as applicable
- (iii) Issuing auditor's reports that are appropriate in the circumstances and
- (iv) The engagement team's ability to raise concerns without fear of reprisals.

(b) The fact that quality is essential in performing audit engagements.