

**Mock Test Paper - Series II: April, 2024**

**Date of Paper: 12 April, 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**

Pluto Limited is engaged in manufacturing and distribution of ergonomic furniture. Such kind of customisable range home office furniture has gained lot of importance in past few years. The company was able to perform well over the years and the same is reflected in their financials.

During year 2023-24, audit firm of S.J. and Associates was reappointed as their auditor. The engagement team consisted of CA Sneha (partner) and five articled assistants. One of the assistants was new to this engagement. Considering huge volume of transactions, the partner asked him to go through files of last year and auditor's report to gain an understanding of issues which arose in last year i.e. 2022-23.

While going through summary page of file of last year, he noticed that below points were under discussion with the partner before audit finalisation:

**Point 1:** For employee benefit expenses, following points were verified by the team:

- The employee benefit expenses shown in the books were actually incurred during the relevant period.
- The expenses in respect of all personnel were accounted for.
- The expense recognised during year 2022-23 related to this year only.

**Point 2:** It was noted that dividend to equity shareholders for the year 2022-23, was declared on 15.04.2023. As the dividend related to the year 2022-23, the same was recognised as liability in the same year.

**Point 3:** Debtors constitute one of the major components of company's financials. As part of audit procedures, verification was made whether company had made allowance for those debtors which were doubtful. In this regard, list of debtors under litigation was also obtained and scrutinized.

**Point 4:** Asset additions during the year amounted to ₹ 50 lakhs. The payment in respect of these assets were made through bank account of the company. However, on scrutiny, it was found that some of invoices were not in the name of the company but in name of one of directors.

**Point 5:** The company was maintaining few bank accounts including one foreign currency account. There was included in previous year file a paper converting foreign currency amount held in a bank account to Indian Rupees at closing exchange rate.

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

- 1.1 In point 1 relating to Employee benefits, which among the following assertions are discussed respectively (in same order as described in point 1)?
- (i) Valuation
  - (ii) Occurrence
  - (iii) Cut-off
  - (iv) Completeness
- Choose the correct combination from below: -
- (a) (i),(ii) and (iv)
  - (b) (ii), (iv) and (iii)
  - (c) (ii), (iii) and (iv)
  - (d) (i),(ii) and (iii)
- 1.2 Do you think the amount of dividend recognised as liability in the year 2022-23 as given in point 2 appropriate?
- (a) Yes. As the amount of dividend related to year 2022-23, it should be recognised in the same year irrespective of the year of declaration.
  - (b) No. The amount should be recognised equally between two financial years.
  - (c) No. The amount should not be recognised as liability in year 2022-23. But it needed to be disclosed in the notes to accounts of that year.
  - (d) No. The amount should not be recognised as liability. Further, no disclosure was needed in the financials of that year.
- 1.3 In relation to matter described in para 3 pertaining to debtors, which of the following assertions was verified by auditors?
- (a) Valuation
  - (b) Rights and obligations
  - (c) Existence
  - (d) Completeness
- 1.4 Read Point 4 and choose which assertion is not proved in this case.
- (a) Existence

- (b) Rights and obligation
- (c) Completeness
- (d) Measurement/Valuation

1.5 Choose the correct statement from below pertaining to matter described in Point 5.

- (a) The company was required to restate said amount in accordance with requirements of AS 1. By verifying it, auditor had verified existence assertion.
- (b) The company was required to restate said amount in accordance with requirements of AS 11. By verifying it, auditor had verified completeness assertion.
- (c) There was no responsibility of company to restate said amount. It was auditor's responsibility to restate said amount in accordance with requirements of AS 11. No assertion was, therefore, verified by auditor.
- (d) The company was required to restate said amount in accordance with requirements of AS 11. By verifying it, auditor had verified valuation assertion.

**(5 MCQs x 2 Marks each = 10 Marks)**

### Case Scenario 2

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 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 importance of Engagement letter. He also arranged a team discussion on matters relating to acceptance of terms of engagement.

First point of consideration was concerning preconditions for an audit. Mr. Arun, a team member could recollect few of them. Those included determining whether 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 letter 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 course of audit. In this respect, specific question was 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 company during the year. Lack of support by management in such a case would, in effect, signify management's refusal to allow auditor to send confirmation requests at the outset before engagement is accepted by auditor.

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

- 2.1 As regards 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.
- 2.2 When CA Kishan, the partner, asked about preconditions for an audit, Mr. Arun could recollect only few of them. Read the passage and find out which among the following points were missed.
- (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.

Choose the correct answer from below options.

- (a) (i), (ii) and (iii)
- (b) (ii), (iii) and (iv)
- (c) (iii) and (iv)
- (d) (i) and (iv)

- 2.3 From what Mr. Kumar replied about the factors requiring a revision of Engagement letter one point was incorrect. Read the passage and find that incorrect factor.
- (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
- 2.4 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 principle of objectivity governing professional ethics.
  - (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 of 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 principle of Professional competence and due care governing professional ethics.
  - (d) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of professional behaviour governing professional ethics.

**(4 MCQs x 2 Marks each = 8 Marks)**

### **Case Scenario 3**

In accordance with requirements of Standards on Auditing, CA Tina (a freshly qualified professional) wants to obtain sufficient appropriate audit evidence in an audit engagement pertaining to financial statements of a partnership firm for year 2022-23. The firm is trading in FMCG goods. Appointed in May, 2023, she needs evidence to obtain information for arriving at her judgment. Clearly remembering fundamentals that an auditor has to obtain sufficient appropriate audit evidence to draw reasonable conclusions on financial statements, she proceeded in accordance with audit plan prepared by her.

During the year 2022-23, firm was maintaining a current account with a branch of a public sector bank. Her audit plan had included procedure of confirming balance of current account directly from bank. As at 28<sup>th</sup> March, 2023, the firm had an urgent need to pay its utility bill amounting to ₹1.00 lacs. However, due to insufficiency of funds, it had requested branch manager to get cheque drawn on utility company cleared. Therefore, balance in current account of firm in books of bank branch stood at ₹0.92 lacs (Debit). The firm had also issued cheques in evening of 31<sup>st</sup> March, 2023 in anticipation of funds on next working day i.e. 3<sup>rd</sup> April, 2023. It had also certain cheques dated 27<sup>th</sup> March, 2023 from its debtors lying with it which were deposited in afternoon of 31<sup>st</sup> March, 2023 in bank branch at request of debtors.

Her plan also included performance of certain procedures pertaining to verification of inventories. Inventories of FMCG goods were material to financial statements. Her assistant, Tisha, had her own notion about understanding of sufficient appropriate audit evidence. She further feels that when audit evidence is obtained from available records of an entity, it is known as internal evidence like purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law. She is also of the view that audit evidence obtained by auditor is final and conclusive.

**Based upon above, answer the following questions: -**

- 3.1 As regards matter of balance in current account and related issues is concerned, which of following statements is likely to be most appropriate?
- (a) Amount of ₹ 0.92 lac is required to be classified under cash & bank balances in financial statements of firm. Procedure of confirming balance directly from the bank alone is likely to constitute sufficient appropriate audit evidence.
  - (b) Amount of ₹ 0.92 lac is required to be classified under cash & bank balances in financial statements of firm. Procedure of confirming balance directly from the bank alone is not likely to constitute sufficient appropriate audit evidence.
  - (c) Amount of ₹ 0.92 lac is required to be classified under current liabilities in financial statements of firm. Procedure of confirming balance directly from the bank alone is likely to constitute sufficient appropriate audit evidence.
  - (d) Amount of ₹ 0.92 lac is required to be classified under current liabilities in financial statements of firm. Procedure of confirming balance directly from the bank alone is not likely to constitute sufficient appropriate audit evidence.
- 3.2 Considering matter of verification of inventories, which of following statements is based on facts described in the situation and also in essence of Standards on Auditing?
- (a) She should verify subsequent sale invoices of inventory items lying in stocks as at year end. Besides, she should also review stock records of year 2022-23 and subsequent period. Such evidence may constitute sufficient appropriate audit evidence.
  - (b) She should verify subsequent sale invoices of inventory items lying in stocks as at year end. Besides, she should also review stock records of year 2022-23 and subsequent period. She should attend physical inventory count at year end in above situation. Such evidence may constitute sufficient appropriate audit evidence.
  - (c) She should verify purchase invoices of inventory items lying in stocks as at year end. Stock records are not required to be verified. Such evidence is likely to constitute sufficient appropriate audit evidence.



- (d) She should verify purchase invoices of inventory items lying in stocks as at year end. She should attend physical inventory count at year end in above situation. Such evidence may constitute sufficient appropriate audit evidence.

3.3 Identify correct statement on the basis of description provided in case scenario: -

- (a) Purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are all examples of internal evidence. Audit evidence obtained by auditor is final and conclusive.
- (b) Purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are all examples of internal evidence. Audit evidence obtained by auditor is persuasive.
- (c) Only debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are examples of internal evidence. Audit evidence obtained by auditor is persuasive.
- (d) Only debit notes issued by firm on debtors for GST short charged earlier during the year is an example of internal evidence. Audit evidence obtained by auditor is persuasive.

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

### MCQs

1. CA D, during the course of audit of a company engaged in export business, notices that credit facilities taken by company during the year from a bank for ₹10 crores have almost been fully utilized during the year. On going through sanction letter provided by bank to company, it is observed that rate of interest stipulated in sanction letter is 8% p.a. Financial statements of company show bank interest amounting to ₹60.00 lacs. Which type of substantive analytical procedure is being used by CA D?
  - (a) Trend analysis
  - (b) Ratio analysis
  - (c) Reasonableness tests
  - (d) Structural modelling
2. An auditor of a company has found that accountant of a company has entered bogus purchase bills for ₹50 lacs in its books of accounts. Which of following is most appropriate regarding auditor's duty as far as reporting is concerned under Companies Act, 2013?
  - (a) Report the matter to jurisdictional ROC

- (b) Report the matter to Secretary, MCA
  - (c) Report the matter to Board of Directors of company
  - (d) Report the matter to jurisdictional ROC as well as GST authority
3. During course of audit of a company, it is noticed by auditor that Profit before tax of company is Rs. 5 lakhs. Depreciation on building reflected in Schedule of PPE forming part of financial statements has been computed for Rs.10 lacs. The correct depreciation, according to him, should be Rs.25 lacs. The above description as a whole is an example of \_\_\_\_\_?
- (a) Misstatement
  - (b) Assertion
  - (c) Sampling method
  - (d) Audit risk

### Division B - Descriptive Questions

**Question No. 1 is compulsory.**

***Attempt any four questions from the Rest.***

1. (a) Sanjeev, an articled clerk in an audit firm, is part of an engagement team conducting audit of a company for year 2023-24. It is a small company having a turnover of about ₹25 crores. During the course of audit, he notices that senior team member has taken following approach for selecting items for testing reflected in financial statements to obtain audit evidence: -
- He has selected to test items debited under the head "Machinery repair & maintenance" as expenditure relating to it during year 23-24 has increased considerably as compared to last year.
  - Out of purchases, he has selected to test purchases from related parties amounting to ₹ 5 crores.
  - He has also selected to test all individual items of expenditure exceeding ₹5 lakhs.
  - Besides, he has also selected amount of ₹0.50 lakhs debited under head "legal expenses" to know purpose of payment made to external legal counsel.
- Sanjeev understands that senior team member is using "audit sampling" for selecting items for testing. Do you agree with him? Which risk is involved in above approach? Discuss with reasons. **(4 Marks)**
- (b) Following is the extract from Schedule no. 10 of Advances as appearing in financial statements of branch of a nationalized bank for year ending 31<sup>st</sup> March, 2024.



**Schedule 10 - Advances**

<b>S. No.</b>	<b>Particulars</b>	<b>Amount (In ₹ Crores) rounded off</b>
1.	Bills Purchased and Discounted	50.00
2.	Cash credits, overdrafts and loans repayable on demand	150.00
3.	Term Loans	75.00
	<b>Total</b>	<b>275.00</b>

In carrying out audit of above advances as part of statutory audit of branch, a statutory auditor would obtain evidence about certain matters. State those matters. **(4 Marks)**

- (c) CA J is working as internal auditor in JKL Limited, a non-listed company. The responsibilities of internal auditor include reviewing financial information and performing detailed tests on transactions and balances. He is also responsible for compliance with laws, regulations and external requirements.

During the year 2022-23, services of an employee of company were terminated. The said employee had filed a suit against the company in respect of certain compensation dues amounting to ₹ 10 lakhs which were not paid to him. Based upon advice of legal counsel, the company had made a provision of ₹ 10 lacs in financial statements for year 2022-23. However, somewhere in June 2023, there is an out of court settlement between company and employee for ₹ 6 lakhs. The statutory audit of company is under progress and audit report has not yet been finalized. How internal auditor should have proceeded in situation?

**(3 Marks)**

- (d) KST Limited is engaged in manufacturing business. It appoints CA T to provide it an assurance report on its financial statements prepared on the basis of historical financial information. The characteristic of such an engagement is that it involves gathering of sufficient appropriate evidence on basis of which limited conclusions can be drawn up by practitioner. Identify type of engagement. Which are two other features of such an engagement? **(3 Marks)**

2. (a) Written representation about management's responsibilities involves confirmation of fulfilment of management's responsibilities in the preparation of the financial statements providing the relevant information and also informing about completeness of transactions. Explain.

**(4 Marks)**

- (b) Planning includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to

consider, prior to the auditor's identification and assessment of the risks of material misstatement, certain matters. Discuss those matters.

**(4 Marks)**

- (c) In an initial audit engagement, in the case of inventories, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, in such a case, additional audit procedures become necessary so that auditor may obtain sufficient appropriate audit evidence. Discuss those additional audit procedures. **(3 Marks)**
- (d) Internal Control Questionnaire is a comprehensive series of questions concerning internal control. A company is engaged in business of manufacturing of chemicals. It has two plant locations in city "A" and one plant location in city "B" involving huge value of assets. Building at three locations is owned by the company. The company earns handsome profits and does not want to suffer losses due to business interruptions. It has a dedicated department for looking after insurance matters. As an auditor, prepare an internal control questionnaire concerning this department for obtaining staff responses. **(3 Marks)**
3. (a) Tisa Industries Private Limited has prepared its financial statements for year 2023-24. The financial statements and notes to accounts show following information and disclosure in respect of trade receivables of the company: -

S. No.	Particulars	Amount (in ₹ lacs)
1.	Trade Receivables	240.00

Trade receivables ageing schedule.

*Outstandings for following periods from due date of payment*

(in ₹ lacs)

Particulars	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
MSME	150.00	30.00	10.00	XXX	190.00
Others	40.00	XXX	XXX	XXX	40.00
Disputed dues-MSME	XXX	XXX	XXX	XXX	XXX
Disputed dues-others	10.00	XXX	XXX	XXX	10.00

You are part of engagement team conducting audit of the company. Point out discrepancies including omissions in above disclosure. (Do not prepare another table). **(4 Marks)**

- (b) Being statutory auditor of JAL Limited, a company engaged in manufacturing of chemicals, CA Gopika has understood that company is expected to have material work-in-progress as on 31<sup>st</sup> March, 2024.

State few audit procedures to verify existence and valuation assertions for work-in-progress. **(4 Marks)**

- (c) The ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications. Give three instances to explain. **(3 Marks)**
- (d) One of the factors affecting the form, content and extent of audit documentation relates to size and complexity of the entity. State six other factors in this respect. **(3 Marks)**
4. (a) It is important to carry out the Tests of Controls for checking effectiveness of internal control over sales as a part of the debtors' audit procedure. In above context, state the points which need to be considered in respect of trade receivables. **(4 Marks)**
- (b) M/s S R & Associates are the Statutory Auditors of Vanee Textile and Garments Ltd., a company engaged in the business of manufacturing of various textile products. The auditor has completed the audit and is in the process of forming an opinion on the financial statements for the F.Y. 2023-2024. CA S, the engagement partner, wants to conclude whether the financial statements as a whole are free from material misstatements, whether due to fraud or error. Guide him about the factors he should consider to reach that conclusion. **(4 Marks)**
- (c) Nature of financial reporting itself is one of causes of inherent limitations of audit of financial statements. Explain. **(3 Marks)**
- (d) Discuss the objective of the auditor as per Standard on Auditing (SA) 705 "Modifications to The Opinion in The Independent Auditor's Report". **(3 Marks)**
5. (a) Column A describes description of certain terms used in banking industry. Complete Column B by suggesting term appropriate to description given.

Column A	Column B
Audit of borrower client of bank carried out at bank's request to verify borrower's current assets	?
Limit up to which an entity can withdraw from sanctioned working capital limit	?
Statutory right of a creditor to adjust debit balance in debtor's account against any credit balance lying in another account of debtor	?
Creation of security in a bank branch by mere delivery of title deeds by a prospective borrower of funds	?

**(4 Marks)**

- (b) Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit. State few areas in which such an understanding is helpful to auditor. **(4 Marks)**
- (c) You are auditor of a college running different courses operating in your city. During audit of a year, it is noticed that fees concessions to students have been provided in substantial number of cases. Discuss, how, you as an auditor, would proceed to verify the same and also explain two other points to verify fees from students. **(3 Marks)**
- (d) The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit *engagement letter* or other suitable form of written agreement. Who gives engagement letter to whom and what is included in such a letter? **(3 Marks)**
6. (a) Auditor of Sunshine Ltd. is of the view that due to greater management intervention to specify accounting treatment, the risk of material misstatement is greater for non-routine transactions. Is view of the auditor correct? Specify the other matters due to which the risk of material misstatement is greater for significant non-routine transactions. **(4 Marks)**
- (b) On reviewing internal control over accounting for sales as part of statutory audit of A Ltd, auditor finds certain deficiencies in segregation of duties, authorization of sales orders, preparation of invoices, preparation and authorization of debit/credit notes etc. and non-following of standard procedures as stipulated by the management. The auditor finds these lapses to be significant deficiencies in internal control over sales.
- He points it out to the management in a one-liner as under: -
- "Instructions on internal control related to sales are not properly followed by the staff."
- Is above communication by the auditor proper? **(4 Marks)**
- OR
- (c) Audit against propriety seeks to ensure that expenditure conforms to certain principles which have for long been recognised as standards of financial propriety. Explain those principles.

- (d) The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant. Preliminary identification of material classes of transactions, account balances and disclosures help auditor in establishing overall audit strategy. More energies need to be devoted to significant matters to obtain desired outcomes. Give three examples to explain the above situation.

**(3 Marks)**

- (e) CA. Ravi Patnaik is conducting audit of a company for which reporting requirements under CARO, 2020 are applicable. He finds that cash credit facilities amounting to ₹ 4 crores were released to the company by branch of a bank for meeting its working capital requirements. He finds that out of above funds, ₹ 1 crore have been used by company for installing effluent treatment plant to meet State pollution control Board requirements.

Is there any reporting obligation upon him under CARO,2020?

**(3 Marks)**

**Mock Test Paper - Series II: April, 2024**

**Date of Paper: 12 April, 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> (ii), (iv) and (iii)
<b>1.2</b>	<b>(c)</b> No. The amount should not be recognised as liability. But it needs to be disclosed in the notes to accounts.
<b>1.3</b>	<b>(a)</b> Valuation
<b>1.4</b>	<b>(b)</b> Rights and obligation
<b>1.5</b>	<b>(d)</b> The company was required to restate said amount in accordance with requirements of AS 11. The auditor had verified valuation assertion.

**Case Scenario 2**

<b>Question No.</b>	<b>Answer</b>
<b>2.1</b>	<b>(c)</b> The auditor should not accept such an engagement.
<b>2.2</b>	<b>(c)</b> (iii) and (iv)
<b>2.3</b>	<b>(d)</b> A modest change in nature or size of the entity's business
<b>2.4</b>	<b>(d)</b> It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of professional behaviour governing professional ethics.

**Case Scenario 3**

<b>Question No.</b>	<b>Answer</b>
<b>3.1</b>	<b>(d)</b> Amount of ₹ 0.92 lac is required to be classified under current liabilities in financial statements of firm. Procedure of confirming balance directly from the bank alone is not likely to constitute sufficient appropriate audit evidence.
<b>3.2</b>	<b>(a)</b> She should verify subsequent sale invoices of inventory items lying in stocks as at year end. Besides, she should also review

	stock records of year 2022-23 and subsequent period. Such evidence may constitute sufficient appropriate audit evidence.
3.3	(c) Only debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are examples of internal evidence. Audit evidence obtained by auditor is persuasive.

### General MCQ's

1. (c)
2. (c)
3. (a)

### Division B -Descriptive Answers

1. (a) Audit Sampling refers to the application of audit procedures to less than 100% of items within a population relevant under the audit such that all sampling units (i.e. all the items in the population) have an equal chance of selection.

In the given situation, senior team member is not selecting items for testing by means of audit sampling. He is only selecting **specific items from a population**. In accordance with SA 500, one of the means available to auditor for selecting items for testing is "by selecting specific items."

Specific items selected may include: -

- **High value or key items:** The auditor may decide to select specific items within a population because they are of high value, or exhibit some other characteristic, for example, items that are suspicious, unusual, particularly risk-prone or that have a history of error.
- **All items over a certain amount:** The auditor may decide to examine items whose recorded values exceed a certain amount so as to verify a large proportion of the total amount of a class of transactions or account balance.
- **Items to obtain information:** The auditor may examine items to obtain information about matters such as the nature of the entity or the nature of transactions.

Therefore, Sanjeev's understanding is not proper.

The above approach for selecting items for testing is subject to non-sampling risk. Non-sampling risk is the risk that auditor may reach an erroneous conclusion for any reason not related to sampling risk. Like, erroneous conclusion may be reached due to some inappropriate audit procedure.

- (b) In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following: -
  - (i) Amounts are included in balance sheet in respect of advances



which are outstanding at the date of the balance sheet.

- (ii) Advances represent amount due to the bank branch.
  - (iii) Amounts due to the bank branch are appropriately supported by loan documents and other documents as applicable to the nature of advances.
  - (iv) There are no unrecorded advances.
  - (v) The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.
  - (vi) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
  - (vii) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.
- (c)** Subsequent events are events occurring between the date of 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.

In the given case, the company had already made provision of ₹ 10 lakhs in financial statements for year 2022-23. However, there is an out of court settlement between the company and employee for ₹ 6 lakhs.

It is an example of event which provides evidence of conditions that existed at the date of financial statements i.e. 31<sup>st</sup> March, 2023. It provides evidence on adjustment in provision amount already made in financial statements. Therefore, internal auditor should ask management to revise provision downwards to ₹ 6 lakhs so that financial statements are in accordance with applicable accounting standards.

- (d)** As given above, the engagement involves gathering of sufficient appropriate evidence on the basis of which limited conclusion can be drawn up. It is a limited assurance engagement like review. Other two features of such type of engagement are: -
- (1) It provides lower level of assurance than reasonable assurance engagement.
  - (2) It performs fewer procedures than reasonable assurance engagement.
- 2. (a)** Written representation about management's responsibilities involves confirmation of fulfilment of management's responsibilities in following areas: -

**(I) Preparation of the financial statements**

The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the

applicable financial reporting framework, including, where relevant, their fair presentation, as set out in the terms of the audit engagement.

Due to its responsibility for the preparation and presentation of the financial statements and its responsibilities for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing and presenting the financial statements and the assertions therein on which to base the written representations.

## **(II) Information provided and completeness of transactions**

**The auditor shall request management to provide a written representation that: -**

- (i) It has provided the auditor with all relevant information and access as agreed in the terms of the audit engagement and
  - (ii) All transactions have been recorded and are reflected in the financial statements.
- (b)** Prior to auditor's identification and assessment of risks of material misstatement, planning includes the need to consider following matters:
1. The analytical procedures to be applied as risk assessment procedures.
  2. Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
  3. The determination of materiality.
  4. The involvement of experts.
  5. The performance of other risk assessment procedures.
- (c)** In an initial audit engagement, in the case of inventories, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, additional audit procedures may be necessary, and one or more of the following may provide sufficient appropriate audit evidence:
- Observing a current physical inventory count and reconciling it to the opening inventory quantities.
  - Performing audit procedures on the valuation of the opening inventory items.
  - Performing audit procedures on gross profit and cut-off.
- (d) Internal Control Questionnaire**
- Are competitive quotes obtained from different insurers?

- Is comprehensive insurance cover obtained for fire, flood, burglary, earthquake risks etc.?
- Are all three locations in city A and B covered?
- Are all assets consisting of building, plant & machinery and inventories covered?
- Is there an adequate procedure to ensure that assets acquired between two renewal dates are also covered by insurance?
- Is there an official who decides on value for which policies are taken?
- Does officer who decides on policy value review periodically adequacy of insurance cover?
- Is loss-of-profits insurance cover taken?
- Have there been any instances of rejection of claims?
- Are pending claims followed-up with insurers?

3. (a) The above disclosure is not in accordance with requirements of Division I of Schedule III of Companies Act, 2013. The discrepancies are as under: -

- (1) The Company has wrongly disclosed information for trade receivables in a manner which is applicable for trade payables.
- (2) No distinction between MSME and other trade receivables is required.
- (3) Trade receivables are to be categorised into undisputed and disputed trade receivables as under: -
  - Undisputed trade receivables considered good
  - Undisputed trade receivables considered doubtful
  - Disputed trade receivables considered good
  - Disputed trade receivables considered doubtful
- (4) Aging is to be reflected for each of above categories in respect of outstandings for the following periods from due date of payment
  - for less than 6 months
  - 6 months-1 year
  - 1- 2 years
  - 2-3 years
  - more than 3 years
- (5) Following information is also required to be disclosed: -  
Trade receivables shall be sub-classified as:
  - (a) Secured, considered good
  - (b) Unsecured, considered good

- (c) Doubtful.
- (6) Allowance for bad and doubtful debts shall be disclosed under the relevant heads separately.
- (7) Debts due by
  - directors or other officers of the company or any of them either severally or jointly with any other person or
  - firms or private companies respectively in which any director is a partner or a director or a member should be separately stated.
- (b)** Audit procedures to verify existence and valuation assertions for work-in-progress are as under: -
  - Attend inventory count in accordance with SA 501 and understand how work in progress is arrived at.
  - Evaluate work of management expert, if any, in this regard.
  - Ascertain how the various stages of production/ value additions are measured and in case estimates are made, understand the basis for such estimates.
  - Ascertain 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.
  - Ensure that material costs exclude any abnormal wastage factors.
- (c)** The ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications. Some of the instances are given under: -
  - The entity's timetable for reporting
  - Organization of meetings to discuss of nature, timing and extent of audit work with management
  - Discussion with management regarding the expected type and timing of reports to be issued including the auditor's report
  - Discussion with management regarding the expected communications on the status of audit work throughout the engagement.
  - Expected nature and timing of communications among engagement team members, including the nature and timing of team meetings and timing of the review of work performed.
- (d)** One of the factors affecting the form, content and extent of audit documentation relates to size and complexity of audit. Other factors are:

1. The nature of the audit procedures to be performed.
  2. The identified risks of material misstatement.
  3. The significance of the audit evidence obtained.
  4. The nature and extent of exceptions identified.
  5. The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
  6. The audit methodology and tools used.
4. (a) It is important to carry out Tests of Controls for checking the effectiveness of internal control over sales as a part of the debtors' audit procedure. Following points need to be considered in respect of trade receivables:
- Only bona fide sales lead to trade receivables.
  - All such sales are made to approved customers.
  - All such sales are properly recorded in the books of accounts.
  - Once recorded, the debtors can be settled only by receipt of cash or on the authority of a responsible official.
  - Segregation of duties at every point in sales transaction. (accounting for debtors, collecting the payments, sending reminders etc.)
  - Debtors are collected on time.
  - In case debtors are not collected in time, sending reminders and taking legal actions if required.
  - Balances are regularly reviewed.
  - A proper system of follow up exists and if necessary, adequate provision for bad debt should be made by preparing adequate ageing schedule of the debtors.

**(b) Factors to be considered to form an opinion:**

The auditor shall form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. That conclusion shall take into account:

- (1) whether sufficient appropriate audit evidence has been obtained
- (2) whether uncorrected misstatements are material, individually or in aggregate.

(3) The evaluations required

- (i) The auditor shall evaluate whether the financial statements are prepared in accordance with the requirements of the applicable financial reporting framework.
- (ii) This evaluation shall include consideration of the qualitative aspects of the entity's accounting practices, including indicators of possible bias in management's judgments.

- (c) Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.

One of the premises for conducting an audit is that management acknowledges its responsibility of preparation of financial statements in accordance with applicable financial reporting framework and for devising suitable internal controls. However, such controls may not have operated to produce reliable financial information due to their own limitations.

Therefore, nature of financial reporting itself is one of causes inherent limitations of audit.

- (d) As per Standard on Auditing (SA) 705 "Modifications to the Opinion In The Independent Auditor's Report", the objective of the auditor is **to express clearly an appropriately modified opinion** on the financial statements that is necessary when:

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

5. (a) Audit of borrower client of bank carried out at bank's request to verify borrower's current assets- **Stock audit**

Limit up to which an entity can withdraw from sanctioned working capital limit- **Drawing power**

Statutory right of a creditor to adjust debit balance in debtor's account against any credit balance lying in another account of debtor- **Set-off**

Creation of security in a bank branch by mere delivery of title deeds by a prospective borrower of funds- **Equitable Mortgage**

- (b) Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. The understanding establishes a frame of reference within which the auditor

plans the audit and exercises professional judgment throughout the audit, for example, when:

1. Assessing risks of material misstatement of the financial statements
2. Determining materiality in accordance with SA 320
3. Considering the appropriateness of the selection and application of accounting policies
4. Identifying areas where special audit consideration may be necessary, for example, related party transactions, the appropriateness of management's use of the going concern assumption, or considering the business purpose of transactions
5. Developing expectations for use when performing analytical procedures
6. Evaluating the sufficiency and appropriateness of audit evidence obtained such as the appropriateness of assumptions and of management's oral and written representations.

**(c) Fee from Students:**

The fees concessions have to be under proper authority of college management. The auditor would verify internal controls in this regard. Besides, detailed checking of few cases needs to be undertaken to ensure genuineness of fees concessions and proper management approvals.

Other points to verify fee from students are :

1. Check names entered in the Students Fee Register for each month or term, with the respective Class Registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal control which ensures that demands against the students are properly raised.
2. Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
3. Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
4. Check admission fees with admission slips signed by the head of the institution and confirm that the amount has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
5. Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority.



6. Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded.
- (d) The audit engagement letter is sent by the auditor to his client. It is in the interest of both the auditor and the client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent. Such a letter includes:
- (a) The objective and scope of the audit of the financial statements
  - (b) The responsibilities of the auditor
  - (c) The responsibilities of management
  - (d) Identification of the applicable financial reporting framework for the preparation of the financial statements and
  - (e) Reference to the expected form and content of any reports to be issued by the auditor and a statement that there may be circumstances in which a report may differ from its expected form and content.
6. (a) **Risk of Material Misstatement – Greater for Significant Non-Routine Transactions:**
- Significant risks often relate to significant non- routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently.
- Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:
- (a) Greater management intervention to specify the accounting treatment.
  - (b) Greater manual intervention for data collection and processing.
  - (c) Complex calculations or accounting principles.
  - (d) The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.
- Keeping in view above, view of Auditor of Sunshine Ltd is correct.
- (b) While pointing out significant deficiencies in internal control, auditor has not only to communicate significant deficiencies giving their description but also explain the potential effects and sufficient information to those charged with governance and management to understand context of communication.
- Therefore, the above communication is not proper. Not only significant deficiency has to be communicated, it should also be explained to management the potential effects of not following the standard instructions/ procedures specified in relation to various aspects of sales as stipulated by the management. It should explain that such a significant deficiency can lead to misstatement of revenue and trade receivables impacting profits of the company. Highlighting importance of

such a control, it should be stated that responsibility be fixed for concerned persons for adhering to such an important control.

**OR**

- (c)** Some general principles have been laid down in the Audit Code, which have for long been recognised as standards of financial propriety. Audit against propriety seeks to ensure that expenditure conforms to these principles which have been stated as follows:
- (a) The expenditure should not be prima facie more than the occasion demands. Every public officer is expected to exercise the same vigilance in respect of expenditure incurred from public moneys as a person of ordinary prudence would exercise in respect of expenditure of his own money.
  - (b) No authority should exercise its powers of sanctioning expenditure to pass an order which will be directly or indirectly to its own advantage.
  - (c) Public moneys should not be utilised for the benefit of a particular person or section of the community unless:
    - (i) the amount of expenditure involved is insignificant; or
    - (ii) a claim for the amount could be enforced in a Court of law; or
    - (iii) the expenditure is in pursuance of a recognised policy or custom; and
    - (iv) the amount of allowances, such as travelling allowances, granted to meet expenditure of a particular type should be so regulated that the allowances are not, on the whole, sources of profit to the recipients.
  - (d)** The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant. Preliminary identification of material classes of transactions, account balances and disclosures helps auditor in establishing overall audit strategy. More energies need to be devoted to significant matters to obtain desired outcomes. Few examples are listed as under: -
    - Volume of transactions which may determine whether it is more efficient for the auditor to rely on internal control
    - Significant industry developments such as changes in industry regulations and new reporting requirements.
    - Significant changes in the financial reporting framework, such as changes in accounting standards.
    - Other significant relevant developments, such as changes in the legal environment affecting the entity.

- (e)** Clause (ix) (d) of CARO, 2020 whether funds raised on short term basis have been utilised for long term purposes, if yes, the nature and amount to be indicated.

In the given situation, funds have been raised for meeting working capital requirements for ₹ 4 crores. Cash credit facilities for meeting working capital requirements are, by their very nature, short term borrowings. Out of above, ₹ 1 crore have been used by the company for investment in effluent treatment plant which is ostensibly for a long-term purpose.

Hence, the matter needs to be reported in accordance with requirements of Clause (ix) (d) of CARO, 2020.