

Chapter 1 - Nature, Objective and Scope of Audit

Q1.	<p>Which of the following is not an advantage of audit?</p> <p>(a) It provides high quality financial information. (b) It acts as a moral check on employees. (c) It enhances risk of management bias. (d) It helps in safeguarding the interests of shareholders.</p> <p>(ICAI Study Material - Test Your Knowledge)</p>
	<p>Correct answer: (c) It enhances risk of management bias Explanation: Advantages of Audit are- provides high quality financial information, acts as a moral check on employees, helps in safeguarding interests of shareholders, helpful to government authorities, relied upon by lenders, detect fraud or error, and reviews existence and operations of various controls. "It enhances risk of management bias" is not an advantage of audit.</p>
Q2.	<p>Which of the following is NOT TRUE about an assurance engagement?</p> <p>(a) It relates to providing assurance about historical financial information only. (b) The practitioner obtains sufficient appropriate evidence. (c) There is some information to be examined by practitioner. (d) A written assurance report in appropriate form is issued by practitioner.</p> <p>(ICAI Study Material - Test Your Knowledge)</p>
	<p>Correct answer: (a) It relates to providing assurance about historical financial information only. Explanation: Assurance can also be related to matters other than historical financial information. Such an assurance may relate to prospective financial information. It may relate to providing assurance on internal controls in an entity. Hence, statement 1 is incorrect.</p>
Q3.	<p>Which of the following is TRUE about Engagement Standards?</p> <p>(a) Engagement standards ensure proper rights to practitioners in course of performance of their duties. (b) Engagement standards ensure preparation and presentation of financial statements in a standardized manner. (c) Engagement standards ensure uniformity by practitioners in course of performance of their duties. (d) Engagement standards ensure savings in resources of clients</p> <p>(ICAI Study Material - Test Your Knowledge)</p>
	<p>Correct answer: (c) Engagement standards ensure uniformity by practitioners in course of performance of their duties Explanation: Standards are needed for carrying out audits against established benchmarks, for improving quality of financial reporting, for promoting uniformity, for equipping professional accountants with professional knowledge & skill and for ensuring audit quality.</p>
Q4.	<p>Consider following statements in relation to "Limited assurance engagement":- Statement I - It involves obtaining sufficient appropriate evidence to draw reasonable conclusions. Statement II - Review of interim financial information of a company is an example of limited assurance engagement.</p> <p>(a) Statement I is correct. Statement II is incorrect. (b) Both Statements I and II are correct. (c) Both Statements I and II are incorrect. (d) Statement I is incorrect. Statement II is correct.</p> <p>(ICAI Study Material - Test Your Knowledge)</p>
	<p>Correct answer: (d) Statement I is incorrect. Statement II is correct Explanation: In reasonable assurance engagements, the practitioner obtains sufficient appropriate evidence to be able to draw reasonable conclusions. Whereas, in Limited assurance engagements, the practitioner obtains sufficient appropriate evidence to be able to draw limited conclusions. Therefore, statement 1 is incorrect. Example of SRE is SRE 2410 Review of Interim Financial Information Performed by the Independent Auditor of the Entity</p>
Q5.	<p>Which of the following is TRUE about Standards on auditing?</p>

	<p>(a) These deal mainly with voluntary responsibilities of auditors. (b) These deal mainly with mandatory responsibilities of auditors. (c) Their sole purpose is to help government authorities in augmenting revenues. (d) These deal mainly in carrying out audit according to legal provisions (ICAI Study Material - Test Your Knowledge)</p>
	<p>Correct answer: (b) These deal mainly with mandatory responsibilities of auditors. Explanation: Engagement Standards issued under the authority of Council of ICAI deal with responsibilities of auditor/practitioner.</p>
Q6.	<p>As explained in SA 200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", _____ is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level. (a) absolute assurance (b) limited assurance (c) reasonable assurance (d) reasonable or absolute assurance (Sample MCQs) (ICAI MCQs)</p>
	<p>Correct answer: (c) reasonable assurance Explanation:</p> <ul style="list-style-type: none"> • Absolute assurance means that there is absolutely no misstatement in the financial statement and thus financial statements are absolutely reliable and relevant for the user of financial statements. • On the other hand, reasonable assurance is also a high level of assurance but it means that auditor has conducted the audit in a way that he is reasonably sure (to the best possible extent) that financial statements are free from material misstatement but there might be some misstatements that go undetected due to inherent limitations of an audit.
Q7.	<p>As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are: (a) To obtain reasonable assurance (b) To report on the financial statements (c) Both (a) and (b) above (d) to obtain absolute assurance. (ICAI MCQs)</p>
	<p>Correct answer: (c) Both (a) and (b) above Explanation: The objective of the auditor as per SA 200 is to obtain reasonable assurance about whether FS as a whole are free from material misstatement, whether due to fraud or error and to report on FS and communicate as required by SAs.</p>
Q8.	<p>An employee of Fruits and Vegetables Limited was of the opinion that auditor of a company is required to express an opinion. On which one of the following the auditor of a company is required to express an opinion: (a) Only Balance Sheet of the Company. (b) Financial Statements of the Company. (c) Only Profit and Loss Account of the Company. (d) Only Cash Flow Statement of the Company. (ICAI MCQs)</p>
	<p>Correct answer: (b) Financial Statements of the Company. Explanation: The auditor is required to express an opinion on the Financial Statements. Financial statements include Balance Sheet, Profit and Loss Account and Cash Flow Statement.</p>
Q9.	<p>The auditor of Delicious Sweets Limited was of the opinion that the objective of audit of financial statements of a company is to provide reasonable assurance that financial statements of that company are free from misstatements. Which type of misstatements are mentioned by auditor of Delicious Sweets Limited:</p>

	<p>(a) Simple (b) Material (c) Easy (d) Competent (ICAI MCQs)</p>
	<p>Correct answer: (b) Material Explanation: The objective of audit is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion.</p>
Q10.	<p>_____ along with other disciplines such as accounting and law, equips you with all the knowledge that is required to enter into auditing as a profession. (a) Auditing (b) Taxation (c) Finance (d) Law (ICAI MCQs)</p>
	<p>Correct answer: (a) Auditing</p>
Q11.	<p>No business or institution can effectively carry on its activities without the help of proper _____: (a) Audit (b) Record and accounts (c) neither (a) nor (b) (d) both (a) and (b) (ICAI MCQs)</p>
	<p>Correct answer: (b) Record and accounts</p>
Q12.	<p>Which of the following is the responsibility of the auditor: (a) Preparation and presentation of the financial statements in accordance with applicable financial reporting (b) Design, implementation and maintenance of internal controls (c) Express an opinion on the Financial Statements (d) To obtain limited assurance (ICAI MCQs) (MTP2, May 2022, 1 mark)</p>
	<p>Correct answer: (c) Express an opinion on the Financial Statements Explanation:</p> <ul style="list-style-type: none"> • The responsibility of the auditor is to obtain reasonable assurance about whether the FSs as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the FSs are prepared, in all material respects, in accordance with AFRF.; • Management is responsible for design, implementation and maintenance of IC and preparation and presentation of the FS as per AFRF.
Q13.	<p>_____ refers to a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. (a) Misstatement (b) Error (c) Fraud (d) Any of the above (Sample MCQs) (ICAI MCQs) (MTP2, May 2019, 1 Mark) (MTP1, Nov 2019, 1 Mark)</p>
	<p>Correct answer: (a) Misstatement Explanation:</p>

	<ul style="list-style-type: none"> • Misstatement refers to a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements in the financial statements can arise from either fraud or error. • Fraud can be committed by anyone such as management, TCWG, employees and third parties. Such an act has been committed using unfair means and is an intentional activity (deliberate action) to gain personal benefit directly or indirectly illegally. While errors are acts of unintentional mistakes or negligence which can be detected easily.
Q14.	<p>Which of following is false about meaning /nature of auditing?</p> <p>(a) Its basic nature lies in providing assurance to users of financial statements. (b) It is interdisciplinary in nature. (c) It is independent examination of financial statements of listed entities alone. (d) Its nature helps in providing comfort that financial statements are not misleading.</p> <p>(BOS Portal MCQs)</p>
	Correct answer: (c) It is independent examination of financial statements of listed entities alone.
Q15.	<p>Which of the following is not included in scope of audit of financial statements?</p> <p>(a) Proper disclosure of financial information (b) Expression of opinion (c) Preparation and presentation of financial statements (d) Reliability and sufficiency of financial information</p> <p>(BOS Portal MCQs)</p>
	Correct answer: (c) Preparation and presentation of financial statements
Q16.	<p>Which of following is not one of objectives of auditor in accordance with SA 200?</p> <p>(a) To obtain a reasonable assurance whether financial statements as a whole are free from material misstatement (b) To report on the financial statements (c) To communicate in accordance with auditor's findings as required by Standards on Auditing. (d) To obtain an absolute assurance that financial statements are free from any fraudulent transaction</p> <p>(BOS Portal MCQs)</p>
	Correct answer: (d) To obtain an absolute assurance that financial statements are free from any fraudulent transaction
Q17.	<p>In order to express an opinion on the financial statements, the auditor needs to satisfy himself that</p> <ol style="list-style-type: none"> the accounts have been drawn up with reference to entries in the books of account which are adequately supported by sufficient and appropriate evidence. none of the entries in the books of account has been omitted in the process of compilation and nothing which is not in the books of account has found place in the statements the information conveyed by the statements is clear and unambiguous. The financial statement amounts are properly classified, described and disclosed in conformity with accounting standards the statement of accounts present a true and fair picture of the operational results and of the assets and liabilities. <p>(a) I, II (b) I, II, III (c) II, III, IV (d) I, II, III, IV</p> <p>(BOS Portal MCQs)</p>
	Correct answer: (d) I, II, III, IV
Q18.	<p>_____ framework means a framework adopted in the preparation and presentation of the financial statements that is acceptable in view of the nature of the entity and the objective of the financial statements, or that is required by law or regulation.</p> <p>(a) Financial reporting</p>

	<p>(b) Applicable financial reporting (c) Financial verification (d) Financial analysis (BOS Portal MCQs)</p>
	Correct answer: (b) Applicable financial reporting
Q19.	<p>An auditor of financial statements expresses opinion: - (a) In accordance with management's requirements (b) In accordance with directions of appointing authority (c) In accordance with auditor's findings (d) In accordance with requirements of users (BOS Portal MCQs)</p>
	Correct answer: (c) In accordance with auditor's findings
Q20.	<p>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 are responsibilities of: (a) Statutory Auditor (b) Internal Auditor (c) Legal counsel (d) Management (BOS Portal MCQs)</p>
	Correct answer: (d) Management
Q21.	<p>ZETA Private Limited is a recently established start-up formed with objective for promoting use of polyhouses and offering farmers necessary know-how for setting up such structures. Polyhouses enable farmers to grow good quality crops like vegetables throughout the year. At a meeting, directors discuss about pros and cons of independent audit of financial statements in a start-up like theirs. Which of following statements is false in this regard? (a) It is mandatory requirement for their start-up. There are no choices. (b) Audited financial statements may be used by start-up for obtaining funds from prospective investors. (c) Such an audit can point out deficiencies in internal control system of start-up's business. (d) Such an audit would necessarily result in reflection of higher profits leading to higher income tax liabilities for start-up. (BOS Portal MCQs)</p>
	Correct answer: (d) Such an audit would necessarily result in reflection of higher profits leading to higher income tax liabilities for start-up.
Q22.	<p>Audited financial statements are not a guarantee against probable wrong doings in financial matters of companies. What kind of assurance does audit of financial statements provide? (a) It provides reasonable assurance meaning a moderate level of assurance. (b) It provides reasonable assurance meaning a low level of assurance. (c) It provides reasonable assurance meaning a high level of assurance. (d) It provides reasonable assurance meaning an absolute level of assurance. (BOS Portal MCQs) (MTP1, Sep 2024, 2 Marks)</p>
	Correct answer: (c) It provides reasonable assurance meaning a high level of assurance.
Q23.	<p>Identify the most appropriate statement: - (a) Prospective financial information relates to future events. Since no evidence is available to support the assumptions on which prospective financial information is based, auditor is not in a position to express an opinion whether results shown in prospective information will be achieved. (b) In assurance reports involving prospective financial information, Standards on Auditing apply. (c) In assurance engagements involving prospective financial information, practitioner provides a report assuring that nothing has come to practitioner's attention to suggest that assumptions do not provide a reasonable basis for the</p>

	<p>projection.</p> <p>(d) In assurance engagements involving prospective financial information, practitioner provides a report assuring that nothing has come to practitioner's attention to suggest that assumptions provide a reasonable basis for the projection.</p> <p>(BOS Portal MCQs)</p>
	<p>Correct answer: (c) In assurance engagements involving prospective financial information, practitioner provides a report assuring that nothing has come to practitioner's attention to suggest that assumptions do not provide a reasonable basis for the projection.</p>
Q24.	<p>Inherent limitations of an audit of financial statements arise due to a number of factors. Which of the following is not such a factor?</p> <p>(a) Practical limitations on ability of auditor to obtain audit evidence (b) Legal limitations on ability of auditor to obtain audit evidence (c) Involvement of subjective judgments in preparation of financial statements (d) Ability of auditor to accept valid evidence due to high professional knowledge</p> <p>(BOS Portal MCQs)</p>
	<p>Correct answer: (d) Ability of auditor to accept valid evidence due to high professional knowledge</p>
Q25.	<p>One of your junior audit team members is confused with the term 'material misstatement'. You explain to him that a material misstatement is untrue information in a financial statement that could affect the financial decisions of one who relies on the statement. Which of the following would constitute material misstatement?</p> <p>(1) An error of ₹ 5,000 in relation to assets of ₹ 20 lakhs. (2) A payroll fraud of ₹100 in a company where profit before tax is ₹11,000. (3) Non-disclosure of a material uncertainty. (4) Financial statements have been prepared on a going concern basis when the company is in the process of being liquidated.</p> <p>(a) 1 and 2 (b) 3 and 4 (c) 2 and 3 (d) 1 and 4</p> <p>(MTP2, May 2019, 2 Marks)</p>
	<p>Correct answer: (b) 3 and 4</p> <p>Explanation:</p> <ul style="list-style-type: none"> • An error of ₹ 5,000 i.e. an unintentional mistake in the financial information does not constitute a material misstatement. Payroll fraud of ₹ 100 is immaterial. • However, Non-disclosure of a material uncertainty and financial statements have been prepared on a going concern basis when the company is in the process of being liquidated would constitute material misstatement as such misstatements can impact the economic decisions of the users of the financial statements. • A material misstatement is information in the financial statements that is sufficiently incorrect that it may impact the economic decisions of the users of the financial statements. • There are some factors that can be considered while deciding if a misstatement is material or not. Factors are: the comparative size of the misstatement, the nature of the misstatement, the relationship to other misstatements, the inherent character of the mistake.
Q26.	<p>Which of the following is correct :</p> <p>(a) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. (b) The auditor is expected to and can reduce audit risk to zero and can therefore obtain absolute assurance. (c) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain reasonable assurance that the financial statements are free from material misstatement due to fraud or error. (d) The auditor is expected to and can reduce audit risk to zero and can therefore obtain reasonable assurance that the financial statements are free from material misstatement due to fraud or error.</p> <p>(MTP2, May 2019, 1 Mark)</p>

	<p>Correct answer: (a) the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.</p>
Q27.	<p>M/s KYC & Co. is a reputed Audit firm in Mumbai. They are appointed as Statutory Auditors of Blessed Ltd. Which of the below is the responsibility of M/s KYC & Co.</p> <p>(a) Preparation of financial statements (b) Designing, implementation and maintenance of internal control system (c) Reporting on true and fair view of financial statements (d) Compliance with the applicable law and regulation (RTP, Nov 2020, NA)</p> <p>Correct answer : (c) Reporting on true and fair view of financial statements Explanation: The responsibility of M/s KYC & Co. i.e. audit firm is to express opinion as to whether the financial statements exhibit a true and fair view of the affairs of the entity. The management is responsible for preparation of financial statements, designing, implementation and maintenance of internal control systems and compliance with the applicable law and regulation.</p>
Q28.	<p>The persons with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity are :</p> <p>(a) Management (b) those charged with governance (c) audit committee (d) board of directors (RTP, May 2021, NA) (MTP1, May 2021, 1 Mark) (RTP, Nov 2021, NA) (RTP, Nov 2023, NA) (MTP2, Nov 2023, 1 mark)</p> <p>Correct answer: (b) those charged with governance Explanation:</p> <ul style="list-style-type: none"> • Management : The person(s) with executive responsibility for the conduct of the entity's operations. Management is responsible for the day to day work and implementing the policies framed by TCWG. • Those charged with governance: TCWG are responsible for strategic decisions. TCWG supervises the work done by the management and is responsible for approving the financial statements. TCWG is a higher authority. For example - Board of Directors, corporate trustee • Management and TCWG can be the same in some entities, say in small organisations.
Q29.	<p>Owing to the _____ limitations of an audit, there is _____ risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.</p> <p>(a) Inherent, unavoidable (b) Inherent, complete (c) Management, unavoidable (d) Regulatory, control (MTP1, May 2022, 1 mark)</p> <p>Correct answer: (a) Inherent, unavoidable</p>
Q30.	<p>With respect to auditing, which of the following statement is correct:</p> <p>(a) Audited financial statements are absolutely free from all material misstatement due to fraud or error. (b) An audit is an official investigation into alleged wrongdoing and auditor has specific legal powers to conduct investigation (c) The auditor can obtain only a reasonable assurance about whether the financial statement as a whole are free from material misstatement and report on it. (d) An auditor's opinion is an assurance as the future viability of the enterprise or the efficiency or effectiveness of the management. (MTP2, May 2023, 1 mark)</p> <p>Correct answer: (c) The auditor can obtain only a reasonable assurance about whether the financial statement as a whole are free from material misstatement and report on it.</p>

	<p>Explanation:</p> <ul style="list-style-type: none"> • Statement 1 is incorrect as Audited financial statements are not absolutely free from all material misstatement due to fraud or error. The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. • Statement 2 is incorrect as an audit is not an official investigation into alleged wrongdoing and the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation. • Statement 4 is incorrect as the user should not assume that the auditor's opinion is an assurance as to the future viability of the enterprise or the efficiency or effectiveness with which management has conducted the affairs of the enterprise.
Q31.	<p>During the course of audit of a company, it is noticed by the auditor that Profit before tax of the company is Rs. 5 lakhs. Depreciation on building reflected in the 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 _____?</p> <p>(a) Misstatement (b) Assertion (c) Sampling method (d) Audit risk</p> <p>(MTP2, May 2024, 2 Marks)</p> <p>Correct answer: (a) Misstatement</p> <p>Explanation: A misstatement occurs when something has not been treated correctly in FS, meaning that AFRF has not been properly applied. Examples of misstatement, which can arise due to error or fraud, could include an incorrect amount has been recognised, an item is classified incorrectly, presentation is not appropriate, disclosure is not correct or misleading disclosure has been included as a result of management bias.</p>
Q32.	<p>A practicing Chartered Accountant is appointed by a company to perform certain agreed-upon procedures relating to its trade payables. Such agreed upon procedures include verifying listing with books of accounts, sending confirmation letters and reporting factual discrepancies to company management. Which of statements is correct in this context?</p> <p>(a) The practicing CA shall perform work in accordance with Standards on Related Services and SA 220. (b) The practicing CA shall perform work in accordance with Standards on Related Services and SQC 1. (c) The practicing CA shall perform work in accordance with Standards on Auditing including SA 220. (d) The practicing CA shall perform work in accordance with Standards on Assurance Engagements and SQC 1.</p> <p>(MTP2, Sep 2024, 2 marks)</p> <p>Correct answer: (b) The practicing CA shall perform work in accordance with Standards on Related Services and SQC 1.</p> <p>Explanation: Standards on Quality Control (SQCs) are to be applied for all services covered by Engagement Standards. Standards on Related Services apply in engagements to perform agreed-upon procedures regarding financial information.</p>

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