



CA Inter Audit Test-6 (SA 500/501/505)

Time: 1 Hour

Marks: 30 Marks

Instructions:

- Reading time: 5 mins
- Do **underline key words** while presenting answer
- Leave **proper spacing** between 2 points/paras
- Do quote SA No. with Name only wherever applicable.

MCQs [10 Marks (5Q * 2 Marks each)]

CA Drishti Khandelwal is conducting audit of a company engaged in manufacturing of towels and bedspreads. The company is having its own manufacturing set-up. However, it also gets some manufacturing processes outsourced from third parties. The company has three locations having substantial quantities of inventories in the same city. Besides, due to outsourcing of some processes, inventories are also held in premises of third parties in the same city. As part of audit procedures, she is performing many audit procedures required by different Standards on Auditing.

In particular, she is attending physical inventory count process of the company at year end in accordance with requirements of SA 501. The inventory of the company includes raw materials consisting mainly of natural and dyed yarns, work in process in different stages of manufacturing and finished stocks of towels and bedspreads.

She is also planning sending confirmations to parties to whom the company has sold goods. On reviewing trade receivables list, she finds that the list also contains large number of parties having small balances. She further finds that these receivables have arisen due to sale of bedspreads to small time retailers and possibility of difference in balances as per company's records and as per records of these small-time retailers is low. Risk of misstatements in relation to trade receivables has been assessed as low. Besides, there is nothing to suggest that small-time retailers would disregard such requests.

While conducting audit, she is testing controls operating in the company. She is also conducting tests of various items of income and expenditure as well as balances appearing in balance sheet. She intends to rely upon sampling extensively.

Based on above description, answer the following questions:

1. Which of the following statements is most appropriate regarding inventory count by auditor in accordance with SA 501?

- a. She should inspect the inventory to ascertain its existence and condition at all locations, observe how company personnel are carrying out count procedures and perform test counting.
- b. She should inspect the inventory to ascertain its existence at all locations, observe how company personnel are carrying out count procedures and perform test counting. The matter of condition of inventories falls in domain of expert.



- c. She should inspect the inventory to ascertain its existence at selected location, observe how company personnel are carrying out count procedures and perform test counting. The matter of condition of inventories falls in domain of expert.
- d. She should inspect the inventory to ascertain its existence and condition at all locations and perform counting of each and every item.

2. As regards inventories lying with third parties, which of following statements meets requirements of SA 501?

- a. She should request confirmation from third parties regarding quantity and condition of inventories held on behalf of the company as well as request third parties to allow her to inspect inventories held by them. Both requirements are necessary to be complied with.
- b. She should request confirmation from third parties regarding quantity and condition of inventories held on behalf of the company or request third parties to allow her to inspect inventories held by them. Compliance of any one of these or both is required for purposes of SA 501.
- c. There is no obligation cast upon an auditor in respect of inventories lying with third parties.
- d. She should request confirmation from third parties regarding quantity, condition and value of inventories held on behalf of the company or request third parties to allow her to inspect inventories held by them. Compliance of any one of these is sufficient for purposes of SA 501.

3. Keeping in view description regarding trade receivables, identify the most appropriate statement in context of SA 505?

- a. She should not plan and design confirmation requests for large number of parties having small balances.
- b. She should plan and design positive confirmation requests for large number of parties having small balances.
- c. She should plan and design positive confirmation requests for large number of parties having small balances and meticulously analyse exception rate
- d. She should plan and design negative confirmation requests for large number of parties having small balances.

4. As regards sampling, which of the following statements is most appropriate in terms of requirements of SA 530?

- a. Sampling is used in tests of transactions as well as tests of controls.
- b. Sampling is used in tests of balances as well as tests of controls.
- c. Sampling is used in tests of details.
- d. Sampling is used in tests of details as well as tests of controls.

5. Since she intends to rely upon sampling extensively, which of the following statements is true about sampling risk?

- a. Sampling risk can be eliminated.
- b. Increase in sampling risk would lead to decrease in detection risk.
- c. Decrease in sampling risk would lead to increase in detection risk.
- d. Sampling risk will always be in existence.



Descriptive Questions [20 Marks]

1. Patanjali Foods Ltd is manufacturer of pickles, ginger garlic paste, jams etc having its plant at Haridwar. Being in food industry, the company is facing many litigations in various courts across India. Auditors Ramdev & Co. wants to identify such litigations and claims involving the company which may give rise to risk of material misstatement. Guide the auditor as to how they should proceed for the purpose.

[3M]

2. Zoom TV Ltd has been into the media business since 1990. During the F.Y 2023-2024 many notices were received by the company for hurting public sentiments and financial claims were filed against the company. As an auditor of the company, you requested the management for arranging the meeting with company's external legal counsel. Management is of the view that such meetings are necessary in some certain circumstances only. Can you list down those certain circumstances?

[3M]

3. Expert Industries Limited is engaged in petrochemical business. Due to nature of its business, the company has hired PQR Associates, a reputed firm of chartered engineers, to determine the quantity and valuation of inventories for preparation of financial statements. The auditor of Expert Industries Limited want to use the same as audit evidence. Before using the work of PQR Associates, management's expert, what aspects should be taken care by auditor?

[4M]

4. CA P is the auditor of MN Ltd. While scrutinising the accounts of MN Ltd., he observed that the company had large volume of Trade payable outstanding in the Balance sheet as on 31st March, 2024 for which external confirmations are not available, CA P wants to send external confirmation request to selected Trade payables but management of MN Ltd . refused for the same. Discuss how CA P should deal in this regard as per relevant Standard on Auditing.

[5M]

5. Quality Products Limited is engaged in manufacturing of bicycles. As part of manufacturing activities, it sends raw material to some business entities and procures finished components from them. As on 31st March 2024 inventories lying with such business entities are material. Being statutory auditor of Quality Products Limited, how you will obtain sufficient appropriate audit evidence regarding existence and condition of inventories lying with such business entities?

[5M]