### Division A - Multiple Choice Questions

#### Case Scenario 1

<table>
<thead>
<tr>
<th>Question No.</th>
<th>Answer</th>
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<tbody>
<tr>
<td>1.1</td>
<td>(b) To verify deferred tax asset likely created in financial statements in accordance with AS 22</td>
</tr>
<tr>
<td>1.2</td>
<td>(b) The company’s accounting treatment of treating cost of CDs with software costs as intangible assets is proper.</td>
</tr>
<tr>
<td>1.3</td>
<td>(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.</td>
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<tr>
<td>1.4</td>
<td>(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.</td>
</tr>
<tr>
<td>1.5</td>
<td>(c) prescribed under Schedule II to Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule II.</td>
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#### Case Scenario 2

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<tr>
<th>Question No.</th>
<th>Answer</th>
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<tr>
<td>2.1</td>
<td>(a) 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.</td>
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<td>2.2</td>
<td>(c) Separate determination of materiality and identifying &amp; 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.</td>
</tr>
</tbody>
</table>
2.3 (a) During year 2023-24, inventories of Branch I have moved faster in comparison to Branch II.

2.4 (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.

Case Scenario 3

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

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<tbody>
<tr>
<td>(a)</td>
<td>amount required to be spent by the company during the year</td>
</tr>
<tr>
<td>(b)</td>
<td>amount of expenditure incurred</td>
</tr>
<tr>
<td>(c)</td>
<td>shortfall at the end of the year</td>
</tr>
<tr>
<td>(d)</td>
<td>total of previous years shortfall</td>
</tr>
<tr>
<td>(e)</td>
<td>reason for shortfall</td>
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<tr>
<td>(f)</td>
<td>nature of CSR activities - Women empowerment activities through implementing agency</td>
</tr>
<tr>
<td>(g)</td>
<td>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</td>
</tr>
<tr>
<td>(h)</td>
<td>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</td>
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(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. 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) | **Column A (Description of control in an automated environment)** | **Column B (Type of control)** |
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<tbody>
<tr>
<td>Reasonableness checks</td>
<td>Application controls</td>
</tr>
<tr>
<td>Controls over Data centre and network operations</td>
<td>General IT controls</td>
</tr>
<tr>
<td>Controls over application system acquisition, development and maintenance</td>
<td>General IT controls</td>
</tr>
<tr>
<td>Program change controls</td>
<td>General IT controls</td>
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(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.