

### MCOs for Practical Training Accounting +Auditing+ Law – Level 1

1. The management of Magoo Ltd. has developed a strong internal control in its accounting system in such a way that the work of one person is reviewed by another. Since no individual employee is allowed to handle a task alone from the beginning to the end, the chances of early detection of frauds and errors are high. CA. Olive has been appointed as an auditor of the company for current Financial Year 2017-18. Before starting the audit, she wants to evaluate the internal control system of Magoo Ltd. To facilitate the accumulation of the information necessary for the proper review and evaluation of internal controls, CA. Olive decided to use internal control questionnaire to know and assimilate the system and evaluate the same. Which of the following questions need not be framed under internal control questionnaire relating to purchases?
- (a) Are authorized signatories for purchases limited to elected officials?
  - (b) Are payments approved only on original invoices?
  - (c) Does authorized officials thoroughly review the documents before signing cheques?
  - (d) Are monthly bank reconciliations implemented for each and every bank accounts of the company?

**Answer** (d) Are monthly bank reconciliations implemented for each and every bank accounts?

**Reason:** Question based on bank reconciliation is not related to purchases, thus, needs to be framed under questionnaire relating to bank accounts of the company.

2. CA. Bobby is a recently qualified Chartered Accountant. He is appointed as an auditor of Droopy Ltd. for the current Financial Year 2017-18. He is quite conservative in nature which is also replicated in his professional work. CA. Bobby is of the view that he shall record all the matters related to audit, audit procedures to be performed, audit evidence obtained and conclusions reached. Thus, he maintained a file and recorded each and every of his findings during the audit. His audit file, besides other thing, includes audit programmes, notes reflecting preliminary thinking, letters of confirmation, e-mails concerning significant matters, etc. State which of the following need not be included in the audit documentation?
- (a) Audit programmes.
  - (b) Notes reflecting preliminary thinking.
  - (c) Letters of confirmation.
  - (d) E-mails concerning significant matters.

**Answer** . (b) Notes reflecting preliminary thinking.

**Reason:** As per SA 230 'Audit Documentation', the auditor need not include in audit documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

3. The notes to the account statement of ASD Ltd. shows the break-up of accounts payable for the Financial Year 2016-17 as follows:

Accounts Payable	Amount (in Rs.)
Mr. Kraby	1,20,000
Mr. Runny	40,000
Mr. Bluffy	14,56,000
<b>Total</b>	<b>16,16,000</b>

CA. Sandy, the auditor of ASD Ltd., wants to investigate the valuation of accounts payable of Mr. Bluffy amounting to Rs. 14,56,000. Which of the following procedures is best fitted & more reliable to be followed by CA. Sandy to get more reliable evidence for the existence of such balance as on 31<sup>st</sup> March, 2017?

- (a) Inspect each and every journal entry passed in the books of ASD Ltd.
- (b) Ask ASD Ltd. to provide the details of payment made during the year 2017-18.
- (c) Inspect the invoices issued by Mr. Bluffy and the payments made.
- (d) Interrogate the cash manager of ASD Ltd.

**Answer** (c) Inspect the invoices issued by Mr. Bluffy and the payments made.

**Reason:** Invoices issued by Mr. Bluffy is an external evidence as it has been originated outside the client's organization. External evidence is generally considered to be more reliable as they come from third parties who are normally not interested in manipulation of the accounting information of others.

4. Misstatements in the financial statements can arise either from fraud or error. The auditor is concerned with fraud that causes a material misstatement in the financial statements which may further be classified as fraudulent financial reporting or misappropriation of assets.

There are certain events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud which may be termed as fraud risk factors. Which of the following is an example of fraud risk factor relating to misstatements arising from misappropriation of assets?

- (a) Known history of violations of laws and regulations.
- (b) Management failing to remedy known significant deficiencies in internal control on a timely basis.
- (c) Inventory items that are small in size, but of high value or in high demand.
- (d) An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.

**Answer** (c) Inventory items that are small in size, but of high value or in high demand.

**Reason:** Inventory items that are small in size, but of high value or in high demand is an example of risk factors related to misstatements arising from misappropriation of assets. On the other hand, Known history of violations of laws and regulations, management failing to remedy known significant deficiencies in internal control on a timely basis, an interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons are examples of risk factors related to misstatements arising from fraudulent financial reporting.

5. In July, 2018, M/s Tom & Co. entered into an agreement with M/s Jerry & Co. under which a machinery would be let on hire and M/s Jerry & Co. would have the option to purchase the machinery in accordance with the terms of the agreement. Thus, M/s Jerry & Co. agreed to pay M/s Tom & Co. a settled amount in periodical instalments. The property in the goods shall be passed to M/s Jerry & Co. on the payment of last of such instalments. While checking such hire-purchase transaction, what would the auditor examine?

- (a) That the periodical instalments paid are charged as an expenditure by M/s Jerry & Co.
- (b) That the hire purchase agreement specifies clearly the hire-purchase price of the machinery to which the agreement relates.
- (c) That M/s Tom & Co. charges depreciation throughout the life of the machinery.
- (d) All of the above.

**Answer** (b) **Reason:** While checking the hire-purchase transaction, the auditor may examine that the hire purchase agreement specifies clearly the hire-purchase price of the goods to which the agreement relates. The accounting treatment of installments paid and the charging of depreciation as provided under other options are wrong.

6. The management of BOB Ltd. could not differentiate between any obligation for which either provisions need to be made or the contingent liability to be shown. The auditor of the company clarifies the management that the provisions are the amounts charged against revenue to provide for a known liability, the amount whereof cannot be determined with substantial accuracy. On the other hand, a contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability. The auditor further explains the concept with the help of examples. State which of the following examples the auditor must have provided in respect of contingent liability?
- (a) Depreciation.
  - (b) Clean-up costs for unlawful environmental damage.
  - (c) Product warranties.
  - (d) Lawsuit against the company where it is more likely that no present obligation exists.

**Answer (d)** Lawsuit against the company where it is more likely that no present obligation exists.

**Reason:** As provided under AS 29 'Provisions, Contingent Liabilities and Contingent Assets', in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an enterprise determines whether a present obligation exists at the balance sheet date by taking account of all available evidence, including, for example, the opinion of experts. On the basis of such evidence where it is more likely that no present obligation exists at the balance sheet date, the enterprise discloses a contingent liability.

7. Toddler Innaya is a charitable institution running hostel for students pursuing different field of professional courses. The hostel charges only Rs. 600 per month as rental from students but a fine of Rs. 100 per day for late entry after 10:00 p.m. M/s Strong & Co., the audit firm, have been appointed as an auditor of the hostel. The audit firm allotted different areas to be examined between all of its partners. You, being one of the partners, have been assigned verification of receipts of the hostel. State which of the following need not be examined by you with respect to receipts of the hostel.
- (a) Amounts received on account of monthly rental and receipts issued for the same.
  - (b) Rental receipts and register maintained comprising students' information.
  - (c) Additional amounts received on account of fines, penalties, etc.
  - (d) Eligibility of institution for income tax exemption.

**Answer (d)** Eligibility of institution for income tax exemption.

**Reason:** Check for the eligibility of institution for income tax exemption is not a part of receipts of hostel thus, needs to be examined by another partner.

8. An entity in addition to undertaking purchases and incurring employee benefit expenses also spends on other expenditure that are essential and incidental to running of business operations. One of such expenses is the legal and professional expenses. These are the fees paid for professional advices regarding specific deals. Iconic Ltd. is having a retainership agreement with a lawyer, Mr. Avi, to whom the company is paying a huge sum as legal and professional expenses on monthly basis. While vouching such expenses, what should be kept in mind by the auditor?
- (a) In case of monthly retainership agreements, only verify if the expenditure for all 12 months has been recorded correctly.
  - (b) The auditor should verify that the payments have been only through bank vouchers.
  - (c) The auditor should be cautious while vouching for legal expenses as the same may highlight a dispute for which the entity may not have made any provision and the matter may also not have been discussed/ highlighted to the auditor for his specific consideration.

- (d) In case of monthly retainership agreements, only verify that all the payments have been made and there is no outstanding balance to be shown as liability in the Balance Sheet.

**Answer (c)**      **Reason:** While vouching legal and professional expenses, the auditor should be cautious as the same may highlight a dispute for which the entity may not have made any provision and the matter may also not have been discussed/ highlighted to the auditor for his specific consideration.

9. OPPOLO MOUNT is a renowned hospital running across the country. CA. Pooh, a newly qualified Chartered Accountant, has been appointed as an auditor of the hospital for the current Financial Year. Being a new-fangled in the audit of hospitals, he request you to kindly guide him regarding auditing the same. State which of the following audit procedures needs to be performed while auditing the receipts from patients of a hospital?

- (a) Verify that grants, if any, received from Government or local authority has been duly accounted for.
- (b) Compare the totals of various items of expenditure with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
- (c) Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence, for example, copies of patients' bills.
- (d) None of the above.

**Answer (c)**      Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence, for example, copies of patients' bills.

**Reason:** Question is specifically asking for audit procedure to be performed while auditing the receipts from patients of a hospital thus, cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence, for example, copies of patients' bills needs to be checked.

10. With the shift in favour of formal internal controls in the management of affairs of BEN Ltd., the possibilities of routine errors and frauds have greatly diminished and the auditor, CA. Nohara, finds extensive routine checking as nothing more than a ritual because it seldom reveals anything material. Therefore, he decided to select the sample without following a structured technique. Although no structured technique is used, CA. Nohara would nonetheless avoid any conscious bias or predictability and thus attempt to ensure that all items in the population have a chance of selection. What method of sample selection is he following?

- (a) Simple Random Sampling.
- (b) Systematic Sampling.
- (c) Block Sampling.
- (d) Haphazard sampling.

**Answer (d)** Haphazard sampling.

**Reason:** Haphazard selection is one of the sample selection methods, in which the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability (for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection.