

CA INTER RTP, MTP & SM CASE SCENARIOS FOR MAY 24

Particulars	No of Case scenarios
RTP May 24	
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ICAI SM 23	
Chapter No	
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7	1
8	1
9	1
10	1
11	1
Total SM Case scenarios	14

Multiple Choice Questions based on Case Scenarios

(RTP MAY 24)

Case Scenario I

	(M24R)
<p>DS & Co., Chartered Accountants, are statutory auditors of SAR Industries Pvt Ltd, a company engaged in manufacturing business since 2018. The company is operating from rented premises and it does not have building of its own. It had upgraded its machinery last time in 2020. Except interest in this company, promoters, directors, key managerial persons and their relatives do not have interest or ownership in any other entity. Also, the company does not enter into any business dealings with promoters, directors, key managerial persons and their relatives. The directors and key managerial persons get only reasonable remuneration from the company. Though company has</p>	

an internal control system in place, it has not appointed internal auditor. It is also not mandatorily required to make such an appointment under the provisions of the Companies Act, 2013.

DS & Co. have accepted audit of the above company for year 2022-23 for the first time. Promoters and directors of the company are known to engagement partner only socially for quite some time. However, it is for the first time that any type of professional work related to this company has been accepted by them.

While formulating audit plan for the company, CA D (engagement partner) has planned certain risk assessment procedures and further audit procedures consisting of tests of controls and substantive procedures in relation to different areas.

The following is extract of financial information of the company: -

(figures in rupees crores)

S. No.	Particulars	Year 2022-23	Year 2021-22
1.	Turnover	30.00	15.00
2.	Inventories	5.00	2.00
3.	Property, plant and equipment (Gross block)	1.25	1.25
4.	Property, plant and equipment (Net block)	1.00	1.25
5.	Gross profit	6.00	3.75
6.	Trade receivables	12.50	5.00

The PPE items consist of machinery only. While planning procedures in respect of Property, Plant and Equipment, auditor has included audit procedures like inspecting and reviewing company's plan for performing physical verification of PPE, assessing depreciation method used, verifying cost of PPE items acquired during the year with purchase bills and recalculation of depreciation charged in statement of profit and loss.

Further, while performing risk assessment procedures to identify risk of material misstatements in financial statements, engagement partner has come to notice that there is considerable variation in gross profit ratio as compared to last year. During performance of substantive procedures, he has also studied data of purchases and sales of the company during the year under audit and has also compared such data with preceding year and earlier years also.

Based on above, answer the following questions: -

I. Keeping in view description provided in the case scenario, which of the following statements is likely to be most appropriate?

- Engagement partner is known socially to promoters and directors of the company. The situation mandatorily involves advocacy threat casting a doubt on auditor's independence. Irrespective of this, detection risk in engagement is low.
- Engagement partner is known socially to promoters and directors of the company. The situation mandatorily involves familiarity threat casting a doubt on auditor's independence. Irrespective of this, detection risk in engagement is high.
- The situation reflected in the case scenario may not constitute threat to independence of auditor. Irrespective of this, detection risk in engagement is low.
- The situation reflected in the case scenario may not constitute threat to independence of auditor. Irrespective of this, detection risk in engagement is high.

II. CA D has included in audit plan certain procedures in respect of PPE items. Which of the following audit procedure included in audit plan is not likely to be relevant?

- Inspecting and reviewing company's plan for physical verification of PPE
- Assessing depreciation method used
- Verifying cost of PPE items acquired during the year with purchase bills
- Recalculation of depreciation charged in statement of profit and loss

III. Which of the following statements is likely to be most suitable to explain the fact relating to variation in gross profit ratio as compared to last year?
<p>(a) Gross profit ratio has decreased in year 2022-23 as compared to year 2021-22. It may be due to the reason that sales prices may have been reduced by the company to procure more orders.</p> <p>(b) Gross profit ratio has increased in year 2022-23 as compared to year 2021-22. It may be due to the reason that cost of materials purchased by company could have decreased.</p> <p>(c) Gross profit ratio has decreased in year 2022-23 as compared to year 2021-22. It may be due to the reason that office staff salary engaged in administrative functions and office maintenance expenditure could have increased.</p> <p>(d) Gross profit ratio has decreased in year 2022-23 as compared to year 2021-22. It may be due to the reason that company has not made an allowance for obsolescence in respect of inventories during the year.</p>
IV. CA D has also studied purchases and sales data of the company during the year and has also compared such data with preceding year and earlier years also. It is an example of __?
<p>(a) Ratio analysis forming part of substantive analytical procedures</p> <p>(b) Trend analysis forming part of substantive analytical procedures</p> <p>(c) Reasonable test forming part of substantive analytical procedures</p> <p>(d) Structural modelling forming part of substantive analytical procedures</p>
V. Considering case scenario in totality, identify which of following combination of Standards is not proper for their likely relevance in performing and completing above engagement?
<p>(a) SQC 1, SA 220, SA 501, SA 505</p> <p>(b) SA 550, SA 510, SA 220, SA 610</p> <p>(c) SA 700, SA 510, SA 220, SA 500</p> <p>(d) SQC 1, SA 700</p>

Case Scenario - 2

(M24R)
<p>CA M. Raja has accepted offer of appointment of auditor of an entity. As business carried on by the entity is new to him, he wants to gain an understanding about the entity and its environment including its internal control. In this regard, he has performed procedures to obtain audit evidence about design and implementation of relevant controls. He has performed various procedures like inquiry, inspection and observation in this regard.</p> <p>He wants reasonable assurance that accounting system is adequate and that all accounting information which should be recorded has, in fact, been recorded.</p> <p>Further, during the course of audit, he has noticed as under: -</p> <ul style="list-style-type: none"> • As required by the management, bank reconciliation is required to be performed monthly. However, the same is not carried out as stipulated due to time constraints faced by accountant. • The entity has a system of procuring its raw material supplies on the basis of valid purchase orders issued by the entity. However, purchase orders are not numbered in a sequence properly. • Wage sheets are not verified by a responsible official as required by management. • Staff of the entity is responsible for bringing cash from centers in nearby areas to entity's premises from where it is deposited into entity's bank account. However, concerned officer has not renewed insurance for cash in transit. <p>Based on above, answer the following questions: -</p> <p>I. The auditor has performed procedures to obtain audit evidence about design and implementation of controls. Which of the following procedures is more reliable to obtain audit evidence relating to application of a control?</p>

	<ul style="list-style-type: none"> (a) Observing application of control (b) Inspecting documentation pertaining to control (c) Inquiry about application of control (d) Studying design of control
	<p>II. Examination and evaluation of internal control is indispensable for CA M. Raja. It provides him necessary comfort relating to completeness of accounting information. However, review of internal controls of the entity will not enable him to know _____</p>
	<ul style="list-style-type: none"> (a) whether errors or frauds are likely to be located in ordinary course of operations of business (b) whether an effective internal audit department is operating (c) whether his opinion needs modification (d) whether any administrative control has bearing on his work
	<p>III. As regards weaknesses identified by the auditor in control system, which of the following represent(s) significant deficiencies in internal control?</p>
	<ul style="list-style-type: none"> (a) Not performing bank reconciliation timely and not verifying wage sheets by responsible official only (b) Not performing bank reconciliation timely and lack of proper sequence in purchase orders only (c) Not performing bank reconciliation timely, lack of proper sequence in purchase orders, not verifying wage sheets by responsible official and lack of insurance for cash in transit (d) Lack of insurance for cash in transit only
	<p>IV. Which of the following is most appropriate regarding auditor's responsibility in accordance with SA 265?</p>
	<ul style="list-style-type: none"> (a) To communicate significant deficiencies in internal control to management (b) To communicate significant deficiencies in internal control along with explanation of their potential effects to management (c) To communicate significant deficiencies in internal control along with explanation of their potential effects, to provide sufficient information to understand context of communication to management and express opinion on effectiveness of internal control. (d) To communicate significant deficiencies in internal control along with explanation of their potential effects and to provide sufficient information to understand context of communication to management.

General MCQs

1.	(M24R)
<p>CA Muskan is auditor of two concerns viz. Well Star Homes and Well Star Stores. The partners in both the firms are common. While auditing financial statements of Well Star Homes, she has noticed that few expenditure bills pertaining to Well Star Stores have been entered in its books. Which assertion of Well Star Homes is disproved in above situation?</p>	
<ul style="list-style-type: none"> a) Completeness b) Accuracy c) Occurrence d) Classification 	
2.	(M24R)
<p>CA X is nearing completion of audit procedures during course of audit of a company. He has found nothing unusual till now. The company is earning handsome profits since last many years and there is little debt burden on it. It is also in the process of expanding its business by taking loan from a bank. The bank has also granted "in-principle" approval for lending money to the company. Which of the following statements is most appropriate in evaluation of going concern assumption being followed by management?</p>	

	<p>a) Appropriateness of management's assessment in relation to going concern assumption may be made by auditor without performing detailed evaluation procedures.</p> <p>b) Appropriateness of management's assessment in relation to going concern assumption would be made by auditor by performing detailed evaluation procedures.</p> <p>c) The appropriateness of going concern assumption would be made by auditor directly by skipping management's assessment.</p> <p>d) Appropriateness of going concern assumption would be made by auditor by necessarily examining cash flow forecast.</p>
3.	(M24R)
	<p>CA Piyush is offered appointment as statutory auditor of branch of a bank. He has also taken housing loan of ₹ 75 lakhs from the same bank. Identify threat to independence involved.</p> <p>a) Advocacy threat</p> <p>b) Self-interest threat</p> <p>c) Self-review threat</p> <p>d) Familiarity threat</p>
4.	(M24R)
	<p>A Chartered Accountant finds during the course of statutory audit of a company that management is not serious about findings of internal audit reports. No action has been taken on findings of internal auditor and reports for last two quarters are gathering dust.</p> <p>He has further found that management has not disclosed information relating to transactions with another company. However, he has assiduously gathered that it is a related party by going through annual reports of past years and searching online database on MCA portal.</p> <p>The described situation most appropriately denotes _____?</p> <p>a) Objectivity</p> <p>b) Professional knowledge</p> <p>c) Independence</p> <p>d) Professional skepticism</p>
5.	(M24R)
	<p>You have been appointed as statutory auditor of a company for the first time. It has become very important for you to understand the company and its environment. Which of the following activities are not expected to be included in your attempts to know about the company and its environment?</p> <p>a) Gaining a knowledge about debt structure of the company</p> <p>b) Evaluating whether company's accounting policies are appropriate for its business</p> <p>c) Understanding business risks faced by the company.</p> <p>d) Gathering evidence about valuation of trade receivables of the company</p>

Answers

Case Scenario – 1

I	(d)
II	(C)
III	(a)
IV	(b)
V	(b)

Case Scenario - 2

I	(a)
II	(C)
III	(C)
IV	(d)

General MCQs

1.	c)
2.	a)
3.	b)
4.	d)
5.	d)

MTP - 1 Case Scenario (May 24)

Case I

	M24M
<p>Dhanush, a CA student undergoing articles, is part of an engagement team conducting audit of Test Enterprises Private Limited. The company is engaged in business of conducting aptitude and language tests every fortnight at center spread all over major cities of country for Indian students desirous of applying to foreign universities. It also sells books containing model test papers for the benefit of students.</p> <p>The company has substantial number of computers at each center to enable seamless experience for students appearing for standardized aptitude and language tests. The company has acquired new identifiable software involving substantial expenditure for conducting tests during the year which is expected to drive company's revenues in coming years. At the time of taking a test, a CD containing software is run in each system for enabling students to take tests. Cost of CD without software is nominal.</p> <p>The revenue of the company during the year 2023-24 was ₹ 50 crores (₹ 45 crores from fees charged from students and ₹ 5 crores from sale of books). Besides, company has also received ₹ 10 lacs as interest on certain investments during the year. The company has a history of profitable operations.</p> <p>During the course of audit, it is noticed by Dhanush that computers form significant chunk of PPE items in financial statements of company. The company has taken useful life of computers consisting of desktops for 3 years. However, depreciation charged on computers in financial statements of the company is higher than depreciation allowable under Income tax law. It results in lower accounting income as per books of accounts of company as compared with taxable income under Income tax law.</p> <p>During the course of audit, he notices that cost of CDs along with software cost is treated as an intangible asset by company. It is also part of his responsibility to verify PPE register in accordance with audit programme. On perusing details in PPE register, he finds that some computers have moved from one Centre to another Centre to meet business requirements. Further, many computers were disposed or scrapped in earlier years. However, proper details in relation to movement and disposal/scrapping have not been entered in PPE register. When these items were physically verified by the management during the year, it has resulted in material discrepancies. The management has properly dealt with such discrepancies in books of accounts.</p>	
<p>I. Considering description provided in case scenario regarding accounting income as per books of accounts and taxable income under Income tax law, choose appropriate responsibility of</p>	

Dhanush:
<ul style="list-style-type: none"> (a) To verify deferred tax liability likely created in financial statements in accordance with AS 22 (b) To verify deferred tax asset likely created in financial statements in accordance with AS 22 (c) To verify deferred tax asset likely created in financial statements in accordance with AS 29 (d) To verify deferred tax liability likely created in financial statements in accordance with AS 29
II. Keeping in view description provided in case scenario, which of following statements is likely to be correct regarding accounting treatment of cost of CDs and software acquired by company to run tests?
<ul style="list-style-type: none"> (a) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated such costs as revenue expenditure. (b) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is proper. (c) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as intangible asset. (d) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as revenue expenditure.
III. As regards discrepancies noticed in computer systems on physical verification by management as described in case scenario, which of following statements is most appropriate?
<ul style="list-style-type: none"> (a) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it may result in modification of auditor's opinion. (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. (c) The management has properly dealt with such discrepancies. Therefore, Dhanush should not do anything further. (d) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it is in nature of misstatement which needs to be communicated and documented by auditor.
IV. Which of following statements meets requirements of law in respect of revenue from operations of the company?
<ul style="list-style-type: none"> (a) Revenue from operations of ₹ 50 crores should be shown in Statement of Profit and loss. (b) Revenue from operations of ₹ 50.10 crores should be shown in Statement of Profit and loss. However, revenue from sale of books, fees charged from students and interest on investments should be disclosed separately in notes. (c) Revenue from operations of ₹ 50.10 crores should be shown in Statement of Profit and loss. (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.
V. The company has taken useful life of desktops to be 3 years. Such a requirement is _____
<ul style="list-style-type: none"> (a) prescribed under Schedule III to Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule III. (b) is not prescribed under Companies Act, 2013. It depends upon manufacturing specifications of desktops. (c) prescribed under Schedule II to Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule II. (d) is not prescribed under Companies Act, 2013. It needs to be arrived at mandatorily by a management expert.

Case Scenario - 2

(M24M)

CDL Limited, a company dealing in FMCG goods, is having 50 branches in India. SKC & Associates (referred to as company's auditor) are appointed as statutory auditors of the company for year 2023-24. Further, company has also appointed Mr. D as branch auditor for 5 of its branches.

Since Mr. D is conducting audit of only 5 branches of company, he has not arrived at materiality level in respect of auditee branches. On the same lines, identification and assessment of risk of material misstatement has not been performed. He is of the view that determination of materiality and identifying & assessing risks of material misstatement is done for financial statements of company as a whole. He has mainly performed substantive audit procedures in respect of financial statements of auditee branches like verification of PPE items, inventories, trade receivables, cash, bank balances and trade payables at auditee branches and maintained documentation of the same.

During the course of audit at two branches dealing in same kind of goods, Mr. D has performed analytical procedures pertaining to inventories. He has arrived at and compared inventory turnover ratio (Cost of goods sold/Average inventory) over a period of years of two branches. The results of analytical procedures are summarized in Table I below:

Table 1

Particulars	Branch	Year 2021-22	Year 2022-23	Year 2023-24
Inventory turnover ratio	I	15	14	1
Inventory turnover ratio	II	4	6	10

The company's auditor has also decided to use work of Mr. D with respect to financial information of 5 branches included in financial information of the company. During the course of audit, company's auditor has advised Mr. D by way of email certain significant accounting, auditing and reporting requirements and has asked him to provide representation as to compliance with them. Irritated and surprised, Mr. D is of the view that such an email is beyond the rights of the company's auditor.

I. As regards audit of a branch of CDL Limited as referred to in case scenario is concerned, which of following statements is most appropriate?

- (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 the 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.
- (b) The accounts of a branch shall only be audited by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of Companies Act, 2013 except company's auditor. In such a case, branch audit report is sent by branch auditor to members of company.
- (c) The accounts of a branch shall only be audited by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of Companies Act, 2013 except company's auditor. In such a case, branch audit report is sent by branch auditor to company's auditor.
- (d) 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 members of company.

II. After reading methodology for carrying out branch audits by Mr. D, which of following statements is likely to be most appropriate?

- (a) Separate determination of materiality and identifying & assessing risk of material misstatement is not required in respect of each of the branches. He is required to perform only substantive procedures as described in the case scenario in respect of auditee branches and maintain documentation of the same.
- (b) Separate determination of materiality and identifying & assessing risk of material misstatement is required in respect of each of branches. However, documentation for these matters regarding branches is not required. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.

- (c) Separate determination of materiality and identifying & 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 scenario in respect of auditee branches and also maintain documentation of the same.
- (d) Identifying & assessing risk of material misstatement is required along with documentation in respect of each of branches. However, materiality is required to be arrived at for financial statements of company as a whole. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.

III. Choose the correct statement regarding results of analytical procedures performed by Mr. D summarized in Table 1 in case scenario.

- (a) During year 2023-24, inventories of Branch I have moved faster in comparison to Branch II.
- (b) During year 2023-24, inventories of Branch II have moved faster in comparison to Branch I.
- (c) Comparison of inventory turnover ratio of Branch II over a period of years may indicate that branch's sales have likely been weak with higher inventory holdings in year 2023-24 as compared to previous years.
- (d) Comparison of inventory turnover ratio of Branch I over a period of years may indicate that branch's sales have likely been strong with lower inventory holdings in year 2023-24 as compared to previous years.

IV. Considering contents of email sent by company's auditor to Mr. D, which of following statements is likely to be in accordance with Standards on Auditing?

- (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.
- (b) Company's auditor can advise Mr. D certain significant accounting, auditing and reporting requirements. However, asking him to provide representation as to compliance with them is breach of Mr. D's independence.
- (c) Company's auditor cannot advise Mr. D certain significant accounting, auditing and reporting requirements. It is breach of Mr. D's independence.
- (d) Company's auditor can advise Mr. D regarding certain significant accounting, auditing and reporting requirements only when Mr. D makes such a request.

Case Scenario - 3

(M24M)

CA B is conducting statutory audit of branch of a nationalized bank. Saurabh, a CA student, is also part of engagement team conducting statutory branch audit. The field of bank branch audit is new to him and he is following instructions as required by engagement partner.

The engagement partner has asked him to prepare a summary of non-funded credit facilities outstanding as on balance sheet date. The following information is appearing in branch's CBS data/records as on 31st March, 2023:

Serial number	Particulars in CBS (Core Banking solution)/records	Amount in ₹ crores
1.	Agricultural term loans	15.00
2.	Staff housing loans	3.50
3.	Staff vehicle loans	0.20
4.	Housing loans-General public	10.00
5.	Letters of credit issued	2.50
6.	Education loans	1.50
7.	Guarantees issued (Fully secured by 100% margin)	1.00
8.	Bills purchased and discounted	2.00
9.	Bills for collection	0.10

On going through listing of housing loans to general public, CA B notices that branch has sanctioned many housing loans of small ticket size ranging between ₹ 10.00 to ₹ 20 lakhs. Therefore, he has assessed

<p>risk of material misstatements to be high. As a consequence, he has designed procedures to perform tests of controls as well as substantive tests.</p> <p>Saurabh has been further asked to go through SMA (Special Mention Accounts) jotting as on 30th November, 2022. Such reports are available from system on monthly frequency. Being new to such type of assignment, he is unable to understand relevance of above audit procedure mandated by engagement partner.</p>	
<p>I. Considering table given in the case scenario, which of the following combinations is appropriate example of non-funded credit facilities provided by branch to its customers?</p>	
<p>(a) Bills purchased and discounted; bills for collection (b) Bills for collection; staff housing loans; letters of credit issued (c) Bills purchased and discounted; letters of credit issued; guarantees issued (fully secured by 100% margin) (d) Letters of credit issued, guarantees issued (fully secured by 100% margin)</p>	
<p>II. CA B's decision to perform both tests of controls as well as substantive tests was taken after he had assessed risk of material misstatement in financial statements to be high due to large number of small ticket size loans. Which Standard on Auditing deals with auditor's responsibility to design such tests?</p>	
<p>(a) SA 500 (b) SA 330 (c) SA 300 (d) SA 315</p>	
<p>III. Saurabh is unable to understand relevance of going through SMA jotting as on 30th November, 2022. Which of following statements is most appropriate in this context?</p>	
<p>(a) It would necessarily help auditor in identifying accounts with significant lending exposure. (b) It would help auditor in identifying accounts which may involve downgrading from Sub-standard asset category to doubtful category. (c) It would help auditor in identifying accounts where substantial recoveries have been received during the year. (d) It would help auditor in identifying accounts which may involve downgrading from standard category to non-performing asset.</p>	

General MCQs

1.	(M24R)
<p>"We, the people" is an NGO working for rights of citizens. Due to nature of its activities, its volunteers take part in agitations which acquire political overtones. It also gets money from trusts based in overseas countries.</p> <p>The government has tightened regulatory mechanism for NGOs receiving foreign funding. The finance and accounts department in NGO is headed by an experienced person, a former volunteer and activist himself. However, he has no professional or legal educational background. CA N is appointed as auditor of above NGO for the first time.</p> <p>Choose the most appropriate option regarding audit risk inferred by you from above.</p> <p>a) Audit risk in the above situation is low. b) The situation does not provide quantitative data. Therefore, it is not possible to make a precise measurement of audit risk. c) Audit risk in the above situation is high. d) The situation does not provide information affecting all components of audit risk. Therefore, inference cannot be made properly.</p>	
2.	(M24R)
<p>CA J is in process of planning audit for a large company engaged in business of dealing and manufacturing of pharmaceutical products. Central Drugs Standard Control Organization (CDSCO), National regulatory</p>	

Authority under Ministry of Health & Family Welfare is responsible for approval of drugs, conduct of clinical trials and laying down Standards for drugs and control over quality of imported drugs. Auditor is also considering whether to make use of audit evidence obtained in previous audit of the same company. Besides, he is also considering volume of transactions to determine whether it is efficient to rely on internal controls. As part of planning activities, he is also considering extent of substantive audit procedures to be performed. Consider following factors stated from 1 to 5:

1. Reporting requirements required by CDSCO, if any
2. Need for specialized knowledge of pharma industry
3. Expected use of audit evidence obtained in previous audit
4. Volume of transactions to consider reliance on internal control
5. Nature and extent of substantive audit procedures

Choose the most appropriate factor/combination of factors which could be relevant to CA J in establishing audit strategy: -

- a) 1, 3, 4 and 5
- b) 1 only
- c) 1, 2, 3 and 4
- d) 2 only

3.

(M24M)

CA Tarini is in process of formulating audit plan for conducting audit of a company engaged in business of dealing in commodity futures. Which of following is not likely to be an appropriate audit procedure to be included in audit plan for the abovesaid company?

- a) Verification of turnover of company
- b) Verification of cost of raw material consumed
- c) Examination of company's accounting policy for revenue recognition
- d) Verification of contract notes with brokers

Answers

Case Scenario – 1

I	(b)
II	(b)
III	(b)
IV	(d)
V	(c)

Case Scenario - 2

I	(a)
II	(c)
III	(a)
IV	(a)

Case Scenario - 3

I	(d)
II	(b)
III	(d)

General MCQs

1.	c
2.	c
3.	b

ICAI SM Case Scenarios

Chapter 01

1.	(SM23)
<p>Rohit, Gurpreet, AN and Goreti are friends since their school days based in Mumbai. They have cleared CA foundation exams in the same attempt and now plan to appear for CA Intermediate exams. All of them are avid news listeners and regularly keep track of business news even on social media.</p> <p>They are trying to understand new subjects including auditing. Rohit, Gurpreet and Ali have also started attending Live Coaching Classes (LCC) being conducted by Board of studies of ICAI. Goreti has not been able to join Live Coaching Classes yet as she was away on a holiday with her parents. However, she plans to catch it up with her friends very soon. Ali had also joined the classes but he had skipped some lectures.</p> <p>During one informal get together, their discussions centred around new subject of auditing. They discussed many things regarding its nature, scope, benefits and other general practical issues. Goreti was regular in keeping track of audited results of companies being published in leading newspapers. Her view was that audited financial statements of companies give 100% guarantee to different stake holders. It is the main reason behind so much reliance upon auditing. But she could not understand why wrong doings in financial matters are being discovered after many years have gone by.</p> <p>Ali also concurred with her view and added that when financial statements are audited, each and every transaction appearing in books of accounts is verified. However, he could not give clarity to Goreti.</p> <p>Gurpreet was of the opinion that audit was conducted on the basis of sample checking. He was also of the view that audited financial statements are not a guarantee against probable wrong doings in financial matters of the companies.</p> <p>Not to be left behind, Rohit also jumped in the fray. He supported Gurpreet and also added something of his own.</p>	
<p>I. Gurpreet was of the view that 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?</p>	
<p>(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.</p>	
<p>II. Rohit added that auditor can force an employee of the company to provide him required information and documents. Can he do so?</p>	

	<p>(a) Yes, he can do so. It is necessary to obtain audit evidence.</p> <p>(b) Yes, he can do so. There are express rights given to him in this respect.</p> <p>(c) No, he cannot do so. He can only request for providing him with necessary information and documents. But it cannot be forced by him.</p> <p>(d) No, he cannot do so. He has no right of seeking information and documents. Therefore, question of forcing does not arise.</p>
	<p>III. Ali had listened in one of the classes that audit covers all aspects of an entity and concluded that each and every transaction of entity is verified by auditor. Goreti also seemed to be in agreement with him but she was of the view that besides this, it also meant that audit should be so organized to cover all areas of an entity. Which of following statements is appropriate in this regard?</p>
	<p>(a) Only view of Ali is correct.</p> <p>(b) Only view of Goreti is correct.</p> <p>(c) Views of both Ali and Goreti are correct.</p> <p>(d) Views of both Ali and Goreti are incorrect.</p>
	<p>IV. All of them also discussed about benefits of auditing. Which of the following is not a likely benefit of auditing?</p>
	<p>(a) Since auditing is connected to future events, audited information can be easily relied upon by users.</p> <p>(b) Errors or frauds may be discovered during audit.</p> <p>(c) Government authorities can make use of audited accounts for different purposes.</p> <p>(d) It can help in bringing out deficiencies in maintenance of financial records.</p>
	<p>V. Goreti told her friends that she had read a news report about how a company had misled its auditors by producing some fabricated documents. Which of following statements seems to be appropriate in this regard?</p>
	<p>(a) It was wrong on the part of auditor to rely upon fabricated documents. He must have discovered it as the same falls within the scope of his duties.</p> <p>(b) Although it was wrong on the part of auditor to rely upon fabricated documents, he cannot do anything in the matter. He has to report on the basis of documents provided to him. He has no duty in this regard.</p> <p>(c) Auditor has to conduct audit by exercising professional skill. But he is not an expert in discovering genuineness of documents. Hence, management consisting of dishonest persons may have led him to rely upon fabricated documents deliberately.</p> <p>(d) Management cannot mislead auditor due to high level of knowledge and expertise possessed by him. The above is an outlier case-one of the rare, odd cases.</p>
2.	(SM23)
	<p>Me and You Private Limited has been newly incorporated. The plant of the company has recently started production with the help of funds provided by a bank for purchase and installation of machinery. Further, the company is also utilizing working capital credit facilities from the same bank for meeting its day to day working capital requirements like for purchase of raw materials, labour payment etc. However, just within six months of its operations, the management feels that working capital funds are inadequate and situation is creating liquidity issues in the company.</p> <p>The management of the company has approached its bankers and requested for enhancement in working capital credit facilities. The bank manager is insisting upon financial statements of the company for half year along with report providing assurance in this respect duly signed by Chartered Accountant as audit is far away. It also requires projected financial statements for coming years along with a report from CA providing</p>

<p>assurance regarding these projections to consider request of management.</p> <p>The management approaches CA P, who has qualified recently and started practising. Reports providing assurance for half yearly results and projected financial statements are sought from CA P. The Management provides necessary information and records to him in this regard.</p> <p>Assume, in above case, the company only provides trial balance, financial statements in draft/preliminary form along with accompanying records for the relevant half year to CA P and requests him to provide duly signed financial statements with a report for mutually agreed professional fees.</p>
<p>I. The management of company has engaged CA P to issue a duly signed report for half year. Which of the following standards, if any, issued by ICAI are relevant for CA P?</p>
<p>(a) Standards on Review Engagements (b) Standards on Auditing (c) Standards on Related Services (d) There are no standards for issuing report in such situation.</p>
<p>II. Which of the following statements is MOST APPROPRIATE in given case situation?</p>
<p>(a) CA P can assist management in preparation of financial statements of the company. However, issue of a report in such a case is outside the scope of work. (b) CA P can assist management in preparation of financial statements of the company and he can issue an audit report. (c) CA P can assist management in preparation of financial statements of the company and he can issue a compilation report in this respect. (d) The responsibility of preparation of financial statement is of company's management. CA P cannot assist management in preparation of financial statements of the company. However, he can issue a review report.</p>
<p>III. In the above said scenario for issuance of signed financial statements for half year by CA P, as discussed in last para of Case Study, identify the MOST APPROPRIATE statement: -</p>
<p>(a) Standard on Quality control (SQC 1) is not applicable as CA P cannot issue audit report. (b) Standard on Quality Control (SQC I) is not applicable as CA P cannot issue review report. (c) Standard on Quality Control (SQC 1) is applicable in such type of engagement. (d) Standard on Quality Control (SQC 1) is not applicable as CA P is barred from issuing any report in such type of engagement.</p>
<p>IV. The banker of company has also requested for projected financial statements for coming years along with a report from CA regarding these projections to consider request of management. Which of the following standards issued by ICAI are relevant for CA P in such a situation, if any?</p>
<p>(a) Standards on Review Engagements (b) There are no standards for issuing such type of reports. (c) Standards on Related Services (d) Standards on Assurance Engagements</p>
<p>V. Suppose CA P also accepts work of issuing projected financial statements with a report to be signed by him. The management has projected turnover of ₹700 crore for the next year, ₹150 crore & ₹200 crore for following years respectively as compared to present turnover of ₹25 crore in current half year. Identify the MOST APPROPRIATE statement in this situation: -</p>
<p>(a) CA P has to satisfy himself regarding arithmetical accuracy of projected data.</p>

	<p>(b) CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover and its consistency with actuals.</p> <p>(c) CA P has to satisfy himself regarding arithmetical accuracy of data along with its proper presentation to banker.</p> <p>(d) CA P has to satisfy himself regarding reasonableness of assumptions underlying projected turnover, its consistency with actuals, disclosure and presentation.</p>
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Chapter 02

3.	(SM23)
	<p>Kaur & Associates, a sole proprietor firm of Simran Kaur, is offered appointment as auditor of a company engaged in manufacturing of automobile components for the first time. She is fact checking about the integrity of promoters of the company and key managerial persons. Matters such as competence of staff to perform the engagement are also considered by her. The appointment is subsequently accepted by her.</p> <p>She is also taking into account number and location of branches of the company, requirements of Schedule III of Companies Act, 2013 and expected time by which audit has to be completed keeping in view statutory requirements. Initially, she has thought it proper to inquire key employees of the company in procurement and marketing departments and planned for the same. She has also planned to visit three plants of the company. The purpose of planned inquiry and visit is to identify and assess risk of material misstatements.</p> <p>A detailed set of instructions has been prepared by her office and it has been handed over to assistants in engagement team. These set of instructions include details of extent of checking and nature of audit procedures to be performed regarding purchases, sales, items of income, items of expenditure etc. During the course of execution of above set of instructions, it has been brought to her notice that company is also producing substantial quantities of scrap generated during manufacturing process. However, no instructions have been given to engagement team in this regard.</p>
	<p>I. Auditor is fact checking about promoters and key managerial persons. She is also considering competence of staff to perform engagement. What is she trying to do?</p>
	<p>(a) She is establishing audit strategy.</p> <p>(b) She is conducting preliminary engagement activities.</p> <p>(c) She is designing audit plan.</p> <p>(d) She is checking her compliance of ethical requirements.</p>
	<p>II. Consideration of number and location of branches, requirements of financial reporting framework and expected time of completion are relevant factors primarily for which of the following -</p>
	<p>(a) Developing audit plan</p> <p>(b) Establishing overall audit strategy</p> <p>(c) Designing audit programme</p> <p>(d) Designing risk assessment procedures</p>
	<p>III. Taking into account description of planned inquiry and visit, which of the following statements is TRUE?</p>
	<p>(a) Planned inquiry and visit fall in area of audit strategy.</p> <p>(b) Planned inquiry and visit are planned risk assessment procedures and fall in field of audit plan.</p> <p>(c) The said description is not related to audit planning.</p> <p>(d) Planned inquiry and visit fall in scope of audit programme.</p>
	<p>IV. What is detailed set of instructions given to assistants in engagement team known as?</p>
	<p>(a) Audit guidelines</p> <p>(b) Audit plan</p>

	<p>(c) Audit Programme (d) Audit Procedures</p>
V.	<p>The issue of generation of scrap has been overlooked in detailed set of instructions given to engagement team. What should be proper course of action by CA Simran Kaur?</p> <p>(a) She should ignore this information as audit has already begun. (b) She should modify earlier set of instructions. (c) She should leave the matter to wisdom of engagement team. (d) She should put the ball in court of management as she was not provided with complete information earlier</p>

Chapter 03

4.	(SM23)
<p>CA Paritosh is auditor of a company. The financial statements of the company have just been received for audit. Following issues have been flagged pertaining to the financial statements of the company for purpose of risk assessment: -</p> <ol style="list-style-type: none"> i. The revenue of company has fallen from ₹ 50 crore in last year to ₹ 5 crore in current year (for which financial statements have been received for audit) due to lack of demand in the market for company's products. ii. Due to advent of new products in the market, company's products are fast becoming outdated. iii. A large customer having an outstanding balance of ₹ 5 crore has failed to pay to the company despite efforts made by the company. iv. Inventory holding period has increased from 30 days in last year to 90 days. v. The company also gets carried out job operations from third parties. Therefore, parts of inventories are lying with third parties. 	
<p>I. Regarding drastic fall in revenue of the company, which of the following is an audit risk?</p> <ol style="list-style-type: none"> (a) Fall in revenue would result in fall of profits for the company. (b) Drastic fall in revenue may imply that company is not able to carry out its operations in foreseeable future due to lack of demand in the market for company's products. There is a risk that going concern disclosure is omitted to be made in financial statements. (c) The company can explore some new line of activity, if demand of its products is falling. (d) Fall in revenue would mean lower tax liabilities for the company. 	
<p>II. The company's products are getting outdated in the market. Which of the following is an audit risk?</p> <ol style="list-style-type: none"> (a) The company should devise strategies to sell products in the market. (b) Inventories may be understated in such a scenario. (c) Inventories may be overstated in such a scenario. (d) The company should launch a 1+1 free offer for its customers. 	
<p>III. A large customer has failed to pay to the company. Identify audit risk from below:</p> <ol style="list-style-type: none"> (a) Receivables may be misstated if irrecoverable debt is not written off. (b) Receivables may be overstated if irrecoverable debt is not written off. (c) Writing off irrecoverable debt would impact profits of company adversely. (d) Failure to recover outstanding debt would impact cash flows of company adversely. 	
<p>IV. Identify audit risk involved when inventory holding period has increased from 30 days to 90 days.</p>	

	<p>(a) There is a risk of overstatement of inventories.</p> <p>(b) There is a risk relating to existence of inventories.</p> <p>(c) There is a risk that slow movement of stocks would increase tax liability when GST rates are increased.</p> <p>(d) There is a risk relating to holding and storage cost of inventories.</p>
	<p>V. Part of inventories are lying with third parties. Identify audit risk involved.</p> <p>(a) There is a risk that third parties do not manufacture according to specifications of the company.</p> <p>(b) There is a risk that by getting job work done from third parties, company is increasing its costs.</p> <p>(c) There is a risk that sufficient and appropriate evidence would not be available in respect of quantity and condition of inventories lying with third parties.</p> <p>(d) There is a risk that sufficient and appropriate evidence would not be available for quality control in respect of inventories lying with third parties.</p>

5.	(SM23)								
<p>CA Piyush is understanding internal controls as part of audit exercise of a company. It is a new client. He has studied controls in place in various operational areas of the company. After studying and gaining an understanding of such controls, he has decided to test few controls to actually see whether these are operating as intended by the management.</p> <p>Till now, he has studied controls over inventories and bank. Few of such controls are listed below: -</p>									
<table border="1"> <thead> <tr> <th>Nature of Control</th> <th>Control description</th> </tr> </thead> <tbody> <tr> <td>Control over inventories</td> <td>Inventories of the company lying at each location should be insured.</td> </tr> <tr> <td>Control over inventories</td> <td>There should be inventory counts on a regular basis for each location of the company.</td> </tr> <tr> <td>Control over Bank operations</td> <td>Bank reconciliations are to be performed at regular intervals.</td> </tr> </tbody> </table>		Nature of Control	Control description	Control over inventories	Inventories of the company lying at each location should be insured.	Control over inventories	There should be inventory counts on a regular basis for each location of the company.	Control over Bank operations	Bank reconciliations are to be performed at regular intervals.
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<p>I. Which of the following most appropriately describes test of control regarding insurance of inventories?</p> <p>(a) Inspect insurance policies to verify that inventories at each location are insured for fire and burglary. The sum insured and period of validity of policy are not relevant.</p> <p>(b) Inspect insurance policies to verify that inventories at each location are comprehensively insured. Ensure adequacy of sum insured by comparing it with value of inventories. Also ensure policy period has not expired.</p> <p>(c) Inspect insurance policies to verify that inventories at each location are comprehensively insured. Ensure policy period has not expired.</p> <p>(d) Inspect insurance policies to verify that inventories at each location are insured for fire and burglary. Ensure policy period has not expired.</p>									
<p>II. Which of the following most appropriately describes test of control regarding inventory counts?</p> <p>(a) Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure.</p> <p>(b) Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure. Attend inventory count.</p>									

	<p>(c) Obtain detail of inventory counting procedure and ensure that inventory count is carried out according to laid down procedure. Attend inventory count and perform test count.</p> <p>(d) Attend inventory count and perform test count.</p>
III.	<p>While testing control over bank reconciliations, it has been noticed that bank reconciliations are not being performed at regular intervals. Identify the most appropriate description of "control deficiency" in this regard: -</p> <p>(a) Bank reconciliations are not being performed regularly as concerned staff is overburdened.</p> <p>(b) Bank reconciliations are not being performed regularly as concerned staff is overburdened. It could result in errors.</p> <p>(c) Bank reconciliations are not being performed regularly as concerned staff is overburdened. It could result in errors. It may result in misstatement of cash and bank balance in financial statements.</p> <p>(d) Bank reconciliations are not being performed regularly as concerned staff is overburdened. These should be performed monthly and reviewed by senior accountant.</p>
IV.	<p>Since the company is a new client, which of the following statements is most appropriate?</p> <p>(a) There is reduced detection risk.</p> <p>(b) There is increased detection risk.</p> <p>(c) There is no effect on detection risk.</p> <p>(d) Detection risk should be increased to lower audit risk.</p>
V.	<p>Which of the following statements is most appropriate regarding auditor's response to assessed risk of a new client?</p> <p>(a) More substantive procedures would require to be performed.</p> <p>(b) Less substantive procedures would require to be performed.</p> <p>(c) There is no effect on substantive procedures.</p> <p>(d) There is no effect on substantive procedures as audit risk is low.</p>

Chapter 04

6.	(SM23)
<p>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.</p> <p>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.</p> <p>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</p>	

<p>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.</p> <p>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.</p>	
<p>I. Which of the following statements is most appropriate regarding inventory count by auditor in accordance with SA 501?</p>	<p>(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.</p> <p>(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.</p> <p>(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.</p> <p>(d) She should inspect the inventory to ascertain its existence and condition at all locations and perform counting of each and every item.</p>
<p>II. As regards inventories lying with third parties, which of following statements meets requirements of SA 501?</p>	<p>(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.</p> <p>(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.</p> <p>(c) There is no obligation cast upon an auditor in respect of inventories lying with third parties.</p> <p>(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.</p>
<p>III. Keeping in view description regarding trade receivables, identify the most appropriate statement in context of SA 505?</p>	<p>(a) She should not plan and design confirmation requests for large number of parties having small balances.</p> <p>(b) She should plan and design positive confirmation requests for large number of parties having small balances.</p> <p>(c) She should plan and design positive confirmation requests for large number of parties having small balances and meticulously analyse exception rate</p> <p>(d) She should plan and design negative confirmation requests for large number of parties having small balances.</p>
<p>IV. As regards sampling, which of the following statements is most appropriate in terms of requirements of SA 530?</p>	<p>(a) Sampling is used in tests of transactions as well as tests of controls.</p> <p>(b) Sampling is used in tests of balances as well as tests of controls.</p> <p>(c) Sampling is used in tests of details.</p> <p>(d) Sampling is used in tests of details as well as tests of controls</p>

	V. Since she intends to rely upon sampling extensively, which of the following statements is true about sampling risk?
	<ul style="list-style-type: none"> (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.

7.	(SM23)
	<p>Financial statements of a firm have been put up for audit before CA Manushi. On going through financial statements, she wants to verify assertions contained in financial statements and has planned certain procedures for carrying out detailed checking.</p> <p>(A) She plans to verify some major bills debited in "Machinery repair" account. The purpose of it is to ensure that bills are entered correctly and their classification is proper.</p> <p>(B) She plans to verify that all balances appearing under trade payables are genuine and not fake.</p> <p>(C) She plans to compare amount of wages paid in current year and last year. It is also planned to verify relationship between the number of employees and wages paid in both years.</p> <p>(D) She is of the view that it is necessary to examine title deeds of "land" appearing in financial statements of the firm.</p> <p>(E) The firm is engaged in export of goods to Europe. The sales invoices raised in Euros are converted into Indian rupees as per applicable norms.</p>
	<p>I. As regards description given regarding verification of bills debited in "Machinery repair" account, identify what she intends to perform?</p> <ul style="list-style-type: none"> (a) Tests of Controls (b) Tests of transactions (c) Tests of balances (d) Risk assessment procedures
	<p>II. Identify which type of assertion she intends to focus when she wants to ensure genuineness of trade payables.</p> <ul style="list-style-type: none"> (a) Occurrence (b) Cut-off (c) Existence (d) Accuracy
	<p>III. As regards comparison of wages of current year and last year and comparison of relationship between the number of employees and wages paid in both years, identify what she is trying to do?</p> <ul style="list-style-type: none"> (a) She is intending to perform tests of details. (b) She is intending to perform tests of transactions. (c) She is intending to perform tests of balances. (d) She is intending to perform substantive analytical procedures.
	<p>IV. In case of examination of title deeds of "land", which of the following fits into most appropriate description of such an audit procedure?</p>

	<p>(a) Observation (b) Inspection (c) External confirmation (d) Enquiry</p>
V.	<p>She wants to verify whether conversion of foreign currency into Indian rupees is proper or not. Identify what she is trying to do?</p> <p>(a) Reperformance (b) Recalculation (c) Observation (d) Inspection</p>

Chapter 05

8.	(SM23)
<p>Sunsteel Ltd. is a company engaged in the manufacture of variety of stainless steel household items ranging from hot pot, pressure cooker, cutlery set, bottles, to serving trays. The company has its corporate office in Delhi and its plant in Raigarh, a city in the state of Chhattisgarh. The company is planning to expand its manufacturing activities by setting up two new plants in the Raipur district of the state. For this purpose, the company also raised funds by making a follow-on public offer during the financial year 2022-23. R K Maheshwari & Associates are the statutory auditors of the company since the year 2020-21. The engagement team consisted of 5 members, with CA Raman as the engagement partner, CA Madhu as the senior associate and three articled trainees namely, Aman, Chetanya and Depesh.</p> <p>The company raised fresh capital of ₹ 5 Cr during the FY 2022-23. The shares with the nominal value of ₹ 10 per share were issued at a premium of ₹ 5 per share.</p> <p>The company has the Reserves and Surplus totalling to ₹ 2 Cr, comprising of securities premium and general reserve.</p> <p>CA Raman directed CA Madhu to verify the issue of the share capital in detail giving special consideration to the utilization of the securities premium amount.</p> <p>The audit engagement team discussed with the management about the performance of the company during the year under consideration. To this, the management told the engagement team that the company is performing very well and the company has doubled its revenue during the year as compared to the last year. The management of the company also told the auditors that during the year the company has made majority of its sales on credit basis to its customers.</p> <p>CA Raman directed Mr. Aman to send balance confirmation requests to debtors having balance in excess of ₹ 1 lakh.</p> <p>During the course of audit, CA Raman, Chetanya and Depesh also visited the power plants in Raigarh to get a detailed understanding of the manufacturing process. The team performed analytical procedures to obtain audit evidence with respect to the overall reasonableness of purchase quantity and price of inventory. More specifically, Chetanya collected the reports from the management for composition of stock i.e. raw materials as a percentage of total stock and compared the same with the data of the previous year. CA Raman and Chetanya thereafter, discussed the reasons for the variations with the management.</p>	

Also, while considering the presentation and disclosure requirements as per Schedule III to the Companies Act, CA Madhu discussed with CA Raman the disclosure with respect to the following account balances:

- Current maturities to long term borrowings
- Long term maturities of finance lease obligations
- Interest accrued but not due on borrowings
- Interest accrued and due on borrowings

I. Which of the following is not correct with respect to shares issued at premium and securities premium account in terms of Section 52 of the Companies Act, 2013?

- (a) Where a company issue shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a securities premium account.
- (b) The securities premium account can be applied by the company in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares.
- (c) The securities premium account cannot be applied by the company in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company.
- (d) The securities premium account can be applied by the company for the purchase of its own shares or securities under section 68.

II. Which of the following is not an example of capital reserve?

- (a) Revaluation reserve arising from revaluation of fixed assets
- (b) Securities Premium
- (c) Capital redemption reserve
- (d) General reserve

III. Statement 1: Confirmations as well as undelivered letters should be given/ returned to the auditor and not to the client.
Statement 2: When no reply is received, the auditor should perform alternate procedures regarding the balances.

- (a) Only statement 1 is correct
- (b) Only statement 2 is correct
- (c) Both statements 1 & 2 are correct
- (d) Both statements 1 & 2 are incorrect

IV. Mr. Chetanya performed which of the following analytical procedures to obtain the audit evidence with respect to the overall reasonableness of purchase quantity and price of raw material?

- (a) Consumption Analysis
- (b) Stock Composition Analysis
- (c) Reasonableness test
- (d) Ratio analysis

V. Which of the following is not correct with respect to the disclosure requirements of Schedule III to the Companies Act 2013?

- (a) Current maturities of long term borrowings is to be disclosed under the head long term borrowings
- (b) Long term maturities of finance lease obligations is to be disclosed under the head long term borrowings
- (c) Interest accrued but not due on borrowings is to be disclosed under the head Other Current Liabilities
- (d) Interest accrued and due on borrowings is to be disclosed under the head Other Current Liabilities

Chapter 06

9.	(SM23)
<p>CA Rajan Pillai is heading the engagement team conducting audit of a company. While audit is in progress, consider following issues regarding audit documentation:-</p>	
<p>(A) Audit programme was prepared assigning responsibilities for different types of works to be performed to team members. The engagement team consists of 4 members Mohit (CA final student), Rohit (CA final student), Shobhit (Paid CA) and CA Rajan Pillai (partner of audit firm).</p>	
<p>(B) The team has determined materiality for financial statements as a whole. The team has assessed risks of material misstatements to be low.</p>	
<p>(C) CA Shobhit is responsible for attending inventory count process and putting down its documentation part.</p>	
<p>(D) During the course of audit, many related party transactions have come to notice.</p>	
<p>I. Work relating to verification of revenue was assigned to Mohit in audit programme. However, it is being performed by Rohit actually. Verification of trade receivables was planned to be carried out by Rohit in audit programme. However, it being performed by CA Rajan Pillai due to last minute practical issues. Which of the following statements is most appropriate in this regard relating to audit documentation?</p>	
<p>(a) Audit programme contains names of persons and work to be performed. It is immaterial whether work assigned to one person is performed by another person.</p>	
<p>(b) Audit programme was already prepared. Only persons assigned specific responsibilities can perform those duties.</p>	
<p>(c) It is necessary that audit programme be suitably updated or notes are given in working papers to this effect so that planned duties are in accordance with actual work performance.</p>	
<p>(d) Changes in audit programme or notes clarifying the matter are required only when a person not forming part of engagement team is deputed to perform a duty. Otherwise, this issue of inter-shuffling of team members is frivolous</p>	
<p>II. As regards materiality, which of the following statements is most appropriate in context of audit documentation?</p>	
<p>(a) Materiality has already been determined. There is no need to put it into working papers.</p>	
<p>(b) Materiality depends upon professional judgment of auditor. Whatever amount has been determined can be documented in working papers.</p>	
<p>(c) Materiality arrived on basis of professional judgment along with factors considered in the determination has to be documented.</p>	
<p>(d) Materiality has been arrived upon professional judgment. It also depends upon professional judgment of auditor whether he wants to document it or not.</p>	
<p>III. As regards team's assessment that risk of material misstatements is low, which of the following statements is odd one relating to documentation of risk?</p>	
<p>(a) Discussion amongst engagement team members and detail of significant decisions reached has to be documented.</p>	
<p>(b) Details of risk assessment procedures have to be documented.</p>	
<p>(c) Details about how understanding of each component of internal control was obtained has to be documented.</p>	
<p>(d) Precise calculation of risk of material misstatements has to be documented.</p>	

IV.	CA Shobhit is responsible for attending physical inventory count of the company. Which of the following is not true in this regard relating to audit documentation?
	<p>(a) Dates on which physical inventory count process was attended by him should be documented. It may also include photographs of that date showing his attendance of inventory counting process at a particular location.</p> <p>(b) Detail of test counting undertaken should form part of audit documentation.</p> <p>(c) Detail of obsolete goods found should form part of audit documentation.</p> <p>(d) Reports showing that stocks conform to quality control standards in accordance with law are essential part of audit documentation.</p>
V.	As regards related party transactions, which of the following should not be part of audit documentation?
	<p>(a) Management representation letter in this regard</p> <p>(b) Related party transaction policy of the company</p> <p>(c) Documentation to show that such transactions are at arm's length basis</p> <p>(d) Documentation to show that such transactions are at close length basis.</p>

Chapter 07

10.	(SM23)
<p>CA. Gaurav Gogoi is about to conclude audit of a company. It has been noticed during the course of audit that there is shortage of important raw material supplies being imported from China due to prevailing geo-political situation. The company has shared with him its plan to deal with the situation. He is satisfied with assessment of the company for dealing with the matter. The issue is disclosed in financial statements and considering management's assessment, it is felt that use of going concern assumption by company in preparation of financial statements is appropriate.</p> <p>Besides, he also wants to be sure that all subsequent events till now have been considered and accounted for, where ever necessary, in financial statements.</p> <p>Before concluding audit, he requests written representations from management regarding its responsibilities. However, it is noticed that such written representations provided by management use qualifying language.</p> <p>He has also communicated significant findings from audit in writing with those charged with governance in the company and has retained copy of relevant mails. Besides, there are certain matters which were communicated by him orally from time to time during the course of audit to those charged with governance.</p>	
<p>I. As regards description of matter above concerning issue of going concern, which of the following statements is most appropriate for auditor's report?</p>	
<p>(a) The auditor should express an unmodified opinion.</p> <p>(b) The auditor should express a qualified opinion as material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.</p> <p>(c) Besides expressing an unmodified opinion, the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" drawing attention to the note in which such disclosure is made in financial statements along with related matters.</p> <p>(d) Such an issue does not affect auditor's opinion.</p>	
<p>II. As regards going concern basis of accounting is concerned, which of the following statements is true?</p>	

	<p>(a) A company showing net loss in its financial statements is essentially not a going concern.</p> <p>(b) Following going concern assumption of accounting is primary duty of auditor.</p> <p>(c) In case, a company is not a going concern, its financial statements must be prepared on liquidation basis.</p> <p>(d) Audit procedure seeking confirmation from banker regarding outstanding balance relates to verification of going concern assumption.</p>
III.	Which of the following statements is true in respect of auditor's responsibilities in respect of subsequent events?
	<p>(a) There is no obligation for an auditor to perform audit procedures for events occurring between date of financial statements and date of auditor's report.</p> <p>(b) There is no obligation for an auditor to perform audit procedures after signing of auditor's report, even if he comes to know of an event, which if known to him earlier would have caused him to amend the audit report.</p> <p>(c) The auditor has only to rely upon written representation of management regarding subsequent events. He has no other means to know about such events.</p> <p>(d) The auditor should perform necessary audit procedures to know about events occurring between the date of financial statements and date of auditor's report.</p>
IV.	As regards use of qualifying language in written representations, which of the following statement is most appropriate?
	<p>(a) It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.</p> <p>(b) Written representations should be unconditional. Such a wording is not acceptable.</p> <p>(c) Such a wording dilutes intent of written representations. However, it can be accepted by auditor only in exceptional circumstances.</p> <p>(d) Qualifying language in written representations is compulsory.</p>
V.	As regards auditor's responsibility regarding matters communicated orally with those charged with governance, which of following is most appropriate?
	<p>(a) Matters communicated orally have to be documented by the auditor stating when and to whom these were communicated.</p> <p>(b) Matters communicated orally need not be put into writing. It is sufficient for auditor to have communicated orally.</p> <p>(c) Matters communicated orally need not be put into writing. It is not practically feasible.</p> <p>(d) Matters communicated orally have to be documented by the auditor stating to whom these were communicated</p>

Chapter 08

11.	(SM23)
<p>M/s AB & Company is a firm of Chartered Accountants based in Mumbai. Mr. A and Mr. B are the Partners of the Firm. The Firm is engaged in various assignments including Audits. The partners are taking a summary of their work in order to prepare themselves to finalize the Audit and issue the audit report to various clients. You are requested to go through the following and answer the questions that follow:</p> <ul style="list-style-type: none"> • During the audit of M/s Persistent & Co, Mr. A found that the firm has changed the method of Depreciation from WDV to SLM but has not given the retrospective effect. Mr. A has calculated the difference of depreciation but M/s Persistent & Co. has stated that 	

	<p>they don't want to change the financial statements and if auditor persists they may give the effect in the next financial year.</p> <ul style="list-style-type: none"> • During the audit of M/s Dubious Brothers, Mr B observed that the firm had a very large amount of cash sales and there were no details of the customers to whom the sales were made. Further, cash generated was not even deposited into bank regularly. When Mr. B asked the firm to give him an opportunity to count cash, the manager of the firm said that the cash is with the owner and it cannot be made available to the auditor for the checking purpose. The manager also declined to give an opportunity for stock verification to Mr B. • During the audit of M/s Honest & Associates, Mr. A came to know that the firm has changed its method of valuation of stock. This change has a material impact on the financial statement of the firm. The firm has made relevant disclosures in the financial statements and has given proper accounting treatment to this exercise.
	<p>I. In case of M/s Persistent & Company, what would be an ideal Audit Opinion?</p>
	<p>(a) Unmodified (b) Qualified (c) Mention the fact in Emphasis of Matter Paragraph (d) Disclaimer</p>
	<p>II. In case of M/s Dubious Brothers, what Audit Opinion should the Auditor give?</p>
	<p>(a) Qualified (b) Adverse (c) Disclaimer (d) Unmodified</p>
	<p>III. According to you, what would be appropriate course to take in case of M/s Honest & Associates?</p>
	<p>(a) Issue Qualified Opinion (b) Issue Adverse Opinion (c) Mention the fact of change in method in Emphasis of Matter Paragraph (d) Issue Disclaimer of Opinion</p>
	<p>IV. When the Auditor, after conclusion of an Audit exercise, is of the opinion that there are material misstatements in the Financial Statements, but they are not pervasive, then what should an Auditor do?</p>
	<p>(a) Issue Unmodified Opinion (b) Issue Qualified Opinion (c) Issue Disclaimer of Opinion (d) Mention it in Emphasis of Matter Paragraph</p>
	<p>V. When the Auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework, Auditor shall give:</p>
	<p>(a) Modified Opinion (b) Qualified Opinion (c) Disclaimer of Opinion (d) Unmodified Opinion</p>

Chapter 09

12.	(SM23)
<p>Consider the following five descriptions: -</p> <p>(A) Audit of "Implementation of Nagpur Metro Rail Project" was conducted by the Comptroller and Auditor General of India.</p> <p>Following is extract of few audit findings placed on website cag.gov.in.</p> <p>"The location of New Airport station was not ideal from the viewpoint of ridership due to sparse population in and around the station and also from the accessibility point of view.</p> <p>Cotton Market station, the second additional station was projected to have high peak hour peak direction trips but the work was kept on hold midway citing fund crunch due to non-release of pending contribution from stakeholders. However, the situation could have been managed through prioritization of works."</p> <p>(B) Another set of audit findings in respect of audit of Haryana Power Generation Corporation Limited, a wholly owned government company responsible for operation of power generation plants in state of Haryana is as under: -</p> <p>"The main reason for low generation was higher variable cost of thermal power stations which resulted in backing down of plants."</p> <p>(C) A report was tabled in Parliament highlighting main features of direct taxes administration of country as mandated in Constitution of India. This report primarily discussed compliance to the provisions of the Income Tax Act, 1961 and the associated rules and procedures etc. as applied to administration of direct taxes including irregularities noticed in finalizing assessments etc.</p> <p>(D) Radial finance corporation Limited is a government company. The audit of the company is conducted by statutory auditors appointed by Comptroller and Auditor General of India.</p> <p>(E) Bharat Insurance Company Limited is a general insurance government owned company. The statutory auditor is appointed by Comptroller and Auditor General of India.</p> <p>The annual report for a particular year also contains comments of statutory auditors on matters such as whether company has carried out reconciliations in respect of its inter-company balances with other government owned insurance companies.</p>	
<p>I. Based upon plain reading of audit findings stated at Para (A), identify type of audit carried out by office of the Comptroller and Auditor General of India.</p>	
<p>(a) Audit against provision of funds (b) Propriety audit (c) Performance audit (d) Compliance audit</p>	
<p>II. Keeping in view audit findings in respect of Haryana Power Generation Corporation Limited, identify type of audit carried out.</p>	
<p>(a) Audit of Government Company (b) Audit against rules and orders (c) Compliance audit (d) Performance audit</p>	

III.	Which of the following is the most appropriate statement in context of report tabled in Parliament regarding administration of direct taxes?
	<p>(a) It is likely to be a report prepared for submission to the President under Article 151 of the Constitution of India by Comptroller and Auditor General of India.</p> <p>(b) It is likely to be a report prepared for submission to the Prime Minister Under Article 151 of the Constitution of India by an independent task force of experts.</p> <p>(c) It is likely to be a report prepared for submission to the President under Article 151 of the Constitution of India by Central Board of Direct Taxes.</p> <p>(d) It is likely to be a report prepared for submission to the Prime Minister under Article 151 of the Constitution of India by Central Board of Direct Taxes.</p>
IV.	Who is empowered to conduct "supplementary audit" in case of Radial finance Corporation Limited, a government company?
	<p>(a) Central Government</p> <p>(b) Another independent auditor appointed by CAG</p> <p>(c) CAG</p> <p>(d) Another independent auditor appointed by Ministry of Corporate Affairs</p>
V.	As regards comments of auditors specified in respect of audit report of above insurance company, which of the following is likely to be most appropriate statement?
	<p>(a) Such are likely to be comments of test audit carried out by CAG.</p> <p>(b) Such are likely to be comments in respect of directions to statutory auditor by CAG for reporting on specific aspect of their audit work.</p> <p>(c) Such are likely to be comments of supplementary audit carried out by CAG.</p> <p>(d) Such are likely to be comments of statutory auditors in accordance with requirements of Standards on Auditing</p>

Chapter 10

13.	(SM23)
<p>CA M is conducting statutory audit of branch of MMC Bank. During the course of audit, it is noticed as under:-</p> <p>(i) Loans under "Kisan credit card" are given by Bank to farmers to meet their short-term credit needs for cultivation of crops.</p> <p>In respect of one agricultural advance classified under "Kisan Credit Card" having an outstanding balance of ₹ 20 lacs as at year end, there is no transaction in account since last 90 days. The said loan has been granted for cultivation of paddy which is harvested in a period of 3-4 months from sowing. The branch has classified the said advance as "Standard asset".</p> <p>(ii) It is also observed that account of one borrower availing cash credit limit of ₹ 50 lacs was taken over from another bank. The proposal was sanctioned by branch manager instead of immediate next higher authority as required in "Manual of Delegation of Powers" of Bank.</p> <p>(iii) It is noticed that head office of bank has flagged a savings account maintained in branch in which interest was wrongly paid at higher rate due to wrong data feeding entry. Now, situation has been rectified by debiting excess interest paid in the account. Since there was little balance in savings account, a debit balance of ₹ 1.50 lac was created in the said savings account due to above reversal. The matter was immediately informed to account holder. However, he has not turned up for payment since matter was informed to him about six months ago.</p>	

<p>(iv) There are many cash credit accounts in the branch. Such borrowers are required to submit monthly stock statements to branch showing calculation of drawing power.</p> <p>(v) One borrower has availed a housing loan and a car loan from the branch. Housing loan EMIs are overdue for 120 days as on date of Balance sheet. Car loan EMIs are overdue for 60 days as on date of Balance sheet.</p>
<p>I. Based upon plain reading of audit findings stated at Para (A), identify type of audit carried out by office of the Comptroller and Auditor General of India.</p>
<p>(a) The branch has erred in making classification as per RBI norms. It is a "Sub-standard" asset.</p> <p>(b) The classification made by branch is proper. However, there are no transactions in account since last 90 days, it is SMA.</p> <p>(c) The classification made by branch is proper.</p> <p>(d) The branch has erred in making classification as per RBI norms. It is a "doubtful" asset.</p>
<p>II. Regarding taken over account from another bank, which of following statements is most appropriate?</p>
<p>(a) It is an internal issue of Bank and auditor is not concerned with it.</p> <p>(b) It is an internal issue of Bank. However, the auditor may, at his discretion, report it.</p> <p>(c) It is a serious violation of laid down procedures of bank for sanction of advances and should be reported by auditor without fail.</p> <p>(d) There is no issue involved as credit facility was properly sanctioned.</p>
<p>III. As regards debit balance of ₹ 1.50 lacs in Savings account, which of the following is correct from point of view of an auditor?</p>
<p>(a) The situation does not attract RBI norms on asset classification.</p> <p>(b) The debit balance of 1.50 lacs should be classified as NPA.</p> <p>(c) The situation does not attract RBI norms on asset classification as no credit facility was granted.</p> <p>(d) The bank cannot demand excess interest paid to account holder.</p>
<p>IV. Which of the following statements is not true about "drawing power" (DP)?</p>
<p>(a) Drawing Power refers to the amount calculated based on primary security less margin as on particular date.</p> <p>(b) It is always less than sanctioned limit.</p> <p>(c) It can be different from sanctioned limit.</p> <p>(d) Creditors for goods are reduced for purpose of calculating Drawing Power.</p>
<p>V. Considering housing loan and car loan availed by a borrower, which of the following statements is appropriate?</p>
<p>(a) Both Housing loan as well as car loan should be classified as "Non Performing Assets" in accordance with RBI norms on asset classification.</p> <p>(b) Housing Loan should be classified as "Non-Performing Asset" in accordance with RBI norms on asset classification. However, Car loan should be classified as Standard asset.</p> <p>(c) Car Loan should be classified as "Non-Performing Asset" in accordance with RBI norms on asset classification. However, Housing Loan should be classified as Standard asset.</p> <p>(d) Both Housing as well as car loans should be classified as Standard assets.</p>

Chapter 11

14.	(SM23)
<p>Das & Co, a firm of auditors, is offered appointment as auditor of a company, a prospective new client. CA Sukanya, one of partners, is dealing with new client. While meeting with officers of the company, she comes to know that Sushant, CFO of the company, was her classmate. In fact, both of them had started CA together. However, Sushant had left CA mid-way due to repeated failures and tried his luck to pursue MBA (finance) from one of leading institutions.</p> <p>During initial discussions, it transpires that company is going to launch new services in the field of "weather-forecasting". Such services would be available on web site of company and micro weather information would be available on payment of charges. The company requests audit firm to be visibly associated with their marketing blitz.</p> <p>Assume that firm choses to accept the offer and writes to previous auditor, Walker & Co., to advise whether there exist any professional reasons for them not to accept the proposed offer. However, Walker & Co. do not reply to the request of Das & Co.</p> <p>During preliminary discussions, it also became known that the said company has acquired all shares of another company. Under relevant provisions of law, financial statements of both companies needed to be consolidated and audited. Despite this knowledge, Das & Co. failed to advise their client regarding audit of consolidated financial statements.</p> <p>The company also offers auditors contract for providing IT services pertaining to information system of company.</p>	
<p>I. Considering discussion about Sukanya and Sushant, which of the following statements seems most appropriate?</p>	
<p>(a) The above discussion is irrelevant in context of proposed offer. (b) The proposed offer should be accepted by firm. The engagement team may be headed by CA Sukanya for better coordination and results. (c) The proposed offer should be accepted by firm. The engagement team may be headed by a different partner of the firm. (d) The matter is too trivial to be reported by CA Sukanya to other partners of firm.</p>	
<p>II. Keeping in view request of the company to be visibly associated with company's new services, identify which type of threat is being faced by audit firm.</p>	
<p>(a) Self-interest threat (b) Familiarity threat (c) Self-review threat (d) Advocacy threat</p>	
<p>III. The previous auditors, Walker & Co., have not replied to communication of Das & Co. Which fundamental principle of professional ethics is not followed by them?</p>	
<p>(a) Objectivity (b) Professional behaviour (c) Professional competence and due care (d) Integrity</p>	
<p>IV. Das & Co. have failed to advise the company regarding audit of consolidated financial statements. Which fundamental principle of professional ethics is violated by Das & Co.?</p>	
<p>(a) Professional behaviour (b) Integrity</p>	

	(c) Objectivity (d) Professional competence and due care
V.	Which of the following statements is most appropriate regarding providing offer of work of IT services by auditors to the company?
	(a) Such offer may create a self-review threat. (b) Such offer may create an advocacy threat. (c) Such offer does not constitute any threat. (d) Such offer may create self-review and advocacy threats.

Answers of SM Case Scenarios

Chapter 1		
1.	I	(C)
	II	(C)
	III	(d)
	IV	(a)
	V	(c)
2.		
	I	(c)
	II	(c)
	III	(c)
	IV	(d)
	V	(d)

Chapter 4		
1.	I	(a)
	II	(b)
	III	(d)
	IV	(d)
	V	(d)
2.	I	(b)
	II	(c)
	III	(d)
	IV	(b)
	V	(b)

Chapter 8	
I	(b)
II	(C)
III	(c)
IV	(b)
V	(d)

Chapter 9	
I	(c)
II	(d)
III	(a)
IV	(c)
V	(b)

Chapter 2	
I	(b)
II	(b)
III	(b)
IV	(C)
V	(b)

Chapter 5	
I	(C)
II	(d)
III	(C)
IV	(b)
V	(a)

Chapter 10	
I	(c)
II	(c)
III	(b)
IV	(b)
V	(a)

Chapter 3		
1.	I	(b)
	II	(c)
	III	(b)
	IV	(a)
	V	(c)
2.	I	(b)
	II	(c)
	III	(c)
	IV	(b)
	V	(a)

Chapter 6	
I	(C)
II	(C)
III	(d)
IV	(d)
V	(d)

Chapter 11	
I	(c)
II	(d)
III	(b)
IV	(d)
V	(a)

Chapter 7	
I	(C)
II	(C)
III	(d)
IV	(a)
V	(a)