

Section A Multiple Choice Questions

MCQs 1-4 carry 1 mark each and MCQs 5-7 carry 2 marks each. (Total 10 marks)

CASE 1

Sun Private Limited is a newly formed private limited company, engaged in the manufacturing of solar panels. Company has appointed M/s M&S Associates, a Partnership Firm of Mr Meticulous and Mr Sincere - as their First Auditors. M/s M&S Associates accepted the assignment and Mr Meticulous being the engagement Partner, started their Audit. During Audit, Mr Meticulous asked the Management for name of the companies operating in similar business so that they can compare the Company's Figures. During this procedure, Mr Meticulous found that the Gross Margin of the Company is lower than the Industry Standard / Fellow Companies. He prepared an Interim Report dealing with this matter and asked the Management about the reasons for this deviation. Management asked him to give all the working along with the Working Papers as they believed it is the Company's Property. Mr Meticulous advised them that he can provide working but cannot give them the working papers as they are the property of the Firm. Management agreed to that and asked Mr Meticulous to go into detail and tell him the reasons for lower Gross Margin to which he agreed.

In above context, answer the following questions: -

1. Mr Meticulous asked about other Companies, he was intending to perform which audit procedure?

- (a) Analytical Procedures
- (b) Substantive Procedures
- (c) Random Sampling
- (d) Statistical Sampling

2. What was the initial procedure carried on by Mr Meticulous?

- (a) Trend Analysis
- (b) Ratio Analysis
- (c) Statistical Modelling
- (d) Random Sampling

CASE 2

M/s JJ & associates having office in Chennai are statutory auditors under Companies Act, 2013 of a company viz. Sweet Aroma Private Limited engaged in business of obtaining and manufacturing rice from paddy catering to both domestic as well as international market mainly in Gulf nations. The company has a huge plant capacity for rice extraction in one of the states in Northern India. Needless to state that inventories are in huge quantity in such type of business consisting of raw material, work in progress and finished goods. The auditors want to obtain sufficient appropriate audit evidence regarding inventories.

In above context, answer the following questions: -

3. Which of the following is most likely correct in relation to obtaining of sufficient appropriate audit evidence regarding existence and condition of inventory?

- (a) It is mandatory for the auditor to attend physical inventory counting on the date of financial statements in all circumstances.
- (b) Physical inventory counting shall not be attended by auditor on the date of financial statement or at a date other than date of financial statements in all circumstances.
- (c) The attendance of auditors at physical inventory counting is impracticable due to time and costs involved because of auditor's office location vis-à-vis company's plant location. Hence, attendance at physical inventory counting will be skipped.
- (d) The auditor shall attend at physical inventory counting unless impracticable. However, issue of time and costs involved because of auditor's office location vis-à-vis company's plant location is not a valid basis for skipping physical inventory counting.

4. Below are given certain cluster of matters which are relevant in planning attendance of auditor at physical inventory counting. Which of the following clusters consists of a likely inappropriate combination?

- (a) Nature of inventory, timing of physical inventory counting and stages of completion of work in progress
- (b) Nature of inventory, timing of physical inventory counting and valuation method of inventory
- (c) Nature of inventory, timing of physical inventory counting, considerations regarding maintenance of a perpetual inventory system
- (d) Risks of material misstatements related to inventory, nature of internal control pertaining to inventory, considerations regarding maintenance of a perpetual inventory system

5. Which of the following is the most likely logical sequence of steps in relation to attendance at physical inventory counting by auditor?

- (a) Observance of performance of management's count procedures, inspection of inventory, performing test counts and evaluation of management's procedures for recording and controlling results of physical inventory counting
- (b) Observance of performance of management's count procedures, performing test counts, inspection of inventory and evaluation of management's procedures for recording and controlling results of physical inventory counting
- (c) Performing test counts, inspection of inventory, Observance of performance of management's count procedures and evaluation of management's procedures for recording and controlling results of physical inventory counting
- (d) Evaluation of management's procedures for recording and controlling results of physical inventory counting, Observance of performance of management's count procedures, inspection of inventory and performing test counts

6. During attendance at physical inventory counting, the auditor inspects inventory. Following outcomes stated as I, II & III are given below of this inspection procedure: - Outcome I --- Existence of inventory

Outcome II ---- Ownership of inventory

Outcome III ----- Condition of inventory

Which of following statements is most likely true?

- (a) Outcomes I, II and III are all necessarily established after inspection.
- (b) Only Outcomes I and III are established after inspection and Outcome II is never established.
- (c) Outcomes I and III are established after inspection. However, outcome II may not be necessarily established.
- (d) Outcome II and III are established after inspection. However, outcome I may not be necessarily established.

7. It was observed by auditors that, out of total rice physically counted on 31st March, 2024 about 67 quintals of rice belonged to M/s PQR, a proprietary concern which had sent paddy to this company's plant for extraction of rice. What would be treatment of this item in financial statements of company?

- (a) The value of 67 quintals rice would be reflected in company's financial statements as per method of valuation adopted by the company.
- (b) The value of 67 quintals rice would be reflected in company's financial statements as per method of valuation adopted by the proprietary concern.
- (c) The value of 67 quintals rice would not be reflected in company's financial statements.
- (d) The value of 67 quintals rice would be reflected in proprietary concern's financial statements as per method of valuation adopted by the company.

Section B : Descriptive Questions

Question 1: While conducting the audit of AB Ltd, the auditor K of KLM and Associates, Chartered Accountants observes that there are large number of Trade payables and receivables standing in the books of accounts as on 31st March. The auditor wanted to send confirmation request to few trade receivables, but the management refused the auditor to send confirmation request. How would the auditor proceed? (5 marks)

Answer 1:

If management refuses to allow the auditor to send a confirmation request, the auditor shall: (a) Inquire as to management's reasons for the refusal, and seek audit evidence as to their validity and reasonableness;

(b) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and

(c) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260. The auditor also shall determine the implications for the audit and the auditor's opinion in accordance with SA 705

Question 2: How can an auditor verify the existence of related party relationships and transactions? (5 marks)

Answer 2:

During the audit, the auditor should maintain alertness for related party information while reviewing records and documents.

He may inspect the following records or documents that may provide information about related party relationships and transactions, for example:

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and those charged with governance.
5. Records of the entity's investments and those of its pension plans.
6. Contracts and agreements with key management or those charged with governance.
7. Significant contracts and agreements not in the entity's ordinary course of business.
8. Specific invoices and correspondence from the entity's professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.
11. Internal auditors' reports.
12. Documents associated with the entity's filings with a securities regulator e.g, prospectuses)

Question 3: CA Aarav wants to verify the payments made by XYZ Ltd. on account of building rent during the FY 2022-23. The rent amounts to `50,000/- per month for the year. The monthly rent payments are consistent with the rent agreement. However, the other companies in the similar industry are paying rent of `10,000/- per month for a similar location. How will applying the analytical procedures impact the verification process of such rental payments by XYZ Ltd.? (5 marks)

Answer 3:

If CA Aarav checks in detail the monthly rent payments, he may find that such payments are consistent with the rent agreement i.e. XYZ Ltd. paid ` 50,000/- per month as rent and the same is getting reflected in the rent agreement.

Here, CA Aarav may not be able to find out the inconsistency in the rent payment with respect to rent payment prevalent in the similar industry for rent of the similar location. If CA Aarav applies analytical procedure i.e. compares the rent payment by XYZ Ltd. with the similar payments made by companies in similar industry and similar area, he will notice an inconsistency in such rent payments as the other companies are paying a very less monthly rent in similar industry for similar area.

However, if CA Aarav does not make such comparison and only checks the monthly payments and rent agreement of XYZ Ltd., he would not have found such inconsistency and as such the misstatement may remain undetected.

Question 4: Parag India Ltd is a manufacturer of various FMCG (fast moving consumable goods) range of products. The company is having several cases of litigation pending in courts. The auditor wanted to identify litigation and claims resulting to risk of material misstatements. Suggest the auditor with reference to SAs. (5 marks)

Answer 4:

The auditor shall design and perform audit procedures in order to identify litigation and claims involving the entity which may give rise to a risk of material misstatement, including:

- (a) Inquiry of management and, where applicable, others within the entity, including in-house legal counsel;
- (b) Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel; and
- (c) Reviewing legal expense accounts.

If the auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other SAs, seek direct communication with the entity's external legal counsel.