CH. 1

MCQs

1. ----------- along with other disciplines such as accounting and law, equips you with all the knowledge that is required to enter into auditing as a profession.

   (a) Auditing

   (b) Taxation

   (c) Finance

   (d) Taxation and Finance both

2. No business or institution can effectively carry on its activities without the help of proper ------------- :

   (a) Audit

   (b) Record and accounts

   (c) neither (a) nor (b)

   (d) both (a) and (b)

3. As per SA-200 "Overall Objectives of the Independent Auditor", in conducting an audit of financial statements, the overall objectives of the auditor are:

   (a) To obtain reasonable assurance

   (b) To report on the financial statements

   (c) Both (a)and (b) above

   (d) none of the above

4 (IESBA Code) related to an audit of financial statements establishes which of the following as the fundamental principles of professional ethics relevant to the auditor when conducting an audit of financial statements :

   (a) Integrity;

   (b) Objectivity;

   (c) Professional competence and due care;

   (d) All of the above

5. The auditor's ________ safeguards the auditor's ability to form an audit opinion without being affected by any influences.

   (a) Objectivity

   (b) Independence

   (c) Confidentiality

   (d) Integrity

Correct / Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

(i) The basic objective of audit does not change with reference to nature, size or form of an entity

(ii) The purpose of an audit is to enhance the degree of confidence of intended users in the financial statements.

(iii) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error.

(iv) The audit engagement letter is sent by the client to auditor.

(v) Specific disclosure is required of the fundamental accounting assumptions followed in the financial statements.

Answers to MCQs

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

Answers to Correct/Incorrect

(i) **Correct:** An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.

(ii) **Correct:** As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

(iii) **Correct:** As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions and bases the auditor's opinion being persuasive rather than conclusive.

(iv) **Incorrect**: As per SA 210 "Agreeing the Terms of Audit Engagements",the Audit engagement letter is sent by the auditor to his client.

(v) **Incorrect**, as per AS 1, "Disclosure of Accounting Policies", specific disclosure of the fundamental accounting assumption is required if they are not followed in the financial statements.

Ch.2

MCQs

1. The audit plan is _____detailed than the overall audit strategy

    (a) Less

    (b) More

    (c) Equal

2. Planning is ____ process of an audit that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement:

    (a) continuous

    (b) discreet

    (c) neither continuous nor discreet

3. The auditor shall develop an audit plan that shall include a description of:

    (a) The nature, timing and extent of planned risk assessment procedures

    (b) The nature, timing and extent of planned further audit procedures at the assertion level.

    (c) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

    (d) All of the above

4. With reference to SA 300, the auditor shall document:

    (a) The overall audit strategy

    (b) The audit plan

    (c) Any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

    (d) All of the above

5. The overall audit strategy and the audit plan remain the ____ responsibility.

    (a) auditor's

    (b) management's

    (c) those charged with governance

    (d) All of the above

6. Determining a percentage to be applied to a chosen benchmark (in relation to materiality) involves the exercise of __________

    (a) Independence

    (b) Professional Judgement

    (c) Professional skepticism

    (d) All of the above

Correct / Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

1. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.
2. Establishing an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan is prerogative of the management.
3. Planning is a discrete phase of an audit
4. Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) does not need any revision.

Answers to MCQs

1. (b)	**2.** (a)	**3.** (d)	**4.** (d)	**5.** (a)	**6.** (b)

Answers to Correct/Incorrect

1. **Correct.** Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of the auditor's resources. The establishment of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes, but are closely inter-related since changes in one may result in consequential changes to the other.
2. **Incorrect.** The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.
3. **Incorrect.** Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures.
4. **Incorrect.** Materiality for the financial statements as a whole (and, if applicable, the materiality level or levels for particular classes of transactions, account balances or disclosures) may need to be revised as a result of a change in circumstances that occurred during the audit (for example, a decision to dispose of a major part of the entity's business), new information, or a change in the auditor's understanding of the entity and its operations as a result of performing further audit procedures.

Ch.3

MCQs

1. _______ refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached.

   (a) Audit Techniques

   (b) Audit evidence

   (c) Audit Documentation

   (d) None of the above

2. ________ may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

   (a) Audit File

   (b) Audit evidence

   (c) Completion Memorandum

   (d) both (a) and (b) above

3. As per SQC-1 "An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than ____ days after the date of the auditor's report".

   (a) 30

   (b) 60

   (c) 90

   (d) 45

4. A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

   (a) Positive confirmation request

   (b) Non Response

   (c) Negative Confirmation request

   (d) Exception

5. Auditor's judgment as to sufficiency may be affected by which factor:

   (a) Materiality

   (b) Risk of material misstatement

   (c) Size and characteristics of the population.

   (d) All of the above

6. Which of the following is not an Audit procedures to obtain audit evidence :

   (a) Inspection

   (b) Observation

   (c) External Confirmation

   (d) None of the above

7. Which of the following is not an assertion about presentation and disclosure:

   (a) Occurrence and rights and obligations

   (b) Completeness

   (c) Classification and understandability

   (d) Existence

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

(i) As per SA 230 on "Audit Documentation", the working papers are not the property of the auditor.

(ii) Purchase invoice is an example of internal evidence.

(iii) Sufficiency is the measure of the quality of audit evidence.

Answers to MCQs

1. (c)	**2.** (a)	**3.** (b)	**4.** (c)	**5.** (d)	**6.** (d)
7. (d)					

Answers to Correct/Incorrect

(i) **Incorrect:** As per SA 230 on "Audit Documentation" the working papers are the property of the auditor and the auditor has right to retain them. He may at his discretion can make available working papers to his client. The auditor should retain them long enough to meet the needs of his practice and legal or professional requirement.

(ii) **Incorrect:** Internal evidence is the evidence that originates within the client's organisation. Since purchase invoice originates outside the client's organisation, therefore, it is an example of external evidence.

(iii) **Incorrect:** Sufficiency is the measure of the quantity of audit evidence. On the other hand, appropriation is the measure of the quality of audit evidence.

Ch. 4

MCQs

1. Audit risk is a function of the risks of material misstatement and ______

(a) detection risk.

(b) inherent risk

(c) control risk

(d) business risk

2. For a given level of audit risk, the acceptable level of detection risk bears _____ relationship to the assessed risks of material misstatement at the assertion level.

(a) direct.

(b) Inverse

(c) no

(d) none of the above

3. Risk of material misstatement has ______components

(a) one

(b) two

(d) three

(d) four

4. Controls can be ________related to an assertion.

(a) directly

(b) indirectly

(c) directly or indirectly

(d) none of the above

5. Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels. Which of the following is an example of control activities:

(a) Authorization.

(b) Performance reviews.

(c) Information processing.

(d) All of the above

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

(i) As per section 138 of the Companies Act, 2013 private companies are not required to appoint internal auditor.

(ii) There is direct relationship between materiality and the degree of audit risk.

(iii) Control risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

(iv) Tests of control are performed to obtain audit evidence about the effectiveness of Internal Controls Systems.

(v) Maintenance of Internal Control System is the responsibility of the Statutory Auditor.

Answers to MCQs

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

Answers to Correct/Incorrect

(i) **Incorrect:** Section 138 of the Companies Act, 2013 requires every private company to appoint an internal auditor having turnover of ₹ 200 crore or more during the preceding financial year; or outstanding loans or borrowings from banks or public financial institutions exceeding ₹ 100 crore or more at any point of time during the preceding financial year.

(ii) **Incorrect:** There is an inverse relationship between materiality and the degree of audit risk. The higher the materiality level, the lower the audit risk and vice versa. For example, the risk that a particular account balance or class of transactions could be misstated by an extremely large amount might be very low but the risk that it could be misstated by an extremely small amount might be very high.

(iii) **Incorrect:** Inherent risk is the susceptibility of an account balance or class of transactions to misstatement that could be material either individually or, when aggregated with misstatements in other balances or classes, assuming that there were no related internal controls.

(iv) **Correct:** Tests of Control are performed to obtain audit evidence about the effectiveness of :

(a) the design of the accounting and internal control systems that is whether, they are suitably designed to prevent or detect or correct material misstatements and

(b) the operation of the internal controls throughout the period.

(v) **Incorrect:** The management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business. Maintenance of Internal Control System is responsibility of management because the internal control is the process designed, implemented and maintained by those charged with governance/ management to provide reasonable assurance about the achievement of entity's objectives.

CH. 5

MCQs

1. When credit purchases of ₹ 5100 is recorded on credit side and credit sales of ₹ 5100 is recorded on debit side, this kind of error is called _____.

   (a) Error of omission.

   (b) Compensating error.

   (c) Error of principle.

   (d) Error of commission.

2. If, as a result of a misstatement resulting from fraud, the auditor encounters exceptional circumstances that bring into question his ability to continue performing the audit, he shall-

   (a) Withdraw from the engagement immediately.

   (b) Report to Audit team regarding withdrawal.

   (c) Determine the professional and legal responsibilities applicable in the circumstances.

   (d) Ask the management for his withdrawal.

3. Which of the following is an example of inflating cash payments?

   (a) Making payments against purchase vouchers.

   (b) Teeming and lading.

   (c) Not accounting for cash sales fully.

   (d) Making payments against inflated vouchers.

4. The type of errors, existence of which becomes apparent in the process of compilation of accounts is known as-

   (a) Self-revealing errors.

   (b) Intentional errors.

   (c) Concealed errors.

   (d) Unconcealed errors.

5. Misappropriation of assets may occur because there is-

   (a) Adequate record keeping with respect to assets.

   (b) Known history of violations of securities laws.

   (c) Lack of complete and timely reconciliations of assets.

   (d) Dispute between shareholders in a closely held entity.

Correct/Incorrect

State with reasons (in short) whether the following statement is correct or incorrect:

(i) Teeming and lading is one of the techniques of inflating cash payments.

(ii) Fraud can be termed as intentional error.

(iii) Auditor needs to report to Central Government in case of fraud involving 20 Lakh rupees.

(iv) The primary responsibility for the prevention and detection of fraud rests with both those charged with governance of the entity and management.

(v) Fraudulent financial reporting only involve manipulation, falsification or alteration of accounting records or supporting documents from which financial statements are prepared

Answers to MCQs

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

Answers to Correct/Incorrect

(i) **Incorrect:** Teeming and Lading is one of the techniques of suppressing cash receipts and not of inflating cash payments. Money received from one customer is misappropriated and the account is adjusted with the subsequent receipt from another customer and so on.

(ii) **Correct:** Fraud is the word used to mean intentional error. This is done deliberately which implies that there is intent to deceive, to mislead or at least to conceal the truth. It follows that other things being equal, they are more serious than unintentional errors because of the implication of dishonesty which accompanies them.

(iii) **Incorrect:** As per section 143(12) of the Companies Act 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is ₹ 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ₹ 1 crore) within such time and in such manner as may be prescribed.

Thus fraud involving amount of 20 lakh rupees should be reported to Audit Committee.

(iv) **Correct:** As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", it is important that management, with the oversight of those charged with governance, place a strong emphasis on fraud prevention, which may reduce opportunities for fraud to take place, and fraud deterrence, which could persuade individuals not to commit fraud because of the likelihood of detection and punishment. This involves a commitment to creating a culture of honesty and ethical behavior which can be reinforced by an active oversight by those charged with governance.

(v) Incorrect: As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraudulent financial reporting may involve manipulation, falsification or alteration of accounting records or supporting documents from which financial statements are prepared, misrepresentation in, or intentional omission from, financial statements of events, transactions or other significant information or Intentional misapplication of accounting principles relating to amounts, classification, manner of presentation or disclosure.

CH. 6

MCQs

1. Which of the following is a General IT control?

   (a) IT Environment

   (b) Application Control

   (c) Access Security

   (d) IT Dependent Control

2. Which of the following is an automated control?

   (a) Program change

   (b) System generated report

   (c) Application control

   (d) Configurations

3. Who is mainly responsible for implementation of internal financial controls in a company?

   (a) Auditors

   (b) Directors

   (c) Employees

   (d) Regulators

4. TheGuidance Note on Audit of Internal Financial Controls over Financial Reporting has been issued by?

   (a) ICAI

   (b) SEBI

   (c) MCA

   (d) RBI

5. The standard that requires auditors to analyse journal entries in an audit is?

(a) SA 260

(b) SA 230

(c) SA 315

(d) SA 240

Correct/Incorrect

State with reasons (in short) whether the following statement is correct or incorrect:

(i) All automated environments are complex.

(ii) In an audit of financial statements, the auditor should plan response to all IT risks.

(iii) General IT controls support the functioning of Application controls.

(iv) Inquiry is often the most efficient audit testing method, but least effective.

(v) Specialised audit tools like IDEA, ACL are required to perform data analytics.

Answers to MCQs

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

Answers to Correct/Incorrect

(i) **Incorrect**: The complexity of an automated environment depends on various factors including the nature of business, level of automation, volume of transactions, use of ERP and so on. There could be environments where dependence on IT and automation is relatively less or minimal and hence, considered less complex or even non-complex.

(ii) **Incorrect.** The auditor should plan response to those IT risks that are relevant to financial reporting and not "all" IT risks.

(iii) **Correct.** General IT controls support the functioning of automated application controls and IT dependent controls..

(iv) **Correct.** Inquiry is the most efficient but least effective. Moreover, testing through inquiry alone is not sufficient. Inquiry should be corroborated by applying any one or a combination of observation, inspection or reperformance.

(v) **Incorrect.** Even though specialised audit tools are very useful, such tools are not always required or necessary to carry out data analytics. More commonly available spreadsheet applications like MS-Excel can also be effectively used for carrying out data analytics.

CH.7

MCQs

1. The main advantage of using statistical sampling techniques is that such techniques:

   (a) Mathematically measure risk

   (b) Eliminate the need for judgmental sampling

   (c) Defines the values of tolerable error

   (d) all of the them.

2. Which of the following factors is (are) considered in determining the sample size for tests of control?

   (a) Projected error

   (b) Tolerable error

   (c) Expected error

   (d) Both (b) and (c)

3. Tolerable error, is the maximum monetary error that the auditor is prepared to accept in the population and still conclude that audit objective has been achieved, is directly related to

   (a) Sample size

   (b) Audit risk

   (c) Materiality

   (d) Expected error

4. Which of the following is source of Non Sampling risk :

   (a) Human Mistakes

   (b) Applying audit procedures not appropriate to the objectives of audit

   (c). Misinterpreting the sample results

   (d) All of the above

5. Which of the following is more scientific :

   (a) Statistical

   (b) Non- statistical

   (c) both (a) and (b)

   (d) none of the above

Correct/Incorrect

State with reasons (in short) whether the following statement is correct or incorrect:

(i) The method which involves dividing the population into groups of items is knows as block sampling.

(ii) Universe refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

(iii) Non Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.

(iv) Sample need not be representative

(v) The objective of stratification is to increase the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

Answers to MCQs

1. (a) **2.** (d) **3.** (c) **4.** (d) **5.** (a)

Answers to Correct/Incorrect

(i) **Incorrect.** The method which involves dividing the population into groups of items is known as cluster sampling whereas block sampling involves the selection of a defined block of consecutive items.

(ii) **Incorrect :** Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.

(iii) **Incorrect :** Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.

(iv) **Incorrect :** Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

(v) **Incorrect** : The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.

CH.8

MCQs

1. What are analytical procedures?
   (a) Substantive tests designed to assess control risk
   (b) Substantive tests designed to evaluate the validity of management's representation letter
   (c) Substantive tests designed to study relationships between financial and non-financial
   (d) All of the above
2. Which of the following is not an analytical procedure?
   (a) Tracing of purchases recurred in the purchase book to purchase invoices.
   (b) Comparing aggregate wages paid to number of employees
   (c) Comparing the actual costs with standard costs
   (d) All of them are analytical procedures
3. Analytical procedures issued in the planning stage of an audit, generally:
   (a) helps to determine the nature, timing and extent of other audit procedures
   (b) directs attention to potential risk areas
   (c) indicates important aspects of business
   (d) All of the above
4. The basic assumption underlying the use of analytical procedures is:
   (a) It helps the auditor to study relationship among elements of financial information
   (b) Relationship among data exist and continue in the absence of known condition to the contrary
   (c) Analytical procedures will not be able to detect unusual relationships
   (d) None of the above
5. What is the primary objective of analytical procedures used in the overall review stage of an audit?
   (a) To help to corroborate the conclusions drawn from individual components of financial statements
   (b) To reduce specific detection risk
   (c) To direct attention to potential risk areas
   (d) To satisfy doubts when questions arise about a client's ability to continue

Correct/Incorrect

State with reasons (in short) whether the following statement is correct or incorrect:

1. As per the Standard on Auditing (SA) 520 "Analytical Procedures" 'the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among financial data only.
2. Auditor can depend on routine checks to disclose all the mistakes or manipulation that may exist in accounts.
3. Only purpose of analytical procedures is to obtain relevant and reliable audit evidence when using substantive analytical procedures.
4. Analytical Procedures are required in the planning phase only.
5. Substantive analytical procedures are generally less applicable to large volumes of transactions that tend to be predictable over time.

Answers to MCQs

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

Answers to Correct/Incorrect

1. **Incorrect.** As per the Standard on Auditing (SA) 520 "Analytical Procedures" 'the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.

2. **Incorrect.** Routine checks cannot be depended upon to disclose all the mistakes or manipulation that may exist in accounts, certain other procedures also have to be applied like trend and ratio analysis in addition to reasonable tests.

3. **Incorrect.** Analytical procedures use comparisons and relationships to assess whether account balances or other data appear reasonable. Analytical procedures are used for the following purposes:

(i) To obtain relevant and reliable audit evidence when using substantive analytical procedures; and

(ii) To design and perform analytical procedures near the end of the audit that assist the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity.

4. **Incorrect.** Analytical Procedures are required in the planning phase and it is often done during the testing phase. In addition these are also required during the completion phase.

5. **Incorrect.** Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.

CH.9

MCQs

1. Which assertion is common among income statement and balance sheet captions:
   - (a) Existence
   - (b) Valuation
   - (c) Completeness
   - (d) Measurement
2. Direct confirmation procedures are performed during audit of accounts receivable balances to address the following balance sheet assertion:
   - (a) Rights and obligations
   - (b) Existence
   - (c) Valuation
   - (d) Completeness
3. Where no reply is received during the performance of direct confirmation procedures as part of audit of accounts receivable balances, the auditor should perform:
   - (a) No additional testing
   - (b) Additional testing including agreeing the balance to cash received; agreeing the detail of the respective balance to the customer's remittance advice
   - (c) Additional testing including preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred
   - (d) Both (b) and (c)
4. Obtaining trade receivables ageing report and analysis and identification of doubtful debts is performed during audit of accounts receivable balances to address the following balance sheet assertion:
   - (a) Valuation
   - (b) Rights and obligations
   - (c) Existence
   - (d) Completeness
5. Observing inventory being counted and personally performing test counts to verify counts is performed during audit of inventory balances to address the following balance sheet assertion:
   - (a) Rights and obligations
   - (b) Valuation
   - (c) Completeness
   - (d) Existence

6. Wages paid to workers would always qualify as:

(a) Revenue expenditure

(b) Capital expenditure

(c) Revenue or capital expenditure depending upon facts and circumstances.

(d) None of the above

7. During the course of audit of intangible assets, expenditure incurred during following phase is generally not capitalised:

(a) Development phase

(b) Research phase

(c) None of the above

(d) Both (a) and (b)

8. Search for unrecorded liability is performed during audit of current liabilities to address the following balance sheet assertion:

(a) Valuation

(b) Rights and obligations

(c) Existence

(d) Completeness

9. Cut-off testing is performed during audit of sales to address the following income statement assertion:

(a) Occurrence

(b) Measurement

(c) Completeness

(d) All of the above

10. ABC's investee company- XYZ declares final dividend for financial year 2016-17 in the meeting of board of directors held on April 10, 2017. In which financial year should ABC account for the dividend income:

(a) Proportionately i.e. considering 10 days of financial year 2017-18 and 355 days of financial year 2016-17

(b) Financial year 2016- 17

(c) Financial year 2017- 18

(d) Equally between financial year 2016-17 and financial year 2017-18

11. All inventory units held by the audit entity and that should have been recorded, has been recognized in the financial statements. The assertion involved is :

(a) Existence

(b) Completeness

(c) Rights and Obligations

(d) Valuation

12. Which of the following is not an example of revenue expenditure -

    (a) Salaries and wages of employees engaged directly or in-directly in production

    (b) Repairs, maintenance and renewals of fixed assets

    (c) Legal and professional expenses

    (d) development expenditure on land

Correct/Incorrect

State with reasons (in short) whether the following statement is correct or incorrect:

1. Employee benefits expense or commonly called payroll represents the sum an entity pays to its employees for their labour/ efforts only.
2. Dividends are recognised in the statement of profit and loss only when the entity's right to receive payment of the dividend is established.
3. "Sweat Equity Shares" means equity shares issued by the company to employees or directors at a premium or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.
4. There is no difference between reserves and provision.
5. **Capital reserves** represent profits that are available for distribution to shareholders held for the time being or any one or more purpose.
6. A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised.
7. If Company X's balance sheet shows building with carrying amount of ₹ 100 lakh, the auditor shall assume that the management has only asserted that the building recognized in the balance sheet exists as at the period-end.
8. **Authorised capital** is the sum stated in the memorandum as the capital of the company with which it is to be registered being the maximum amount which it is authorised to raise by issuing shares, and upon which it pays the stamp duty.
9. The securities premium account may only be applied by the Company towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares.

Answers to MCQs

1. (c)	**2.** (b)	**3.** (d)	**4.** (a)	**5.** (d)	**6.** (c)
7. (b)	**8.** (d)	**9.** (c)	**10.** (c)	**11.** (b)	**12.** (d)

Answers to Correct/Incorrect

1. **Incorrect** : Employee benefits expense or commonly called payroll represents the aggregate sum an entity pays to its employees for their labour/ efforts, as well as associated expenses such as perquisites/ benefits, post- employment benefits like gratuity, superannuation, leave encashment, provident fund contribution etc. as well as towards their hiring, their welfare and training.

2. **Incorrect :** Dividends are recognised in the statement of profit and loss only when:

   (i) the entity's right to receive payment of the dividend is established;

   (ii) it is probable that the economic benefits associated with the dividend will flow to the entity; and

   (iii) the amount of the dividend can be measured reliably.

3. **Incorrect :** "Sweat Equity Shares" means equity shares issued by the company to employees or directors at a discount or for consideration other than cash for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.

4. **Incorrect :** The difference between the two is that provisions are amounts set aside to meet specific/ identified liabilities or diminution in recoverable value of assets. These must be provided for regardless of the fact whether the Company has earned profit or not.

   Reserves on the other hand, represent amounts appropriated out of profits, held for equalising the dividends of the company from one period to another or for financing the expansion of the company or for generally strengthening the company financially.

5. **Incorrect : Revenue reserves** represent profits that are available for distribution to shareholders held for the time being or any one or more purpose.

6. **Correct :** A capital reserve, generally, can be utilised for writing down fictitious assets or losses or (subject to provisions in the Articles) for issuing bonus shares if it is realised. But the amount of share premium or capital redemption reserve account can be utilised only for the purpose specified in Sections 52 and 55 respectively of the Companies Act, 2013.

7. **Incorrect :** If Company X's balance sheet shows building with carrying amount of ₹ 100 lakh, the auditor shall assume that the management has claimed/ asserted that:

   - The building recognized in the balance sheet exists as at the period- end (existence assertion);
   - Company X owns and controls such building (Rights and obligations assertion);
   - The building has been valued accurately in accordance with the measurement principles (Valuation assertion);

   All buildings owned and controlled by Company X are included within the carrying amount of ₹ 100 lakh (Completeness assertion).

8. **Correct : As per section 2(8) of the Companies Act, 2013. "Authorised capital" or "Nominal capital" means such capital as is authorised by the memorandum of a company to be the maximum amount of share capital of the company.** Thus, it is the sum stated in the memorandum as the capital of the company with which it is to be registered being the maximum amount which it is authorised to raise by issuing shares, and upon which it pays the stamp duty. It is usually fixed at the amount, which, it is estimated, the company will need, including the working capital and reserve capital, if any.

9. **Incorrect :** The securities premium account may be applied by the Company:
   (a) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
   (b) in writing off the preliminary expenses of the Company;
   (c) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
   (d) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
   (e) for the purchase of its own shares or other securities under section 68.

CH. 10

Correct/Incorrect:

State with reasons (in short) whether the following statements are correct or incorrect:

(i) The first auditor of a Government company was appointed by the Board in its meeting after 10 days from the date of registration.

(ii) Director's relative can act as an auditor of the company.

(iii) If an LLP (Limited Liability Partnership Firm) is appointed as an auditor of a company, every partner of a firm shall be authorized to act as an auditor.

(iv) AB & Co. is an audit firm having partners Mr. A and Mr. B. Mr. C, the relative of Mr. B is holding securities having face value of ₹ 2,00,000 in XYZ Ltd. AB & Co. is qualified for being appointed as an auditor of XYZ Ltd.

(v) The auditor of a Ltd. Company wanted to refer to the minute books during audit but board of directors refused to show the minute books to the auditors.

(vi) Manner of rotation of auditor will not be applicable to company A, which is having paid up share capital of ₹ 15 crores and having public borrowing from nationalized bank of ₹ 50 crore because it is a Private Limited Company.

(vii) The auditor should study the Memorandum and Articles of Association to see the validity of his appointment.

(viii) Managing director of A Ltd. himself appointed the first auditor of the company.

(ix) A Chartered Accountant holding securities of S Ltd. having face value of ₹ 950 is qualified for appointment as an auditor of S Ltd.

(x) Mr. N, a member of the Institute of Company Secretary of India, is qualified to be appointed as auditor of XYZ Limited.

Answers to Correct/Incorrect

(i) **Incorrect:** According to section 139(7) of the Companies Act, 2013, in the case of a Government company, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company. If CAG fails to make the appointment within 60 days, the Board shall appoint in next 30 days.

(ii) **Incorrect:** As per section 141(3) of the Companies Act, 2013, a person shall not be eligible for appointment as an auditor of a company whose relative is a Director or is in the employment of the Company as a director or key Managerial Personnel.

(iii) **Incorrect:** As per section 141(2) of the Companies Act, 2013, where a firm including a limited liability partnership (LLP) is appointed as an auditor of a company, only the partners who are Chartered Accountants shall be authorised to act and sign on behalf of the firm.

(iv) **Incorrect:** As per the provisions of the Companies Act, 2013, a person is disqualified to be appointed as an auditor of a company if his relative is holding any security of or interest in the company of face value exceeding ₹ 1 lakh.

Therefore, AB & Co. shall be disqualified for being appointed as an auditor of XYZ Ltd. as Mr. C, the relative of Mr. B who is a partner in AB & Co., is holding securities in XYZ Ltd. having face value of ₹ 2 lakh.

(v) **Incorrect:** The provisions of Companies Act, 2013 grant rights to the auditor to access books of account and vouchers of the company. He is also entitled to require information and explanations from the company. Therefore, he has a statutory right to inspect the minute book.

(vi) **Incorrect:** According to section 139 of the Companies Act, 2013, the provisions related to rotation of auditor are applicable to all private limited companies having paid up share capital of ₹ 20 crore or more; and all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of ₹ 50 crore or more.

Although company A is a private limited company yet it is having public borrowings from nationalized bank of ₹ 50 crores, therefore it would be governed by provisions of rotation of auditor.

(vii) **Incorrect:** The auditor should study the Memorandum of Association to check the objective of the company to be carried on, amount of authorized share capital etc. and Articles of Association to check the internal rules, regulations and ensuring the validity of transactions relating to accounts of the company.

To see the validity of appointment, the auditor should ensure the compliance of the provisions of section 139, 140 and 141 of the Companies Act, 2013.

In addition, the auditor should study the appointment letter & the prescribed Form submitted to the Registrar of the Companies to see the validity of his appointment.

(viii) **Incorrect:** As per section 139(6) of the Companies Act, 2013, the first auditor of a company, other than a government company, shall be appointed by the Board of directors within 30 days from the date of registration of the company.

Therefore, the appointment of first auditor made by the managing director of A Ltd. is in violation of the provisions of the Companies Act, 2013.

(ix) **Incorrect:** As per the provisions of the Companies Act, 2013, a person is disqualified to be appointed as an auditor of a company if he is holding any security of or interest in the company.

As the chartered accountant is holding securities of S Ltd. having face value of ₹ 950, he is not eligible for appointment as an auditor of S Ltd.

(x) **Incorrect:** As per section 141 of the Companies Act, 2013, a person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant.

Thus, Mr. N is disqualified to be appointed as an auditor of XYZ Limited.

CH. 11

MCQs

1. In order to form the opinion, the auditor shall conclude as to whether the auditor has obtained ________about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

   (a) reasonable assurance

   (b) absolute assurance

   (c) Limited assurance

   (d) None of the above

2. Which of the following is not a type of modified opinion:

   (a) qualified opinion

   (b) adverse opinion

   (c) disclaimer of opinion

   (d) None of the above

3. The auditor shall express _______opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

   (a) Adverse

   (b) Qualified

   (c) Disclaimer

   (d) None of the above

4. SA-700 requires the use of specific headings, which are intended to assist in making auditor's reports that refer to audits that have been conducted in accordance with SAs more recognizable. Which of the following is that specific heading :

   (a) Key audit matters

   (b) Basis of opinion

   (c) Date

   (d) All of the above

5. The Opinion section of the auditor's report shall:

   (a) Identify the entity whose financial statements have been audited;

   (b) State that the financial statements have been audited;

   (c) Identify the title of each statement comprising the financial statements;

   (d) All of the above

Correct/Incorrect

State with reasons (in short) whether the following statement is correct or incorrect:

(i) The auditor shall express a qualified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

(ii) There is no need of addressee in the Auditor's report.

(iii) The auditor shall modify the opinion in the auditor's report only when the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement.

(iv) The auditor shall express a disclaimer of opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

(v) Communicating key audit matter in the auditor's report constitutes a substitute for disclosure in the financial statements.

Answers to MCQs

1. (a) **2.** (d) **3.** (a) **4.** (d) **5.** (d)

Answer to Correct/Incorrect

(i) **Incorrect**: The auditor shall express an unmodified opinion when the auditor concludes that the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework.

(ii) **Incorrect.** The auditor's report shall be addressed, as appropriate, based on the circumstances of the engagement. Law, regulation or the terms of the engagement may specify to whom the auditor's report is to be addressed. The auditor's report is normally addressed to those for whom the report is prepared, often either to the shareholders or to those charged with governance of the entity whose financial statements are being audited.

(iii) **Incorrect.** The auditor shall modify the opinion in the auditor's report when:

   (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

   (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

(iv) **Correct.** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

(v) **Incorrect.** Communicating key audit matters in the auditor's report is in the context of the auditor having formed an opinion on the financial statements as a whole. Communicating key audit matters in the auditor's report is not a substitute for disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation.

CH. 12

MCQs

1. Regulating body in case of banks is :
   (a) SEBI
   (b) IRDA
   (c) RBI
   (d) ICAI
2. Which of the following is fund based advance :
   (a) Term loans
   (b) Cash credits,
   (c) Demand Loans
   (d) All of the above
3. Which of the following is not classification of NPA-
   (a) Impaired
   (b) sub standard
   (c) doubtful
   (d) Loss

Correct/Incorrect

State with reasons (in short) whether the following statement is correct or incorrect:

(1) RBI has been entrusted with the responsibility of regulating the activities of commercial banks only.

(2) In the computerised environment, the auditor need not be familiar with latest applicable RBI guidelines that have bearing on the classification/ provisions and income recognition.

(3) The auditor can assume that the system generated information is correct and relied upon without evidence that demonstrates that the system driven information is based on validation of the required parameters for the time being in force and applicable.

(4) Collateral security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank.

(5) Registered mortgage is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof.

(6) Any amount due to the bank under any credit facility is 'overdue' if it is not paid within 90 days of becoming due.

(7) An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.

Answers to MCQs

1. (c) **2.** (d) **3.** (a)

Answers to Correct/Incorrect

1. **Incorrect.** RBI has been entrusted with the responsibility of regulating the activities of commercial and other banks.

2. **Incorrect.** In the Computerised environment, it is imperative that the auditor is familiar with, and is satisfied that, all the norms/parameters as per the latest applicable RBI guidelines are incorporated and built into the system that generates information/data having a bearing on the classification/ provisions and income recognition.

3. **Incorrect.** The auditor should not go by the assumption that the system generated information is correct and can be relied upon without evidence that demonstrates that the system driven information is based on validation of the required parameters for the time being in force and applicable.

4. **Incorrect.** Primary security refers to the security offered by the borrower for bank finance or the one against which credit has been extended by the bank. This security is the principal security for an advance.

5. **Incorrect.** Equitable mortgage, on the other hand, is effected by a mere delivery of title deeds or other documents of title with intent to create security thereof.

6. **Incorrect.** Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank.

7. **Correct.** An account should be treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power.

CH. 13

MCQs

1. While auditing a cinema hall, the auditor needs to verify that-

   (a) entrance to the cinema-hall during show is only through printed tickets

   (b) tickets are serially numbered and bound into books

   (c) that for advance booking a separate series of tickets is issued

   (d) All of the above

2. Article 151 requires that the reports of the C&AG relating to the accounts of the Union/State shall be submitted to the -------- who shall cause them to be laid before House of Parliament/State Legislature

   (a) President/Governor

   (b) Prime Minister/ Chief Minister

   (c) Union Finance Minister/State Finance Minister

   (d) All of the above

3. The C&AG Act gives which of the following power to the C&AG in connection with the performance of his duties-

   (a) To inspect any office of accounts under the control of the Union or a State Government including office responsible for the creation of the initial or subsidiary accounts.

   (b) To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places.

   (c) To put such questions or make such observations as he may consider necessary to the person in charge of the office and to call for such information as he may require for the preparation of any account or report which is his duty to prepare.

   (d) All of the above

4. _______aims at ascertaining that the expenditure incurred has been on the purpose for which the grant and appropriation had been provided and that the amount of such expenditure does not exceed the appropriation made.

   (a) Audit against provision of funds

   (b) Propriety audit

   (c) Audit of sanctions

   (d) Audit against rules and orders

Correct/Incorrect

State with reasons (in short) whether the following statement is correct or incorrect:

1. Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the Finance Minister may on the advice of the C&AG prescribe.
2. According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.
3. Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads: (a) general administration and revenue collection, (b) public health, (c) public safety, (d) education, (e) public works, and (f) others such as interest payments.
4. The external control of municipal expenditure is exercised by the Central Government through the appointment of auditors to examine municipal accounts.
5. NGOs may be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives.

Answers to MCQs

1.	(d)	**2.**	(d)	**3.**	(d)	**4.**	(a)

Answers to Correct/Incorrect

1. **Incorrect.** Article 150 of the Constitution provides that the accounts of the Union and of the States shall be kept in such form as the President may on the advice of the C&AG prescribe.
2. **Correct.** According to 'propriety audit', the auditors try to bring out cases of improper, avoidable, or infructuous expenditure even though the expenditure has been incurred in conformity with the existing rules and regulations.
3. **Correct .** Expenditure incurred by the municipalities and corporations can be broadly classified under the following heads: (a) general administration and revenue collection, (b) public health, (c) public safety, (d) education, (e) public works, and (f) others such as interest payments, etc.
4. **Incorrect.** The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts.
5. **Correct.** NGOs can be defined as non-profit making organisations which raise funds from members, donors or contributors apart from receiving donation of time, energy and skills for achieving their social objectives like imparting education, providing medical facilities, economic assistance to poor, managing disasters and emergent situations.