

Paper 6: Auditing and Assurance

1. Marvin Ltd. is a renowned food chain supplier in a posh area providing restaurant facility along with food delivering. CA. Felix was appointed as an auditor of the company for the Financial Year 2017-18. While examining the books of account of the company, CA. Felix came to know about one of the major expenses of the company i.e. rent expense of Rs. 1,20,000 per month, for which he applied substantive analytical procedure for verification purpose. Explain, how would CA. Felix perform substantive analytical procedure in the given scenario?
 - (a) CA. Felix would inspect every single rent invoice per month of Rs. 1,20,000 and verify other elements appropriately.
 - (b) CA. Felix would compare the rental expense of the company with that of another nearby company having corresponding dimensions, for high degree of accuracy.
 - (c) CA. Felix would select the first month rent invoice of Rs. 1,20,000 and appropriately verifying other elements would predict that the rent for the whole year would be Rs. 14,40,000 (i.e. Rs. 1,20,000 * 12). Thereafter, he would compare the actuals with his prediction and follow-up for any fluctuation.
 - (d) (a) and (b), both.
2. Coyote Ltd. is dealing in trading of electronic goods. Huge inventory (60% approximately) of the company is lying on consignment (i.e. under the custody of third party). CA. Star, the auditor of the company, wants to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory lying on consignment. Thus, he requested & obtained confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity, however, it raised doubts about the integrity and objectivity of the third party. Which of the following other audit procedures may be performed by CA. Star to obtain sufficient appropriate audit evidence regarding the existence and condition of the inventory under the custody of third party?
 - (a) Attend third party's physical counting of inventory.
 - (b) Arrange for another auditor to attend third party's physical counting of inventory.
 - (c) Inspect warehouse receipts regarding inventory held by third parties.
 - (d) All of the above.
3. In July, 2018, M/s Tom & Co. entered into an agreement with M/s Jerry & Co. under which a machinery would be let on hire and M/s Jerry & Co. would have the option to purchase the machinery in accordance with the terms of the agreement. Thus, M/s Jerry & Co. agreed to pay M/s Tom & Co. a settled amount in periodical instalments. The property in the goods shall be passed to M/s Jerry & Co. on the payment of last of such instalments. While checking such hire-purchase transaction, what would the auditor examine?
 - (a) That the periodical instalments paid are charged as an expenditure by M/s Jerry & Co.
 - (b) That the hire purchase agreement specifies clearly the hire-purchase price of the machinery to which the agreement relates.
 - (c) That M/s Tom & Co. charges depreciation throughout the life of the machinery.
 - (d) All of the above.
4. The management of Magoo Ltd. has developed a strong internal control in its accounting system in such a way that the work of one person is reviewed by another. Since no individual employee is allowed to handle a task alone from the beginning to the end, the chances of early detection of frauds and errors are high. CA. Olive has been appointed as an auditor of the company for current Financial Year 2017-18. Before starting the audit, she wants to evaluate the internal control system of Magoo Ltd. To facilitate the

accumulation of the information necessary for the proper review and evaluation of internal controls, CA. Olive decided to use internal control questionnaire to know and assimilate the system and evaluate the same. Which of the following questions need not be framed under internal control questionnaire relating to purchases?

- (a) Are authorized signatories for purchases limited to elected officials?
- (b) Are payments approved only on original invoices?
- (c) Does authorized officials thoroughly review the documents before signing cheques?
- (d) Are monthly bank reconciliations implemented for each and every bank accounts of the company?

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

- (a) Audit programmes.
- (b) Notes reflecting preliminary thinking.
- (c) Letters of confirmation.
- (d) E-mails concerning significant matters.

6. While auditing the books of accounts of QHMP Ltd., CA. Ranker, the statutory auditor of the company, came to know that the management of the company has recognized internally generated goodwill as a fixed asset. CA. Ranker discussed with the management that according to accounting standards, internally generated goodwill is not recognized as an asset because it is not an identifiable resource controlled by the enterprise that can be measured reliably at cost. However, the management is quite rigid to the accounting treatment followed for internally generated goodwill and not paying attention to the auditor. Thus, through an example, CA. Ranker explained which type of goodwill may be recognized as a fixed asset for which the management got justified. State which of the following examples the auditor must have given to the management?

- (a) If an item meeting the definition of an intangible asset is acquired in a business combination, it forms part of the goodwill to be recognized at the date of the amalgamation.
- (b) Only those goodwill needs to be recognized as a fixed asset which can be touched like physical assets, for example, land and buildings.
- (c) Goodwill is recognised only when there is a contractual or other legal rights for a physical asset which shall not be amortized over the period.
- (d) All of the above.

7. Eeyore Pvt. Ltd. is incorporated on 1st July, 2017. During the Financial Year ending on 31st March, 2018, the company did not opt for any borrowing at any point of time and have a total revenue of Rs. 60 Lakh. At the year end, it provides the following information regarding its paid-up capital and reserve & surplus-

Particulars	Amount (in Rs.)
Paid-up Capital	
- Consideration received in cash for equity shares	40,00,000

(including unpaid calls of Rs. 5,00,000)	
- Consideration received in cash for preference shares	25,00,000
- Bonus shares allotted	7,00,000
- Share application money received pending allotment	10,00,000
Sub-Total	82,00,000
Reserve & Surplus	
- Balance in Statement of Profit and Loss	15,00,000
- Capital Reserves	10,00,000
Sub-Total	25,00,000
GRAND TOTAL	1,07,00,000

You are provided with the provisions regarding applicability of Companies (Auditor's Report) Order, 2016, (CARO, 2016) issued under section 143(11) of the Companies Act, 2013 to a private limited company that it specifically exempts a private limited company having a paid up capital and reserves and surplus not more than Rs. 1 crore as on the Balance Sheet date and which does not have total borrowings exceeding Rs. 1 crore from any bank at any point of time during the financial year and which does not have a total revenue as disclosed in Scheduled III to the Companies Act, 2013 exceeding Rs. 10 crore during the financial year.

Considering the information given above, which of the following shall be considered as a reason regarding applicability or non-applicability of CARO, 2016?

- Reporting under CARO, 2016 shall be applicable as the company is having a paid up capital and reserves and surplus of Rs. 1.07 crore i.e. more than Rs. 1 crore as on the Balance Sheet date.
- Reporting under CARO, 2016 shall be applicable as the company is having a paid up capital and reserves and surplus of Rs. 1.02 crore i.e. more than Rs. 1 crore as on the Balance Sheet date.
- Reporting under CARO, 2016 shall not be applicable as the company is having a paid up capital and reserves and surplus of Rs. 0.92 crore i.e. not more than Rs. 1 crore as on the Balance Sheet date.
- Reporting under CARO, 2016 shall not be applicable as the company is having a paid up capital and reserves and surplus of Rs. 0.82 crore i.e. not more than Rs. 1 crore as on the Balance Sheet date.

- CA. Goofy has been appointed as an auditor for audit of a complete set of financial statements of Dippy Ltd., a listed company. The financial statements of the company are prepared by the management in accordance with the Accounting Standards prescribed under section 133 of the Companies Act, 2013. However, the inventories are misstated which is deemed to be material but not pervasive to the financial statements. Based on the audit evidences obtained, CA. Goofy has concluded that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern in accordance with SA 570. Further, CA. Goofy is also aware of the fact that a qualified opinion would be appropriate due to a material misstatement of the Financial Statements. State what phrases should the auditor use while drafting such opinion paragraph?

- In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.
- In our opinion and to the best of our information and according to the explanations given to us, with the foregoing explanation, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.

- (c) In our opinion and to the best of our information and according to the explanations given to us, subject to the misstatement regarding inventories, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.
- (d) In our opinion and to the best of our information and according to the explanations given to us, with the explanation described in the Basis for Qualified Opinion section of our report, the aforesaid financial statements present fairly, in all material respects, or give a true and fair view in conformity with the applicable financial reporting framework.
9. While auditing the accounts of ThoughtCo Ltd., CA. Bliss, the auditor of the company came across certain accounts payable balances for which direct confirmation procedure needs to be applied. Thus, for the year ending 31st March, 2018, he sent positive confirmation requests wherein the trade payables are requested to respond whether or not they are in agreement with the balance shown. The auditor received all the confirmation replies from the trade payables on time as correct except from five of them. What other option the auditor is left with regard to trade payables from which no reply for confirmation requests received?
- (a) Perform additional testing which may include agreeing the balance to subsequent cash paid.
- (b) Accept the balances as it is assuming other replies against received confirmation requests being correct.
- (c) Accept the balances as it is assuming that the trade payables must have replied in case of any discrepancies.
- (d) None of the above.
10. CA. Daffy is the auditor of xBose Ltd. for the previous 2 years. However, due to certain unavoidable circumstances, no Annual General Meeting (AGM) was held for the current Financial Year ending on 31st March, 2018 within every possible time limit and thus, the ratification procedure for her appointment in the AGM could not be performed. Whether she may continue to hold the office of the auditor?
- (a) CA. Daffy may continue to hold the office of the auditor for the current Financial Year only and thereafter shall resign herself as the ratification procedure could not be completed.
- (b) CA. Daffy shall continue to hold the office of the auditor and ask the Board to re-appoint her in a private meeting.
- (c) CA. Daffy shall continue to hold the office of the auditor as no such ratification provisions for appointment by members at every AGM exist.
- (d) CA. Daffy shall not continue to hold office of the auditor as the ratification procedure could not be completed as per proviso to section 139(1) of the Companies Act, 2013.
11. While auditing TEN Ltd., CA. Porky divided the whole population of trade receivables balances to be tested in a few separate groups called 'strata' and started taking a sample from each of them. He treated each stratum as if it was a separate population. He divided the trade receivables balances of TEN Ltd. for the Financial Year 2017-18 into groups on the basis of personal judgment as follows:

S. No.	Particulars
1	Balances in excess of Rs. 10,00,000;
2	Balances in the range of Rs. 7,75,001 to Rs. 10,00,000;
3	Balances in the range of Rs. 5,50,001 to Rs. 7,75,000;
4	Balances in the range of Rs. 2,25,001 to Rs. 5,50,000;

5	Balances Rs. 2,25,000 and below
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From the abovementioned groups, CA. Porky picked up different percentage of items for examination from each of the groups, for example, from the top group i.e. balances in excess of Rs.10,00,000, he selected all the items to be examined; from the second group, he opted for 25 % of the items to be examined; from the lowest group, he selected 2% of the items for examination; and so on from rest of the groups. Which one of the following methods of sample selection is he following?

- (a) Systematic sampling.
- (b) Stratified sampling.
- (c) Section sampling.
- (d) Selection sampling.

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

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

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

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

13. CA. Donald was appointed as the auditor of PS Ltd. at the remuneration of Rs. 30,000. However, after 4 months of continuing his services, he could not continue to hold his office of the auditor as his wife got a government job at a distant place and he needs to shift along with her to the new place. Thus, he resigned from the company and did not perform his responsibilities relating to filing of statement to the company and the registrar indicating the reasons and other facts as may be relevant with regard to his resignation. How much fine may he be punishable with under Companies Act, 2013?

- (a) Nothing.
- (b) Rs. 30,000.
- (c) Not less than Rs. 50,000 but which may extend to Rs. 5, 00,000.
- (d) Not less than Rs. 30,000 but which may extend to Rs. 5, 00,000.

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

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

- (a) Known history of violations of laws and regulations.
 - (b) Management failing to remedy known significant deficiencies in internal control on a timely basis.
 - (c) Inventory items that are small in size, but of high value or in high demand.
 - (d) An interest by management in employing inappropriate means to minimize reported earnings for tax-motivated reasons.
15. *MeLeredian* is a renowned hotel operating in the city. The charge for room sales is posted to guest bills by Mr. Charlie, the night auditor. He has the responsibility for balancing the revenue and expense transactions, occurring during the day. He is also required to respond to guests' complaints and handling emergencies that may arise. While vouching the room sales, what special points may be considered by you as an auditor of the hotel?
- (a) Audit tests to be carried out to ensure that the correct numbers of guests are charged for the correct period.
 - (b) Any deviation between the charged rates used on the guests' bills and the standard room rate should be investigated to ensure that they have been properly authorised.
 - (c) Testing of reports, containing details of the rooms which were occupied the previous night and the number of beds kept in each room, with the guests' register and with the individual guest's bill.
 - (d) All of the above.
16. An entity in addition to undertaking purchases and incurring employee benefit expenses also spends on other expenditure that are essential and incidental to running of business operations. One of such expenses is the legal and professional expenses. These are the fees paid for professional advices regarding specific deals.
- Iconic Ltd. is having a retainership agreement with a lawyer, Mr. Avi, to whom the company is paying a huge sum as legal and professional expenses on monthly basis. While vouching such expenses, what should be kept in mind by the auditor?
- (a) In case of monthly retainership agreements, only verify if the expenditure for all 12 months has been recorded correctly.
 - (b) The auditor should verify that the payments have been only through bank vouchers.
 - (c) The auditor should be cautious while vouching for legal expenses as the same may highlight a dispute for which the entity may not have made any provision and the matter may also not have been discussed/ highlighted to the auditor for his specific consideration.
 - (d) In case of monthly retainership agreements, only verify that all the payments have been made and there is no outstanding balance to be shown as liability in the Balance Sheet.
17. CA. Sylvester, the statutory auditor of Yosemite Pvt. Ltd., encountered unavoidable circumstances that bring into question his ability to continue holding office of the auditor. Considering it appropriate, CA. Sylvester resigned from the office of auditor of Yosemite Pvt. Ltd. and thus, the Board of Directors itself appointed CA. Granny, a practicing Chartered Accountant, as the statutory auditor of the company to hold office of the auditor till the conclusion of 6th meeting. Which of the following statement is true in the given scenario?
- (a) The appointment of CA. Granny made by the Board of Directors is invalid.

- (b) Casual vacancy can be filled by the Board of Directors subject to approval by the company at a general meeting convened within 3 months of the recommendation of the Board.
 - (c) CA. Granny cannot hold the office of auditor till the conclusion of 6th meeting i.e. the appointment cannot be made for five years. The auditor can hold office only till the conclusion of the next AGM.
 - (d) All of the above.
18. Minnie Ltd., a listed company, appointed CA. Kranny for auditing complete set of consolidated financial statements of the company. CA. Kranny is unable to obtain sufficient appropriate audit evidence regarding an investment in a foreign associate. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be material but not pervasive to the consolidated financial statements. Based on the audit evidence obtained, CA. Kranny concludes that a material uncertainty does not exist related to events or conditions that may cast significant doubt on the company's ability to continue as a going concern in accordance with SA 570. State what type of opinion CA. Kranny must have provided in the given scenario?
- (a) Unmodified opinion.
 - (b) Qualified opinion.
 - (c) Adverse opinion.
 - (d) Disclaimer of opinion.
19. The management of BOB Ltd. could not differentiate between any obligation for which either provisions need to be made or the contingent liability to be shown. The auditor of the company clarifies the management that the provisions are the amounts charged against revenue to provide for a known liability, the amount whereof cannot be determined with substantial accuracy. On the other hand, a contingent liability is a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability. The auditor further explains the concept with the help of examples. State which of the following examples the auditor must have provided in respect of contingent liability?
- (a) Depreciation.
 - (b) Clean-up costs for unlawful environmental damage.
 - (c) Product warranties.
 - (d) Lawsuit against the company where it is more likely that no present obligation exists.
20. Miss Betty, relative of CA. Tweety (one of the partners of M/s AB & Co.), owed Rs. 1,50,000 to Satyan Ltd. for goods purchased in the normal course of business. Later on, M/s AB & Co. was appointed as statutory auditors of Prakash Ltd. (which holds 51% shares in Satyan Ltd.). On discovering the said fact, Miss Betty cleared the dues to Satyan Ltd. on 59th day following the date of appointment of M/s AB & Co. as statutory auditors of Prakash Ltd. Which of the following statement is true in the given scenario with respect to validity of appointment of M/s AB & Co.?
- (a) Miss Betty, relative of CA. Tweety (one of the partners of M/s AB & Co.) is indebted to the subsidiary of Prakash Ltd. but not to the company itself. Thus, the appointment of M/s AB & Co. as the statutory auditors of Prakash Ltd. is valid.

- (b) M/s AB & Co. is not eligible for appointment as an auditor of Prakash Ltd. as Miss Betty, relative of CA. Tweety (one of the partners of M/s AB & Co.) is indebted to Satyan Ltd. (subsidiary of Prakash Ltd.) Thus, the appointment made is not valid.
- (c) As the corrective action has been taken regarding indebtedness to Satyan Ltd. (subsidiary of Prakash Ltd.) within 60 days of such appointment, the appointment of M/s AB & Co. is valid.
- (d) There is no such contravention of the provisions of the Companies Act, 2013 in the given scenario. Thus, the appointment of M/s AB & Co. as the statutory auditors of Prakash Ltd. is valid.

Solution

1	C	6	A	11	B	16	C
2	D	7	C	12	C	17	D
3	B	8	A	13	D	18	B
4	D	9	A	14	C	19	D
5	B	10	C	15	D	20	D