

WT 3 (Ch. 5 – Audit Evidence & Ch. 6 – Conclusion and Review)

Marks: 25

Time: 45 Minutes

Instructions: Part A comprises of MCQ.

Part B Comprises of descriptive questions.

**Part – A (Multiple Choice Questions)**

During the planning stage of audit of Mobile & Cell Limited, the statutory auditor of the company, ABC & Co. decided:

1. To perform test counts on a sample basis for Inventory Balance which was material. Also, the audit team will inquire management to provide copies of management's completed physical inventory count which will assist them in performing subsequent procedures required to determine whether inventory records accurately reflect actual inventory count results.
2. To perform substantive analytical procedures to gather sufficient and appropriate audit evidence for payroll cost. Audit team decided to recalculate the payroll cost by multiplying the total employees of the company with the average pay-out per employee.
3. To perform substantive procedures over the direct expenses which were assessed as a material with respect to the financial statement as a whole. Moreover, the number of items/transactions in direct expense were huge and of were of non-homogenous nature. As a result, audit team decided to select some samples from each identified strata disaggregated to the lowest level based on their characteristics.
4. The performance materiality for assessing any misstatement was fixed at ₹ 10,00,000.

During the audit phase the audit team identified that:

- I. Since last three years the company is making cash losses and is facing liquidity crisis. Moreover, there was a huge loan instalment due for repayment in next three months. Considering the company's liquidity profile, it was evident that company will default the upcoming loan instalment and the payment of interest thereon. When inquired with the management as to how they will deal with this situation and how they will consider the impact of these events on management's assumption of going concern, the management contended that the company would raise more funds through issue of fresh equity in the primary market to manage the liquidity requirements.
- II. Moreover, there was an ongoing litigation on Company and its Officers for misappropriation of loan funds. As a result, after analysing the SEBI Listing Requirements, it was evident that company was not in position to issue fresh equity in the primary market.
- III. In one of the direct tax litigations, the adjudicating authority issued an unfavourable order against the company because of which the company was now required to pay huge fines and interest to the Tax Authority. The amount of fine and interest there on was material.
- IV. The engagement manager identified that the total payroll costs booked for the period was ₹ 30,00,000 for total 150 employees employed throughout the year from the payroll records & register. Engagement manager was able to identify that the average pay-out per employee was ₹ 20,500. Also, the independent expectation developed for the payroll cost was between ₹ 30,00,000 to ₹ 32,00,000 for the year.

V. The Audit team performed the testing of direct expense and following is the outcome:

Strata Name	Balance as per books	Total of sample value	No of Samples	Exception amount in samples	Reason for exception
Freight Expense	₹ 5,00,000	₹ 1,00,000	10	₹ 25,000	one invoice was incorrectly booked
Loading Charges	₹ 4,00,000	₹ 80,000	15	₹ 3,000	NA
Shipping Charges	₹ 9,00,000	₹ 2,70,000	10	₹ 3,000	NA
Packaging Expense	₹ 8,00,000	₹ 2,40,000	5	₹ 3,000	No documents were available for the said samples
Storing Expense	₹ 12,00,000	₹ 1,20,000	10	₹ 3,000	Warehouse charges were booked as storing expense. Wrong classification.
Total	₹ 38,00,000	₹ 8,10,000	50	₹ 3,000	Projected misstatement was ₹ 1,68,889 (36,000/8,10,000 × 38,00,000).

VI. Management allowed auditor to attend the physical inventory count, however, management did not allow audit team to perform any other procedure during the physical count. When inquired from management regarding the denial to the auditor from performing additional audit procedures along with attending the inventory count, the management explained that the inventory consists of very unstable chemicals and inflammable gases which require handling with skill and care. Any carelessness in handling the inventory can result in catastrophe. As a result, due to safety standards and policies, the management cannot allow the auditor to perform additional audit procedures.

On the basis of the abovementioned facts, you are required to answer the following MCQs:

Q.1 Auditor of the company decided to draw attention of the users of the audit report on the existence of the material uncertainty related to events that have casted significant doubts on the entity's ability to continue as going concern by disclosing the same in other matter paragraph. As an Engagement Quality Control Reviewer, guide the Auditor about the

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correct way of disclosing the existence of the material uncertainty related to events that have casted significant doubts on the entity's ability to continue as going concern when the management has not made appropriate disclosure of a material uncertainty in the financial statement.

- (a) When the management has not made appropriate disclosure of a material uncertainty in the financial statement and there exists a material uncertainty related to events that have casted significant doubts on the entity's ability to continue as going concern then the auditor should disclose the same in "Key Audit Matter" section in Audit Report only. No other disclosure is required.
- (b) Disclosure of the material uncertainty in the financial statement is the responsibility of the management and the auditor should not comment on the same.
- (c) When the management has not made appropriate disclosure of a material uncertainty in the financial statement and there exists a material uncertainty related to events that have casted significant doubts on the entity's ability to continue as going concern then the auditor should express a qualified or adverse opinion and should mention in the Basis of Qualified / Adverse Opinion section of the Audit Report about existence of the material uncertainty.
- (d) When the management has not made appropriate disclosure of a material uncertainty in the financial statement and there exists a material uncertainty related to events that have casted significant doubts on the entity's ability to continue as going concern then the auditor should express an unmodified opinion and should obtain the written representation about existence of the material uncertainty from management.

**Q.2** Considering the inherent limitation with respect to the inventory count, the audit team decided not to perform any other procedure or not to obtain any documentary evidence from management with respect to inventory. Guide the audit team in the current scenario by selecting the appropriate option from below:

- (a) If the auditor has not obtained sufficient appropriate audit evidence as to a material financial statement assertion, the auditor shall not attempt to obtain further audit evidence.
- (b) If the auditor has not obtained sufficient appropriate audit evidence as to a material financial statement assertion, the auditor shall attempt to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall express a qualified opinion or a disclaimer of opinion.
- (c) In case where audit team is not able to obtain sufficient and appropriate audit evidence as to a material financial statement assertion, then the auditor should appoint management's expert and should try to obtain required evidence from such expert.
- (d) In case where audit team is not able to obtain sufficient and appropriate audit evidence as to a material financial statement assertion, then the auditor should communicate to management and should obtain written representation from them.

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- Q.3** Based on the recalculation performed by the audit team, the total payroll cost arrived for the period was ₹ 30,75,000. Analyse and guide the audit team with respect to the results obtained from the substantive analytical procedure by selecting the appropriate option from below: **2**
- (a) The difference identified between the payroll costs derived through substantive analytical procedure and the expectation developed is material based on the materiality fixed by the audit team and hence it requires further investigation.
  - (b) The amount derived through substantive analytical procedure is not in congruence with the total amount of the payroll cost booked for the period. Hence the audit team should investigate the reasons for the difference between the amount derived and the actual cost booked.
  - (c) The total payroll cost arrived is well within the expectation developed and the difference between the amount recorded and the amount derived through substantive analytical procedure is not material. Hence, it does not require any further investigation.
  - (d) The difference identified between the amount derived through substantive analytical procedure and amount developed as an expectation is significant and the audit team should obtain appropriate written representation from management with respect to the completeness and accuracy of the amount derived through substantive analytical procedure.
- Q.4** Based on the above outcome of the direct expense testing the audit team decided to project the total misstatement on the entire balance considered for testing. As per the calculation performed, the projected misstatement was ₹ 1,68,889. Kindly analyse and guide the audit team with respect to the results obtained from the substantive testing by selecting the appropriate option from below: **2**
- (a) The projected misstatement calculated is appropriate. Moreover, based on the performance materiality and projected misstatement the auditor should modify his opinion.
  - (b) When a class of transactions or account balance has been divided into strata, then the misstatement is required to be projected for each stratum separately. Hence, the audit team's approach is incorrect with respect to the calculation of projected misstatement. The Audit team should recalculate the projected misstatement and then they should consider its impact on overall audit opinion based on the materiality.
  - (c) The audit team should have considered the exception of ₹ 8,000 twice while calculating the projected misstatement, as the error is regarding wrong classification and the same will affect two class of transactions or balances. Hence audit team should consider revising the projected misstatement and then they should consider its impact on overall audit opinion based on the materiality.
  - (d) Audit team has appropriately calculated the projected misstatement. However, before modifying the audit opinion the audit team should obtain written representation with respect to the completeness and accuracy of the direct expense balance which could serve as a sufficient and appropriate.

Part B (Descriptive Questions)

Q. No. 1 is Compulsory. Attempt Any two from the rest.

- Q.1 (a) P Ltd. is a company from a business group "ABCD" and is engaged in trading of garments. The promoters of the company are promoters and directors of some other group companies also. You have been appointed as an auditor of P Ltd. P Ltd. has entered into various inter company transactions (within group companies) during the year which are outside its normal course of business. What will be your duties as an auditor in relation to those transactions? 4
- (b) The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report, that requires adjustment of, or disclosure in, the financial statements have been identified. With reference to SA 560, what are the audit procedures included in the auditor's risk assessment? 4
- Q.2 ABC Ltd. appointed Mr. Anand for the actuarial calculation of liabilities associated with insurance contracts and employee benefit plans. These calculations and valuations are then adopted by management in preparing the financial statements. Kindly guide Mr Sushil, the statutory auditor of ABC Ltd, on the use of information prepared by management's appointed expert as audit evidence. Also, explain Mr. Sushil the matters that can impact the nature, timing and extent of audit procedures regarding information to be used as audit evidence which has been prepared using the work of a management's expert. 5
- Q.3 (a) Akash & Associates are the statutory auditors of Deluxe Ltd. for the FY 2023-24. During the course of audit, CA Akash, the engagement partner requested the management of the company to provide written representation with respect to valuation of a transaction. The management, however does not provide the same to CA Akash. What course of action should CA Akash follow in such situation? 2
- (b) Pachranga International Ltd. is manufacturer of pickles, ginger garlic paste, jams etc. having its plant at Jaipur. Being in food industry, the company is facing many litigations in various courts across India. Auditors SPV & Co. wants to identify such litigations and claims involving the company which may give rise to risk of material misstatement. Guide the auditor as to how they should proceed for the purpose. 3

**Q.4** MZE Limited is engaged in the manufacturing and export of ready-made garments. The company has lost overseas buyers to Asian competitors with lower raw materials and labour costs. As a result, MZE Limited has lost out on a significant chunk of export orders, and the trend has become more pronounced in the year 2023-24. Further, the US economic recession caused delays in the company's overseas payments, leading to the company being unable to keep its loan repayment commitments with bankers. Further, the company has not been able to pay its creditors on time. Even statutory dues payable by the company are either not paid or being paid after a gap of 5-6 months, leading to extra costs. Due to declining revenue, the company cannot cover its fixed costs and has begun laying off employees.

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Considering all these circumstances, CA P doubts the company's ability to continue as a going concern while conducting the statutory audit for the year 2023-24. He is studying management's assessment of the company's ability to continue as a going concern by studying projected profitability statements for the next two years containing turnover, expenses and profits estimates. Comment on the above situation with specific reference to audit procedures being performed by CA P in context of relevant Standards on Auditing.

### Instructions for submission of answer sheet

Single PDF of answer sheet is to be e-mail at [test.altclasses@gmail.com](mailto:test.altclasses@gmail.com)

Subject line "Final Audit Test – WT 3 (*Student Name*)"

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