

WT 3 (Ch. 4 – Audit Evidence and Ch. 6 – Audit Documentation)

Marks: 25

Time: 45 Minutes

Instructions: Part A comprises of MCQ.

Part B Comprises of descriptive questions.

Part – A (Multiple Choice Questions)

Case Scenario 1

CA X has accepted offer of conducting statutory audit of financial statements of DOS Solutions Private Limited. Keeping in mind requirements of Standards on Auditing including those relating to SA 300, he plans audit so that it is conducted in an effective manner. He knows that because of inherent limitations of an audit, there is audit risk in audit of financial statements even though audit is properly planned and performed in accordance with Standards on Auditing.

Considering nature of operations of the company, he has decided to use audit sampling in performing audit procedures. The various areas of his testing include testing controls over revenues, expenditures, assets and liabilities of the company. Besides, he has decided to perform tests of details in respect of all these areas of financial statements.

While verifying tests of controls over purchase orders placed by the company based on selected audit samples, he has erroneously concluded that Standard operating procedures (SOP) for placing purchase orders are not being followed strictly and controls are less effective than they actually are.

Further, while testing controls over wage payments, he has tested 20 sample wage sheets of different sections of company and finds that one wage sheet has not been signed by authorized officer of the company. The rate of deviation was earlier set by him at 3%.

During the course of designing procedures for selecting samples for verification of trade receivables, he has decided to divide trade receivable balances into groups viz. balances in excess of ₹ 10 lakh, balances in range of ₹ 7,50,001 to ₹ 10,00,000, balances in range of ₹ 5,00,001 to ₹ 7,50,000, balances in range of ₹ 2,50,001 to ₹ 5,00,000 and balances of ₹ 2,50,000 and below. He has planned to pick up different percentage of items from each of above groups. Random sample is chosen from each group using random number tables.

Some of the trade payables of the company were outstanding since long. He has decided to merely verify arithmetical accuracy of ageing schedule and its reconciliation with books of accounts.

Therefore, nature of audit procedures, nature of financial reporting itself and need for audit to be conducted within a reasonable period of time and at a reasonable period of cost all lead to inherent limitations of audit.

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

- Q.1** The auditor has erroneously concluded that Standard operating procedures (SOP) for placing purchase order are not being followed strictly and controls are less effective than they actually are. Which of the following statements is likely to be true in this regard? **1**
- (a) It is a sampling risk and might lead to auditor expressing inappropriate audit opinion.
 (b) It is a sampling risk and affects audit effectiveness.
 (c) It is a sampling risk and affects audit efficiency.
 (d) It is a control risk and affects audit effectiveness.
- Q.2** The auditor has tested 20 sample wage sheets in different sections of the company and finds that one wage sheet has not been signed by authorized officer of the company. It represents _____? **1**
- (a) Tolerable misstatement
 (b) Misstatement
 (c) Tolerable rate of deviation
 (d) Actual rate of deviation
- Q.3** Which method of selecting samples for verification of trade receivables has been planned by auditor? **1**
- (a) Simple random sampling
 (b) Systematic sampling
 (c) Block sampling
 (d) Stratified sampling
- Q.4** The auditor has decided to merely verify arithmetical accuracy and reconciliation of ageing schedule relating to trade payables. The use of above audit procedure can lead to _____? **1**
- (a) Sampling risk
 (b) Non-sampling risk
 (c) Inherent risk
 (d) Control risk

Case Scenario 2

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

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

- Q.5** Which of the following is most likely correct in relation to obtaining of sufficient appropriate audit evidence regarding existence and condition of inventory? **1**
- (a) It is mandatory for the auditor to attend physical inventory counting on the date of financial statements in all circumstances.
 - (b) Physical inventory counting may be attended by auditor on the date of financial statement or at a date other than date of financial statements in his discretion mandatorily in all circumstances.
 - (c) The attendance of auditors at physical inventory counting is impracticable due to time and costs involved because of auditor's office location vis-à-vis company's plant location. Hence, attendance at physical inventory counting may be skipped and alternative audit procedures may be performed to obtain sufficient appropriate evidence.
 - (d) The auditor shall attend at physical inventory counting unless impracticable. However, issue of time and costs involved because of auditor's office location vis-à-vis company's plant location is not a valid basis for skipping physical inventory counting.
- Q.6** Below are given certain cluster of matters which are relevant in planning attendance of auditor at physical inventory counting. Which of the following clusters consists of a likely inappropriate combination? **1**
- (a) Nature of inventory, timing of physical inventory counting and stages of completion of work in progress
 - (b) Nature of inventory, timing of physical inventory counting and valuation method of inventory
 - (c) Nature of inventory, timing of physical inventory counting, considerations regarding maintenance of a perpetual inventory system
 - (d) Risks of material misstatements related to inventory, nature of internal control pertaining to inventory, considerations regarding maintenance of a perpetual inventory system.
- Q.7** It was observed by auditors that, out of total rice physically counted on 31 March, 2022 about 67 quintals of rice belonged to M/s PQR, a proprietary concern which had sent paddy to this company's plant for extraction of rice. What would be treatment of this item in financial statements of company? **1**
- (a) The value of 67 quintals rice would be reflected in company's financial statements as per method of valuation adopted by the company.
 - (b) The value of 67 quintals rice would be reflected in company's financial statements as per method of valuation adopted by the proprietary concern.
 - (c) The value of 67 quintals rice would not be reflected in company's financial statements.
 - (d) The value of 67 quintals rice would be reflected in proprietary concern's financial statements as per method of valuation adopted by the company.

Part B (Descriptive Questions)

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

- Q.1 State with reasons (in short) whether the following statements are correct or incorrect:**
- (a) While auditing the books of accounts of XYZ Ltd., the auditor of the company was involved in examining records and documents in paper form, electronic form etc. and was also conducting physical examination of assets. In the present case, audit procedure used by the auditor is known as “Observation”. **2**
- (b) Sales invoice is an example of external evidence. **2**
- (c) The Audit engagement documentations should ordinarily be retained by the auditor for minimum of six years from the date of the auditor’s report or is later, the date of the group auditor’s report, whichever ever. **2**
- Q.2 (a) Audit Documentation refers to the record of three items. Explain stating clearly the objective and nature of audit documentation. **4****
- (b) Define the following: **2**
- (i) Positive confirmation request
- (ii) Negative confirmation request
- Q.3 (a) CA Amar is the statutory auditor of XYZ Ltd. for the FY 2023-24. During the course of audit, CA Amar found that a litigation is going against the company for which the company has hired an external legal team (management expert). CA Amar wanted to use the information as audit evidence which is prepared using the work of the management expert. What should CA Amar consider before using the work of such management expert? **3****
- (b) Many related party transactions are in the normal course of business. However, the nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Give few examples of such areas. **3**
- Q.4 (a) Discuss some of circumstances when work of the internal auditor cannot be used by external auditor. **3****
- (b) CA B is appointed as an auditor of M/s. Divine Pharmacy, a wholesale medicine supplier. While auditing for the financial year 2023-24, CA B wants to use test checking technique. Advise CA B, what kind of precautions should be taken by him in this regard. **3**

Instructions for submission of answer sheet

Single PDF of answer sheet is to be e-mail at test.altclasses@gmail.com

Subject line “Inter Audit Test – WT 3”

Mention the following in the E-mail and answer Sheet:

1. Name:
2. Mobile No.:
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