

Suggested Answers and Marking Scheme

MTP 3 (Ch. 5 – Audit Evidence & Ch. 6 – Completion & Review)

Marks: 40

Time: 1 hr. 15 Minutes

Instructions: Part A comprises of MCQ.

Part B Comprises of descriptive questions.

Part – A (Multiple Choice Questions)

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| Q.1 | (c) | Assess whether TechSphere's performance-linked fee creates bias and verify a few system-generated results before reliance. | 2 |
| Reason: | | | |
| A variable fee linked to "data reliability" can impair objectivity. Auditor must evaluate the risk of bias and test outputs before reliance. | | | |
| Q.2 | (a) | Perform later-date test counts, verify post-year-end movements, and reconcile closing records with dispatch and production data. | 2 |
| Reason: | | | |
| Alternate procedures (roll-forward/roll-back verification) provide equivalent assurance when attendance is impracticable. | | | |
| Q.3 | (d) | Obtain further evidence for non-responses and examine the causes of differences before concluding. | 2 |
| Reason: | | | |
| Sufficiency depends on both coverage and quality of evidence. Alternative testing and investigation of mismatches are required. | | | |
| Q.4 | (d) | Disclose it as a non-adjusting event since the conditions for recognition did not exist at the reporting date. | 2 |
| Reason: | | | |
| The scheme was announced well after year-end; only disclosure is appropriate. | | | |
| Q.5 | (a) | Express an unmodified opinion and include a dedicated section highlighting the existence of material uncertainties about the entity's ability to continue operating normally. | 2 |
| Reason: | | | |
| The scheme was announced well after year-end; only disclosure is appropriate. | | | |
| Q.6 | (b) | Analyse the reliability of supporting data, challenge optimistic assumptions, and consider whether these factors create substantial doubt about future operations. | 2 |
| Reason: | | | |
| Auditor must critically assess data and identify whether uncertainties materially affect future operations. | | | |

Part B (Descriptive Questions)**Q. No. 1 is Compulsory. Attempt ANY TWO from the rest.****Q.1 (a) Evaluating the objectivity of the management expert:**

- In the case of Evershine Refineries Ltd., the Company reduced its decommissioning and environmental restoration provision by 15% based on a technical assessment prepared by its internal CTO, who is a management expert. Since the provision involves significant estimation uncertainty and materially impacts profitability, and the CTO's incentives are linked to profitability targets, there is a risk of management bias affecting objectivity. Accordingly, as the assessment is prepared by management's expert, the provisions of SA 500 relating to evaluation of information prepared by management's expert are applicable. **(1 Mark)**
- As per SA 500 "Audit Evidence", when information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that expert's work for the auditor's purposes,
 - (i) Evaluate the competence, capabilities and objectivity of that expert;
 - (ii) Obtain an understanding of the work of that expert; and
 - (iii) Evaluate the appropriateness of that expert's work as audit evidence for the relevant assertion. **(1 Mark)**
- The auditor may obtain information regarding the competence, capabilities and objectivity of a management's expert from a variety of sources, such as personal experience with previous work of that expert; discussions with that expert; discussions with others who are familiar with that expert's work; knowledge of that expert's qualifications; published papers or books written by that expert. **(0.5 Mark)**
- Aspects of the management's expert's field relevant to the auditor's understanding may include what assumptions and methods are used by the management's expert, and whether they are generally accepted within that expert's field and appropriate for financial reporting purposes. **(0.5 Mark)**
- The auditor may also consider the following while evaluating the appropriateness of the management's expert's work as audit evidence for the relevant assertion:
 - (i) The relevance and reasonableness of that expert's findings or conclusions, their consistency with other audit evidence, and whether they have been appropriately reflected in the financial statements.
 - (ii) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods; and
 - (iii) If that expert's work involves significant use of source data, the relevance, completeness, and accuracy of that source data.

Conclusion: CA Meera cannot rely solely on the CTO's assessment due to the possible threat to objectivity and significant estimation uncertainty involved. She should evaluate the assumptions, methods, and supporting data in accordance with SA 500 and obtain sufficient appropriate audit evidence before concluding on the reasonableness of the provision. **(2 Marks)**

(b) Reporting Requirements in the Independent Auditor's report in respect of Going Concern:

- In accordance with SA 570 "Going Concern", if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern by performing additional audit procedures, including consideration of mitigating factors. **(1 Mark)**
- In the given case, SGP Textiles Ltd. is experiencing severe liquidity crisis arising from sudden shift in market demand and cancellation of its largest export order. Further, as at the Balance Sheet date, the company's current liabilities exceed its current assets and it has defaulted in repayment of certain borrowings. These conditions indicate existence of a material uncertainty that may cast significant doubt on the company's ability to continue as a going concern. **(1 Mark)**
- However, the management has disclosed these matters in the notes to the financial statements for FY 2025-26 and has prepared the financial statements on going concern basis based on expectation that a proposed merger with a larger conglomerate is expected to stabilize the company's financial position. **(1 Mark)**
- As such, considering that the going concern assumption is appropriate but a material uncertainty exists, CA Deepa should:
 - (1) Express an unmodified opinion; and
 - (2) Include in his audit report, a separate section under the heading "Material Uncertainty Related to Going Concern" to:
 - (i) Draw attention to the note in the financial statements that discloses the matters; and
 - (ii) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

Conclusion: CA Deepa should report the matter in her Independent Auditor's Report in the above manner in accordance with SA 570. **(2 Marks)**

(c) Audit Procedures to be carried out if physical inventory counting is conducting at a date other than the date of financial statements:

SA 501 "Audit Evidence – Specific Considerations for Specific Items", requires from the auditor that when inventory is material to the financial statements, he shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by attendance at physical inventory counting, unless impracticable, to:

- (1) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;
- (2) Observe the performance of management's count procedures;
- (3) Inspect the inventory; and
- (4) Perform test counts.

If physical inventory counting is conducted at a date other than the date of the financial statements, the auditor shall, in addition to the procedures as specified above, perform audit procedures to obtain audit evidence about whether changes in inventory between the count date and the date of the financial statements are properly recorded. **(2 Marks)**

Relevant matters for consideration when designing audit procedures to obtain audit evidence about whether changes in inventory amounts between the count date and the final inventory records are properly recorded include:

- (i) Whether the perpetual inventory records are properly adjusted.
- (ii) Reliability of the entity's perpetual inventory records.
- (iii) Reasons for significant differences between the information obtained during the physical count and the perpetual inventory records. **(2 Marks)**

Q.2 (a) Reliability of External Confirmation:

- SA 505, "External Confirmations", states that if the auditor determines that a response to a confirmation request is not reliable, the auditor shall evaluate the implications on the assessment of the relevant risks of material misstatement, including the risk of fraud, and on the related nature, timing and extent of other audit procedures. **(1 Mark)**
- SA 500, "Audit Evidence", indicates that even when audit evidence is obtained from sources external to the entity, circumstances may exist that affect its reliability. All responses carry some risk of interception, alteration or fraud. Such risk exists regardless of whether a response is obtained in paper form, or by electronic or other medium. **(1 Mark)**
- Factors that may indicate doubts about the reliability of a response include that it:
 - (i) was received by the auditor indirectly; or
 - (ii) appeared not to come from the originally intended confirming party. **(1 Mark)**
- In the instant case, ABC Limited has 50 customers and 40 vendors in the year 2025-26. M/s R and associates sent positive confirmation letter to top 3 customers and top 3 vendors. However, after 2 days of sending request, management of the company handed over duly signed response received from respective customers and vendors to auditor. Considering the fact that the response was received by the auditor indirectly, it raises questions on the reliability of responses received and indicates a fraud risk factor that requires evaluation. **(1 Mark)**
- In view of above, if the auditor has doubts regarding the reliability of these responses, it becomes necessary to obtain additional audit evidence to address those concerns. The auditor should also reassess the risk of material misstatement, including the possibility of fraud, and accordingly design further audit procedures. **(1 Mark)**

(b) Identification of Previously Undisclosed Significant Related Party Transactions:

As per SA 550 "Related Parties", if auditor identifies related parties or significant related party transactions that management has not previously identified or disclosed to auditor, the auditor shall:

- (a) Verify whether the circumstances substantiate the existence of such transactions.
- (b) Ensure timely communication of the relevant information to all members of the engagement team.

- (c) Confirm that appropriate substantive audit procedures have been conducted.
- (d) Inquire why the entity's controls failed to identify or disclose the related party relationships or transactions.
- (e) Carry out substantive audit procedures specifically for these newly identified related parties or significant related party transactions.
- (f) Reassess risks associated with other related parties.
- (g) Request management to identify all transactions involving the newly identified related parties.
- (h) If it appears that management intentionally did not disclose such transactions, evaluate the implications for the audit.

(1 mark for each correct point – 5 Marks)

(c) Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued:

- As per SA 560, "Subsequent Events", auditor has no obligation to perform any audit procedures regarding the F.S. after date of the auditor's report. However, when, after the date of the auditor's report but before the date the F.S. are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
 - (i) Discuss the matter with management and, where appropriate, TCWG.
 - (ii) Determine whether the financial statements need amendment and, if so,
 - (iii) Inquire how management intends to address the matter in the financial statements.

(1.5 Marks)

- If management amends the financial statements, the auditor shall:
 - (a) Extend the audit procedures to the date of the new auditor's report; and
 - (b) Provide a new auditor's report on the amended financial statements.

New auditor's report shall not be dated earlier than the date of approval of the amended F.S.

(1 Mark)

- In the instant case, XYZ Company Ltd. received an amount of ₹ 5800 crore on account of incentives pertaining to year 2025-26 in the month of May 2026 i.e. after finalisation of financial statements and signing of audit report. Board of Directors of XYZ Ltd. amended the accounts, approved the same and requested the Ramadhan & Co. (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2026.

Conclusion: After applying conditions given in SA 560, Ramadhan & Co. can issue new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

(1.5 Marks)

Q.3 (a) Audit procedures for verification of opening balances in case of initial audit engagement:

As per SA 510, "Initial Audit Engagements - Opening Balances", while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:

- (i) Opening balances contain misstatements that materially affect current period's F.S.; and

- (ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable F.R. framework.

(1 Mark)

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements.

Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated. **(1 Mark)**

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures, say, the collection of opening accounts receivable, (like external confirmations) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In addition, according to SA 505, "External confirmations" the auditor can use external confirmation procedures to obtain audit evidence. **(1 Mark)**

Further, according to SA 580, "Written Representations", the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion. **(1 Mark)**

In the given case, the management of Future (P.) Ltd. has restrained CA Jack, its auditor, from obtaining appropriate audit evidence for balances of accounts receivable outstanding as it is from the preceding year. CA Jack, on believing that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Conclusion: CA Jack should have requested the management to provide written representation for their views and expressions and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme. **(1 Mark)**

(b) Sufficiency of written representation in place of legal confirmation:

- SA 580 "Written Representations" deals with the auditor's responsibility to obtain written representations from management and, where appropriate, TCWG. Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfilment of management's responsibilities or about specific assertions. **(1 Mark)**

- Further, SA 501 “Audit Evidence - Specific Considerations for Selected Items”, states that when audit procedures performed indicate that material litigation or claims may exist, the auditor shall seek direct communication with the entity’s external legal counsel. The auditor shall do so through a letter of inquiry prepared by management and sent by the auditor, requesting the entity’s external legal counsel to communicate directly with the auditor. **(1 Mark)**
- In the given situation, significant payment to an IP litigation law firm, references in Board minutes to a possible patent infringement claim, and management’s refusal to allow direct communication with legal counsel indicate a significant audit risk. As the matter may involve a contingent liability requiring disclosure or provision, she should not rely solely on management representation in this matter. The refusal to permit direct communication with external legal counsel is a significant audit concern and may indicate a scope limitation and risk of material misstatement relating to contingent liabilities and litigation disclosures. **(1 Mark)**
- Accordingly, CA Rukma shall design and perform additional audit procedures in order to identify litigation and claims involving the entity by:
 - (i) Inquiry of management and, where applicable, others within the entity including in-house legal counsel.
 - (ii) Reviewing minutes of meetings of TCWG and correspondence between the entity and its external legal counsel.
 - (iii) Reviewing legal expense account.

Conclusion: CA Rukma should express the modified opinion in accordance with SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”, if she could not communicate with external legal counsel and unable to obtain sufficient appropriate audit evidence by performing additional audit procedures. **(2 Marks)**

(c) Concept of Stratification:

SA 530 “Audit Sampling” defines the term stratification as “the process of dividing a population into sub-populations, each of which is a group of sampling units which have similar characteristics (often monetary value)”. Every such group so divided is called strata. Each stratum is treated as if it were a separate population and proportionate items are selected from each of the stratum. **(0.5 Mark)**

Various uses of stratification in accordance with SA 530 are:

- (i) Audit efficiency may be improved if the auditor stratifies a population by dividing it into discrete sub-populations which have an identifying characteristic. 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. **(0.5 Mark)**
- (ii) When performing tests of details, the population is often stratified by monetary value. This allows greater audit effort to be directed to the larger value items, as these items may contain the greatest potential misstatement in terms of overstatement. **(1 Mark)**
- (iii) The results of audit procedures applied to a sample of items within a stratum can only be projected to the items that make up that stratum. To draw a conclusion on the entire population, the auditor will need to consider the risk of material misstatement in relation to whatever other strata make up the entire population. **(1 Mark)**

- (iv) If a class of transactions or account balance has been divided into strata, the misstatement is projected for each stratum separately. Projected misstatements for each stratum are then combined when considering the possible effect of misstatements on the total class of transactions or account balance. **(1 Mark)**



Link for Resources (Revision Videos, MTPs, Amendments, Charts, etc.) and Inquiries			
1	Youtube Channel	https://www.youtube.com/@altclassesca9193	
2	Telegram Channel	https://t.me/altclasses	
3	Whatsapp Group for Doubts	https://chat.whatsapp.com/LSDM362giy2ErmRgTi7ceA	
4	LMS Link	https://altclasses.in/knowledge-forum-ca-final/	
5	E-mail Id	altclasses11@gmail.com	
6	Contact Number	9319805511, 7206941195	
7	Website Link	https://altclasses.in/	