

Mock Test Paper - Series I: November 2024

Date of Paper: 22nd November 2024

Time of Paper: 2 P.M. to 5 P.M.

INTERMEDIATE GROUP – II

PAPER – 5: AUDITING AND ETHICS

Time Allowed – 3 Hours

Maximum Marks – 100

PART I - Case Scenario based MCQs (30 Marks)

Write the most appropriate answer to each of the following multiple-choice questions by choosing one of the four options given. All MCQs are compulsory and carries 2 Marks each.

Case Scenario 1

While auditing ANJ Industries Private Limited, CA J has decided that it would be appropriate to examine 100% of the items comprising turnover of ₹ 30 crores as reflected in its financial statements. In this regard, he has designed tests of details for transactions forming part of company's turnover. The sales function is automated in the company's information system involving repetitive nature of calculations. Further, in respect of designing of tests of controls pertaining to turnover, he is in a fix.

While verifying turnover of the company, CA J ensures that all the sales are correctly recorded in the books of accounts based on the invoices and discounts have been properly adjusted. Similarly, in respect of verification of employee benefit expenses reflected in the financial statements, he ensured that TDS related adjustments are correctly reconciled and accounted for.

Ankush is an article assistant who has recently joined CA J for practical training. He is also part of the team assisting seniors. Although he has read about assertions, there remain several doubts about assertions in his mind. He noted down the following points about assertions as per his understanding: -

- (i) Assertions are the representations made by the auditors.
- (ii) Assertions are generally explicit and not implied.
- (iii) Verification of the assertions helps the auditor in finding out whether financial statements are in accordance with applicable financial reporting framework or not.

In normal course of business, the company also holds a part of goods as a consignee. While verifying assertions relating to inventories, he ensures that inventory held by the company as consignee of goods on behalf of third parties is excluded from inventories.

Based on the above facts, answer the following: -

1. Considering approach of CA J in respect of tests of details and tests of controls pertaining to sales, which of the following statement is most appropriate?
 - (a) The approach for both designing tests of details and tests of controls is proper.
 - (b) The approach for designing tests of details is proper. However, it is an unlikely approach for tests of controls.
 - (c) The approach for designing tests of controls is proper. However, it is an unlikely approach for tests of details.
 - (d) The approach for designing tests of details as well as tests of controls is not proper.
2. Which assertions are being verified by CA J for correctness of recording of sales on the basis of invoices (including adjustment of discounts) and TDS adjustments for employee benefit expenses respectively?
 - (a) Measurement, Measurement.
 - (b) Completeness, Measurement.
 - (c) Existence, Measurement.
 - (d) Measurement, Completeness.
3. Considering the view of Ankush, which of the following(s) is/are false?
 - (a) 1 and 2.
 - (b) 1,2 and 3.
 - (c) 1 only.
 - (d) 2 only.
4. As regards the matter of holding of certain inventories as consignee of goods, which type of assertion(s) is/are being verified by the auditor?
 - (a) Cut-off and Valuation.
 - (b) Completeness and Rights & Obligations.
 - (c) Completeness only.
 - (d) Rights & Obligations only.

Case Scenario 2

Revanth, Manohar and Piyush are planning to set up a new business for trading of electronic goods. They have heard in business circles that many entrepreneurs are setting up their organisations as Limited Liability Partnerships (LLPs). However, they lack knowledge about such legal structures. So, they decided to approach CA S for understanding the difference between a partnership firm, an LLP and a private company.

They also want to gain the knowledge of legal provisions regarding number of partners and the paperwork involved in forming an LLP. Further, they also have doubts regarding maintenance of books of accounts and the audit requirement for such organisations. Revanth, being cost conscious, specifically asks CA S regarding requirement of audit of LLPs. During the discussion, he shares that they are expecting a turnover of ₹ 5 crores in the first year of their business and funds amounting to ₹ 50 lakhs would be brought by partners as their contribution.

Manohar is concerned about the rules regarding the maintenance of accounts in software with an audit trail feature. He has a vague understanding, gained through social media, that such rules have recently come into effect. Moreover, he believes that these features are useful only for auditors. To address his concerns, CA S attempts to explain these matters to him.

After resolving their doubts, they decided to constitute an LLP named Blitz Products LLP with the professional assistance of CA S, who helped them in completing the necessary paper formalities. After constituting an LLP, they acquired dealerships of few reputed companies and received a good response from market due to prominent location of their showroom and are confident of achieving their turnover expectation within the first year of business.

They plan to get their accounts audited after closure of the financial year 2023-24 from CA S. The finance and accounts function of business is being headed by Piyush and he plans to contact him somewhere around August 2024 for getting audit of financial statements conducted, filing income tax return and making necessary regulatory compliances on behalf of LLP.

Based on the above facts, answer the following: -

5. Which of the following is correct regarding the difference in types of organisational structures and connected matters?
- (a) LLP gives the benefit of flexibility of limited liability of a partnership and good governance of a company. A Minimum of two individuals are required to form an LLP and at least 2 partners are required to take DIN. The regulatory authority in the case of LLPs is Registrar of firms of the respective state where the LLP is located.
 - (b) LLP gives the benefit of limited liability of a company and flexibility of partnership. A minimum of two individuals are required to form an LLP and at least 2 partners are required to take DPIN. The regulatory authority in the case of LLPs is Registrar of Companies (ROC).
 - (c) LLP gives the benefits of limited liability of a company and flexibility of partnership. A minimum of two individuals are required to form an LLP and at least 2 partners are required to take DIN. The regulatory authority in the case of LLPs is Registrar of Companies (ROC).
 - (d) LLP gives the benefits of limited liability of a company and flexibility of partnership. A minimum of three individuals are required to form an LLP and at least 2 partners are required to take DPIN. The regulatory authority in the case of LLPs is Registrar of Companies (ROC).

6. Which advice would have been provided by CA S to Revanth regarding audit of financial statements of LLP considering description provided in case scenario?
- (a) There is no provision for compulsory audit of LLPs under the LLP Act, 2008 and relevant Rules. However, partners may choose to get accounts audited due to advantages associated with an audit.
 - (b) Every LLP is compulsorily required to get its accounts audited under the LLP Act, 2008 and relevant Rules.
 - (c) There exist provisions under the LLP Act, 2008 and relevant Rules for audit of LLPs based upon twin criteria of turnover and contribution thresholds. However, the proposed business doesn't meet thresholds and would not be required to get its accounts audited.
 - (d) There exist provisions under the LLP Act, 2008 and relevant Rules for audit of LLPs based upon twin criteria of turnover and contribution thresholds. The proposed business meets thresholds and would be required to get its accounts audited.
7. Which of the following statement is correct regarding Manohar's point of view?
- (a) Audit trails are useful only for auditors. However, maintenance of accounts in software having feature of audit trail is not compulsory for LLPs.
 - (b) Audit trails are useful for businesses as well as auditors. However, maintenance of accounts in software having feature of audit trail is not compulsory for LLPs.
 - (c) Audit trails are useful for businesses as well as auditors. Maintenance of accounts in a software having feature of audit trail is compulsory for LLPs.
 - (d) Audit trails are useful for businesses as well as auditors. Maintenance of accounts in a software having feature of audit trail is compulsory for LLPs having certain turnover thresholds.
8. Which of the following statement is correct regarding Piyush's plan?
- (a) Auditor is required to be appointed at least 30 days prior to March 31st, 2024. Therefore, Piyush's plan to approach CA S is not in accordance with the relevant rules and regulations.
 - (b) Auditor is required to be appointed at least 60 days prior to March 31st, 2024. Therefore, Piyush's plan to approach CA S is not in accordance with the relevant rules and regulations.
 - (c) Auditor is required to be appointed at any time before March 31st, 2024. Therefore, Piyush's plan to approach CA S is not in accordance with the relevant rules and regulations.
 - (d) Piyush's plan is proper and there are no specific provisions for appointment of auditor of an LLP in accordance with relevant rules and regulations.

9. Considering Piyush's plan to contact CA S in August 2024 for making necessary regulatory compliances could lead to _____
- (a) Default by LLP in filing its annual return.
 - (b) Default by LLP in filing its Statement of account and solvency.
 - (c) Default by LLP in filing its annual return as well as statement of account and solvency.
 - (d) No default by LLP in making necessary compliances.

Case Scenario 3

Vama & Associates were appointed as auditors for Royal Constructions Ltd. for the financial year 2023-2024. During the audit, the auditors observed a significant amount of work-in-progress inventory. Instead of attending the physical inventory count, they relied on alternative procedures. These included reviewing production reports, reconciling them with recorded inventory levels, and analysing variance trends to assess the accuracy of the work-in-progress balance.

The auditor also noticed that the company has obsolete inventory of ₹1,75,000, which had an estimated realisable value of ₹ 50,000, and the company has valued it at cost in its financial statements.

During the review of Property Plant and Equipment (PPE), the audit team noted that the company included ₹ 1,05,000 for employee benefits related to the acquisition of PPE and ₹ 1,25,000 for testing the functionality of the equipment, offset by ₹ 35,000 received from the sale of samples produced during testing.

Vama & Associates derive a significant portion of their income from Royal Constructions Ltd., amounting to ₹ 10,00,000, which represents 65% of their total annual revenue. Despite finding financial discrepancies of ₹ 3,00,000 in the company's accounts, the partners decided to overlook these issues to maintain their lucrative relationship with the client.

Based on the above facts, answer the following: -

10. Royal Constructions Ltd. should value the obsolete inventory at:
- (a) ₹ 50,000.
 - (b) ₹ 1,25,000 .
 - (c) ₹ 1,75,000.
 - (d) It should be written off completely.
11. What amount should be included in the cost of PPE in the financial statements of Royal Constructions Ltd.?
- (a) ₹ 1,95,000.
 - (b) ₹ 2,30,000.
 - (c) ₹ 2,65,000.
 - (d) ₹ 1,05,000.

12. What potential threat to the independence of Vama & Associates arises from receiving fees of ₹ 10,00,000 from Royal Constructions Ltd.?
- (a) Self-interest threat.
 - (b) Self-review threat.
 - (c) Intimidation threat.
 - (d) Familiarity threat.

MCQs

13. M/s RJ & Associates, Chartered Accountants, has been auditing the books of GP Resorts Private Limited for the past two years. GP Resorts Private Limited has experienced a significant increase in visitors due to a successful marketing campaign. This increase in number of visitors has prompted the Resort to introduce new services, such as event hosting, which contribute to higher revenue. Whether M/s RJ & Associates should issue a revised audit engagement letter to the GP Resorts Private Limited?
- (a) No, since M/s RJ & Associates has been auditing the GP Resorts Private Limited for the past two years, new audit engagement letter is not required.
 - (b) Yes, the auditor is required to issue a new audit engagement letter for each period.
 - (c) Yes, a new engagement letter is required due to significant changes in the nature and size in the business of the GP Resorts Private Limited.
 - (d) No, M/s RJ & Associates is not required to provide a new engagement letter, as GP Resorts Private Limited will send new engagement letter to M/s RJ & Associates.
14. TAD & Associates, a sole proprietor firm of Agamy, is offered appointment as auditor of a company engaged in manufacturing of automobile components for the first time. She is checking the facts about the integrity of promoters of the company and key managerial persons. Matters such as the competence of staff to perform the engagement are also considered by her. The appointment is subsequently accepted by her. What is CA Agamy trying to do by checking such facts?
- (a) CA Agamy is establishing an audit strategy.
 - (b) CA Agamy is conducting preliminary engagement activities.
 - (c) CA Agamy is designing audit plan.
 - (d) CA Agamy is checking her compliance of ethical requirements.
15. A practicing Chartered Accountant has been engaged by a company to perform certain procedures relating to its trade payables. Such agreed upon procedures includes verification of purchases from related parties, sending confirmation letters and reporting factual discrepancies to the management of the company. Which of the following statement is correct in this context?

- (a) The practicing CA shall perform work in accordance with Standards on Related Services and Standards on Auditing.
- (b) The practicing CA shall perform work in accordance with Standards on Related Services and SQC 1.
- (c) The practicing CA shall perform work in accordance with Standards on Auditing only.
- (d) The practicing CA shall perform work in accordance with Standards on Assurance Engagements and SQC 1.

PART II - Descriptive Questions

Question No. 1 is compulsory.

*Attempt any **four** questions from the Rest.*

1. (a) During the audit of a company, CA Jack obtained written representations from management regarding all known instances of non-compliance with laws and regulations that should be considered in the preparation of the financial statements. However, during the audit, he observed that the information provided in this regard was incomplete, and the audit evidence indicating such non-compliance contradicted the written representations, casting doubt on their reliability.
- How should CA Jack proceed in this situation? **(5 Marks)**
- (b) CA Shubham, the auditor of Sigma Limited, is performing tests of controls and tests of details using audit sampling. During these procedures, he observed deviations in compliance with management's prescribed procedures for sales transactions of small values of a product at one location during tests of controls. Additionally, misstatements were identified in the sample related to these small-value sales transactions during tests of details. How should he proceed to analyse the nature and cause of the deviations and misstatements observed in the sample results? **(5 Marks)**
- (c) CA Srishti, while auditing KSM Private Limited for the first time, utilised software to analyse financial data, comparing amounts recorded in the financial statements for the current audit year with the preceding two years. Her objective was to evaluate the risk of material misstatement.
- Identify the type of audit procedure performed by CA Srishti in the given case, discuss its relevance, and explain whether an auditor's opinion can solely rely on such procedures. **(4 Marks)**

2. (a) CA Paras has accepted audit of financial statements of an entity. According to the Standards on Auditing, the auditor is required to send an audit engagement letter to the entity. What are the key areas that should be included in the audit engagement letter? Under what circumstances is the auditor not required to record the terms of engagement in such a written agreement? **(5 Marks)**
- (b) "When the auditor modifies the audit opinion, the auditor shall use the heading "Qualified Opinion," "Adverse Opinion," or "Disclaimer of Opinion," as appropriate, for the Opinion section." Briefly explain when the auditor should express:
- (i) Qualified Opinion.
- (ii) Adverse Opinion and
- (iii) Disclaimer of Opinion. **(5 Marks)**
- (c) Rajul Ltd. engaged an external practitioner CA Rajul to provide assurance on its prospective financial information for the upcoming year, which includes projections for a new product line. The company projected a 15% increase in revenue, estimating total sales of ₹ 75 crore, driven by the expected launch of this new product. Mention the applicable Engagement and Quality Control Standard and the level of assurance that will be provided in the given situation. Also explain how Prospective Financial Information is different from Historical Financial Information. **(4 Marks)**
3. (a) Mahavir and Associates is appointed as the statutory auditor of KBC Bank for the financial year 2023-2024. During the audit, Ms. Chandana, an article trainee, noticed that Sidharth Industries had an outstanding loan of ₹ 50,00,000 as on March 31, 2024. On March 29, 2024, the company made a payment of ₹ 10,00,000, reducing the outstanding loan balance to ₹ 40,00,000. However, on April 4, 2024, Sidharth Industries initiated a reversal transaction of ₹ 8,00,000, increasing the outstanding loan balance back to ₹ 48,00,000. The payment and subsequent reversal occurred within a short period, with the final outstanding balance remaining ₹ 48,00,000 after the reversal.
- Considering this scenario, what should be the response of Mahavir and Associates to this matter, particularly regarding the classification of the borrower's account and the potential risk of it slipping into the NPA category? **(5 Marks)**
- (b) You are appointed as an auditor of "The Prestigious Township Club". As the auditor of "The Prestigious Township Club" for the financial year 2023-24, what are the key points you would consider while auditing the income and expenditure items of the club? **(5 Marks)**
- (c) During the audit of a limited company as a statutory auditor you discovered that a fraud amounting to ₹ 5 lakh has been committed by the company. What are the reporting requirements regarding fraud under the Companies Auditor's Report Order, 2020? **(4 Marks)**

4. (a) CA Karan wants to test the “completeness” assertion relating to intangible assets reflected in the financial statements of Data Solutions Private Limited. State audit procedures to be performed by CA Karan in this regard. **(5 Marks)**
- (b) SA 330 states that auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to operating effectiveness of relevant controls. Briefly discuss when such tests are to be designed and performed in accordance with SA 330?
- If an auditor intends to place greater reliance on effectiveness of a control, state its likely effect on audit evidence to be obtained as a result of such tests of controls. Why a higher level of assurance may be sought by an auditor about the operating effectiveness of controls? **(5 Marks)**
- (c) Lotus Ltd., a rapidly growing manufacturing company, appointed Ridhi & Co., as statutory auditor. The engagement team of Ridhi & Co. identified key areas requiring scrutiny, such as revenue recognition, inventory valuation, and related party transactions. Based on his professional judgment, CA Ravi, the engagement partner, directed the engagement team to focus on these critical areas, emphasising the need for detailed testing to ensure accuracy and compliance. Give some examples of the factors need to be considered by CA Ravi for establishing the audit strategy. **(4 Marks)**
5. (a) M/s KSJS & Associates are the statutory auditors of Moon Ltd. for the financial year 2023-24. During an audit briefing, CA Sanket, the engagement partner, explained that the auditor must assemble the audit documentation in an audit file and complete the administrative process of finalising the audit file on a timely basis after the date of the auditor’s report. He also highlighted the requirements of SQC 1 regarding establishment of policies and procedures for the retention of engagement documentation in a firm. Explain the requirements related to the timely assembly and retention of audit files in accordance with relevant Engagement and Quality Control Standards. **(5 Marks)**
- (b) The reliability of audit evidence depends on its source, nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance. Although exceptions may exist, few generalisations can be made about reliability of audit evidence. Considering above discuss such generalisations that can be made about the reliability of audit evidence. **(5 Marks)**
- (c) Kyte Private Limited acquired an immovable property of substantial value during the financial year 2023-24, which is recorded in the financial statements as an addition in the Schedule of PPE. The auditor also observed that this immovable property has been mortgaged to a bank for availing credit facilities. How should the auditor verify the rights and obligations assertion for this property to ensure the entity's legal ownership and identify any charges against it? **(4 Marks)**

6. (a) KR & Associates, an auditor of FDP Ltd., observed that the company has implemented various internal controls addressing financial reporting, operational efficiency, and compliances during their preliminary evaluation. CA Karan suggests that all controls should be assessed to mitigate the risk of material misstatement in the financial statements, while CA Rajat is of the view that only those controls deemed relevant to the audit should be assessed based on professional judgment.

Comment, whether the auditor should assess all the internal controls or limit the assessment to only those considered relevant by the auditor during the audit. Also, discuss the factors influencing the auditor's judgment on the relevance of controls. **(5 Marks)**

- (b) Audit programme is a list of examination and verification steps to be applied and set out in such a way that the inter-relationship of one step to another is clearly shown and designed, keeping in view the assertions apparent in the statements of account produced for audit or based on an appraisal of the accounting records of the client. For example, while auditing a company's inventory, the program may include steps to verify physical stock counts, ownership rights, and valuation. What are the advantages of an audit programme? **(5 Marks)**
- (c) As the statutory auditor of Ginni Ltd., you need to verify if the company has valid legal ownership rights over the inventories recorded in the balance sheet as on March 31, 2024. What audit procedures should you perform to verify the company's ownership of the inventories, including items stored at third-party locations? **(4 Marks)**

OR

During the audit of a company, CA Atul noticed that company is facing significant skilled labour shortages resulting in hampering operations of the company. The company's manufacturing is dependent upon skilled labour coming from villages in certain districts of Eastern UP. However, due to job opportunities available near villages now, many are not interested in leaving their native villages.

The company failed to keep its commitments due to such situation, consequently lost orders and faced decrease in its revenues. The fixed costs of the company remain at a high level. As a result, the company is facing a liquidity crunch and is not able to pay its creditors on time. The bankers of the company are also not willing to help the company to tide over liquidity crisis. The auditor has doubts over going concern status of the company. How should management of the company try to address auditor's concerns? What audit procedures may be performed by auditors in such a situation? **(4 Marks)**