

**MODEL TEST PAPER 1**  
**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**

Dhanush, a CA student undergoing articles, is part of an engagement team conducting audit of Test Enterprises Private Limited. The company is engaged in business of conducting aptitude and language tests every fortnight at centres spread all over major cities of country for Indian students desirous of applying to foreign universities. It also sells books containing model test papers for the benefit of students.

The company has substantial number of computers at each centre to enable seamless experience for students appearing for standardized aptitude and language tests. The company has acquired new identifiable software involving substantial expenditure for conducting tests during the year which is expected to drive company's revenues in coming years. At the time of taking a test, a CD containing software is run in each system for enabling students to take tests. Cost of CD without software is nominal.

The revenue of the company during the year 2023-24 was ₹ 50 crores (₹45 crores from fees charged from students and ₹5 crores from sale of books). Besides, company has also received ₹ 10 lacs as interest on certain investments during the year. The company has a history of profitable operations.

During the course of audit, it is noticed by Dhanush that computers form significant chunk of PPE items in financial statements of company. The company has taken useful life of computers consisting of desktops for 3 years. However, depreciation charged on computers in financial statements of the company is higher than depreciation allowable under Income tax law. It results in lower accounting income as per books of accounts of company as compared with taxable income under Income tax law.

During the course of audit, he notices that cost of CDs along with software cost is treated as an intangible asset by company. It is also part of his responsibility to verify PPE register in accordance with audit programme. On perusing details in PPE register, he finds that some computers have moved from one centre to another centre to meet business requirements. Further, many computers were disposed or scrapped in earlier years. However, proper details in relation to movement and disposal/scrapping have not been entered in PPE register. When these items were physically verified by the management during the year, it has resulted in material discrepancies. The management has properly dealt with such discrepancies in books of accounts.

Based on above, answer the following questions:

1. Considering description provided in case scenario regarding accounting income as per books of accounts and taxable income under Income tax law, choose appropriate responsibility of Dhanush:
  - (a) To verify deferred tax liability likely created in financial statements in accordance with AS 22
  - (b) To verify deferred tax asset likely created in financial statements in accordance with AS 22
  - (c) To verify deferred tax asset likely created in financial statements in accordance with AS 29
  - (d) To verify deferred tax liability likely created in financial statements in accordance with AS 29
2. Keeping in view description provided in case scenario, which of following statements is likely to be correct regarding accounting treatment of cost of CDs and software acquired by company to run tests?
  - (a) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated such costs as revenue expenditure.
  - (b) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is proper.
  - (c) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as intangible asset.
  - (d) The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as revenue expenditure.
3. As regards discrepancies noticed in computer systems on physical verification by management as described in case scenario, which of following statements is most appropriate?
  - (a) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it may result in modification of auditor's opinion.
  - (b) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it entails specific reporting requirement for auditor under the Companies Act, 2013.
  - (c) The management has properly dealt with such discrepancies. Therefore, Dhanush should not do anything further.
  - (d) The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it is in nature of misstatement which needs to be communicated and documented by auditor.

4. Which of following statements meets requirements of law in respect of revenue from operations of the company?
  - (a) Revenue from operations of ₹ 50 crores should be shown in Statement of Profit and loss.
  - (b) Revenue from operations of ₹ 50.10 crores should be shown in Statement of Profit and loss. However, revenue from sale of books, fees charged from students and interest on investments should be disclosed separately in notes.
  - (c) Revenue from operations of ₹ 50.10 crores should be shown in Statement of Profit and loss.
  - (d) Revenue from operations of ₹ 50 crores should be shown in Statement of Profit and loss. However, revenue from sale of books and fees charged from students should be disclosed separately in notes.
5. The company has taken useful life of desktops to be 3 years. Such a requirement is \_\_\_\_\_
  - (a) prescribed under Schedule III to the Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule III.
  - (b) is not prescribed under the Companies Act, 2013. It depends upon manufacturing specifications of desktops.
  - (c) prescribed under Schedule II to the Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule II.
  - (d) is not prescribed under the Companies Act, 2013. It needs to be arrived at mandatorily by a management expert.

## Case Scenario 2

CDL Limited, a company dealing in FMCG goods, is having 50 branches in India. SKC & Associates (**referred to as company's auditor**) are appointed as statutory auditors of the company for year 2023-24. Further, company has also appointed Mr. D as branch auditor for 5 of its branches.

Since Mr. D is conducting audit of only 5 branches of company, he has not arrived at materiality level in respect of auditee branches. On the same lines, identification and assessment of risk of material misstatement has not been performed. He is of the view that determination of materiality and identifying & assessing risks of material misstatement is done for financial statements of company as a whole. He has mainly performed substantive audit procedures in respect of financial statements of auditee branches like verification of PPE items, inventories, trade receivables, cash, bank balances and trade payables at auditee branches and maintained documentation of the same.

During the course of audit at two branches dealing in same kind of goods, Mr. D has performed analytical procedures pertaining to inventories. He has arrived at and compared inventory turnover ratio (Cost of goods sold/Average inventory) over

a period of years of two branches. The results of analytical procedures are summarized in Table I below:

**Table 1**

Particulars	Branch	Year 2021-22	Year 2022-23	Year 2023-24
Inventory turnover ratio	I	15	14	12
Inventory turnover ratio	II	4	6	10

The company's auditor has also decided to use work of Mr. D with respect to financial information of 5 branches included in financial information of the company. During the course of audit, company's auditor has advised Mr. D by way of email certain significant accounting, auditing and reporting requirements and has asked him to provide representation as to compliance with them. Irritated and surprised, Mr. D is of the view that such an email is beyond the rights of the company's auditor.

Based on above, answer the following questions:

6. As regards audit of a branch of CDL Limited as referred to in case scenario is concerned, which of following statements is most appropriate?
  - (a) The accounts of a branch shall be audited either by the company's auditor or by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of the Companies Act, 2013. In case branch accounts are audited by a person other than company's auditor, branch audit report is sent by branch auditor to company's auditor.
  - (b) The accounts of a branch shall only be audited by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of the Companies Act, 2013 except company's auditor. In such a case, branch audit report is sent by branch auditor to members of company.
  - (c) The accounts of a branch shall only be audited by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of the Companies Act, 2013 except company's auditor. In such a case, branch audit report is sent by branch auditor to company's auditor.
  - (d) The accounts of a branch shall be audited either by the company's auditor or by any other person qualified for appointment as an auditor of the company and appointed as such under section 139 of the Companies Act, 2013. In case branch accounts are audited by a person other than company's auditor, branch audit report is sent by branch auditor to members of company.
7. After reading methodology for carrying out branch audits by Mr. D, which of following statements is likely to be most appropriate?
  - (a) Separate determination of materiality and identifying & assessing risk of material misstatement is not required in respect of each of the branches. He is required to perform only substantive procedures as described in

the case scenario in respect of auditee branches and maintain documentation of the same.

- (b) Separate determination of materiality and identifying & assessing risk of material misstatement is required in respect of each of branches. However, documentation for these matters regarding branches is not required. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.
  - (c) Separate determination of materiality and identifying & assessing risk of material misstatement is required along with documentation thereof in respect of each of branches. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.
  - (d) Identifying & assessing risk of material misstatement is required along with documentation in respect of each of branches. However, materiality is required to be arrived at for financial statements of company as a whole. He is required to perform substantive procedures as described in case scenario in respect of auditee branches and also maintain documentation of the same.
8. Choose the correct statement regarding results of analytical procedures performed by Mr. D summarized in Table 1 in case scenario.
- (a) During year 2023-24, inventories of Branch I have moved faster in comparison to Branch II.
  - (b) During year 2023-24, inventories of Branch II have moved faster in comparison to Branch I.
  - (c) Comparison of inventory turnover ratio of Branch II over a period of years may indicate that branch's sales have likely been weak with higher inventory holdings in year 2023-24 as compared to previous years.
  - (d) Comparison of inventory turnover ratio of Branch I over a period of years may indicate that branch's sales have likely been strong with lower inventory holdings in year 2023-24 as compared to previous years.
9. Considering contents of email sent by company's auditor to Mr. D, which of following statements is likely to be in accordance with Standards on Auditing?
- (a) Company's auditor can advise Mr. D regarding certain significant accounting, auditing and reporting requirements and ask him to provide representation as to compliance with them.
  - (b) Company's auditor can advise Mr. D certain significant accounting, auditing and reporting requirements. However, asking him to provide representation as to compliance with them is breach of Mr. D's independence.
  - (c) Company's auditor cannot advise Mr. D certain significant accounting, auditing and reporting requirements. It is breach of Mr. D's independence.

- (d) Company's auditor can advise Mr. D regarding certain significant accounting, auditing and reporting requirements only when Mr. D makes such a request.

### Case Scenario 3

CA B is conducting statutory audit of branch of a nationalized bank. Saurabh, a CA student, is also part of engagement team conducting statutory branch audit. The field of bank branch audit is new to him and he is following instructions as required by engagement partner.

The engagement partner has asked him to prepare a summary of non-funded credit facilities outstanding as on balance sheet date. The following information is appearing in branch's CBS data/records as on 31<sup>st</sup> March, 2023:

Serial number	Particulars in CBS (Core Banking solution)/records	Amount in ₹ crores
1.	Agricultural term loans	15.00
2.	Staff housing loans	3.50
3.	Staff vehicle loans	0.20
4.	Housing loans-General public	10.00
5.	Letters of credit issued	2.50
6.	Education loans	1.50
7.	Guarantees issued (Fully secured by 100% margin)	1.00
8.	Bills purchased and discounted	2.00
9.	Bills for collection	0.10

On going through listing of housing loans to general public, CA B notices that branch has sanctioned many housing loans of small ticket size ranging between ₹10.00 to ₹ 20 lakhs. Therefore, he has assessed risk of material misstatements to be high. As a consequence, he has designed procedures to perform tests of controls as well as substantive tests.

Saurabh has been further asked to go through SMA (Special Mention Accounts) jotting as on 30<sup>th</sup> November, 2022. Such reports are available from system on monthly frequency. Being new to such type of assignment, he is unable to understand relevance of above audit procedure mandated by engagement partner.

Based on above, answer the following questions:

10. Considering table given in the case scenario, which of the following combinations is appropriate example of non- funded credit facilities provided by branch to its customers?
- Bills purchased and discounted; bills for collection
  - Bills for collection; staff housing loans; letters of credit issued
  - Bills purchased and discounted; letters of credit issued; guarantees issued (fully secured by 100% margin)

- (d) Letters of credit issued, guarantees issued (fully secured by 100% margin)
11. CA B's decision to perform both tests of controls as well as substantive tests was taken after he had assessed risk of material misstatement in financial statements to be high due to large number of small ticket size loans. Which Standard on Auditing deals with auditor's responsibility to design such tests?
- (a) SA 500  
(b) SA 330  
(c) SA 300  
(d) SA 315
12. Saurabh is unable to understand relevance of going through SMA jotting as on 30<sup>th</sup> November, 2022. Which of following statements is most appropriate in this context?
- (a) It would necessarily help auditor in identifying accounts with significant lending exposure.  
(b) It would help auditor in identifying accounts which may involve downgrading from Sub-standard asset category to doubtful category.  
(c) It would help auditor in identifying accounts where substantial recoveries have been received during the year.  
(d) It would help auditor in identifying accounts which may involve downgrading from standard category to non-performing asset.

### MCQs

13. "*We, the people*" is an NGO working for rights of citizens. Due to nature of its activities, its volunteers take part in agitations which acquire political overtones. It also gets money from trusts based in overseas countries.
- The government has tightened regulatory mechanism for NGOs receiving foreign funding. The finance and accounts department in NGO is headed by an experienced person, a former volunteer and activist himself. However, he has no professional or legal educational background. CA N is appointed as auditor of above NGO for the first time.
- Choose the most appropriate option regarding audit risk inferred by you from above.
- (a) Audit risk in the above situation is low.  
(b) The situation does not provide quantitative data. Therefore, it is not possible to make a precise measurement of audit risk.  
(c) Audit risk in the above situation is high.  
(d) The situation does not provide information affecting all components of audit risk. Therefore, inference cannot be made properly.
14. CA J is in process of planning audit for a large company engaged in business of dealing and manufacturing of pharmaceutical products. Central Drugs

Standard Control Organisation (CDSCO), National regulatory Authority under Ministry of Health & Family Welfare is responsible for approval of drugs, conduct of clinical trials and laying down Standards for drugs and control over quality of imported drugs. Auditor is also considering whether to make use of audit evidence obtained in previous audit of the same company. Besides, he is also considering volume of transactions to determine whether it is efficient to rely on internal controls. As part of planning activities, he is also considering extent of substantive audit procedures to be performed. Consider following factors stated from 1 to 5:

1. Reporting requirements required by CDSCO, if any
2. Need for specialized knowledge of pharma industry
3. Expected use of audit evidence obtained in previous audit
4. Volume of transactions to consider reliance on internal control
5. Nature and extent of substantive audit procedures

Choose the most appropriate factor/combination of factors which could be relevant to CA J in establishing audit strategy: -

- (a) 1, 3, 4 and 5
  - (b) 1 only
  - (c) 1, 2, 3 and 4
  - (d) 2 only
15. CA Tarini is in process of formulating audit plan for conducting audit of a company engaged in business of dealing in commodity futures. Which of following is not likely to be an appropriate audit procedure to be included in audit plan for the abovesaid company?
- (a) Verification of turnover of company
  - (b) Verification of cost of raw material consumed
  - (c) Examination of company's accounting policy for revenue recognition
  - (d) Verification of contract notes with brokers

## PART II - Descriptive Questions

*Question No. 1 is compulsory.*

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

1. (a) DOX Limited, a service provider company engaged in providing courier services pan-India as well as internationally, has appointed an internal auditor, Mr. G, in accordance with requirements of the Companies Act, 2013 during financial year 2023-24. The company's annual turnover during year 2022-23 and 2023-24 has been about ₹ 300 crores during each of above years. Business of the company has been profitable. Mr. G heads internal audit department of the company assessing governance activities, assisting in improving risk management activities and reviewing controls. Discuss reporting responsibility of statutory



auditor of the company under the Companies Act, 2013 specifically in relation to internal audit and related matters for the year 2023-24.

**(4 Marks)**

- (b) Up and High Private Limited has started its export business during the year 2023-24. The company was catering to domestic market only in past years. CA H, statutory auditor of the company, is of the view that the company has understated its revenue by ₹ 50.00 lacs in the year 2023-24 by not complying with requirements of AS 9 relating to revenue recognition.
- (i) Discuss responsibilities of statutory auditor to communicate with management in the above situation in accordance with SA 450. Also explain the usefulness of such communication.
- (ii) If management refuses to correct misstatement as communicated by the statutory auditor, how should he proceed? **(4 Marks)**
- (c) Prudent Enterprises Private Limited has incurred and fully spent for the first time Corporate Social Responsibility (CSR) expenditure amounting to ₹ 14.50 lacs in pursuance to provisions of section 135 of the Companies Act, 2013. The expenditure was spent for women empowerment programmes through an implementing agency (not a related party). As per law provisions, it was required to spend ₹ 14.00 lacs during the year. Discuss how such information is required to be disclosed in accordance with requirements of Schedule III to the Companies Act, 2013 in financial statements of the company. **(3 Marks)**
- (d) CA Tripad (engagement partner) based at New Delhi is external auditor of Lap of Nature, a firm, since last three years. The firm is engaged in business of providing tourism services including holiday packages to its club members. It has also provided auditor including his team members free holiday for a week every year in one of its premium resorts in Ooty in the State of Tamil Nadu. The company has also booked free air travel for engagement team members during all these years. Discuss why Chartered Accountant is not acting ethically. How are familiarity threats created in above situation? **(3 Marks)**
2. (a) Mention any four financial events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as going concern. **(4 Marks)**
- (b) Adequate planning benefits the audit of financial statements in several ways. Explain. **(4 Marks)**
- (c) The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence. Give one example each for such practical and legal limitations. **(3 Marks)**
- (d) Goods and Services Tax Network (GSTN) is a not for profit, limited by shares, company. Its 50% shareholding is with Union Government and

50% with different State Governments. The company provides IT infrastructure and services to various stakeholders including governments and tax payers. The company is in operation since past few years and subsequent auditor needs to be appointed during financial year 2023-24. Who appoints statutory auditor of such a company described above in accordance with provisions of the Companies Act, 2013? Can any directions be issued to statutory auditors of above company? **(3 Marks)**

3. (a) Suniti, a CA student, is part of an engagement team conducting audit of a company TIM Private Limited. According to audit programme, she is responsible for verifying purchases and PPE items appearing in books of accounts from records/bills of company. Besides, she has also been entrusted responsibility to obtain written representation from management regarding carrying out of physical verification of inventories during the year. During course of her work, she finds that:

- (i) One purchase bill amounting to ₹ 5.00 lacs pertaining to TIM Industries has been entered in books of TIM Private Limited.
- (ii) The management has refused to provide a written representation relating to physical verification of inventories during the year. She has brought it to knowledge of engagement partner who has decided to use lack of such a representation as audit evidence.

Discuss whether each of above constitutes audit evidence. State reasoning for your answer. **(4 Marks)**

- (b) CA B is statutory auditor of Boom Payments Bank for year 2023-24. During the year, banking regulator has imposed restrictions on Bank from accepting new deposits due to non-compliance in conducting KYC in large number of accounts and violation of rules aimed at preventing money laundering. There is material uncertainty regarding probable outcome of such restrictions on ability of Bank to continue as going concern. However, for year 2023-24, auditor has concluded that use of going concern basis of accounting is appropriate. The financial statements of Bank do not make adequate disclosure of material uncertainty due to above events in financial statements. What are implications for auditor's report for year 2023-24 in view of above?

**(4 Marks)**

- (c) Auditor shall develop an audit plan that includes description of audit procedures. Specify requirements in this regard. **(3 Marks)**
- (d) What is meant by audit documentation? What are objectives of an independent auditor in accordance with SA 230? **(3 Marks)**

4. (a) You are part of engagement team conducting audit of an entity engaged in manufacturing business. State few audit procedures you would undertake to perform to verify that recorded sales in financial statements

represent goods actually sold during the period and recorded sales are not overstated. **(4 Marks)**

- (b) While performing statutory audit of Contra Industries Private Limited, a company engaged in manufacturing and assembling of LED lights, CA Varun has decided to attend physical inventory count process of the company on 30<sup>th</sup> and 31<sup>st</sup> March, 2024. The inventories are lying at three different locations - two such locations A and B are in one city and third location C is in another city. Further, company also sends inventories to some service providers for quality control and testing as such facilities are not available with the company.

CA Varun is well-versed with this type of industry and has prepared a list of following matters which could be relevant to him in planning attendance at physical inventory count process for discharging his responsibilities in accordance with SAs: -

- Nature of inventories i.e. LED light components, parts, circuits, panels, body, WIP and finished packed LED lights
- Materiality of inventories at different locations A, B and C
- Stage of completion of work-in-progress
- Maintenance of perpetual inventory system by company
- Materiality of inventories lying with service providers
- Timing of physical inventory counting i.e. year end

There are two important matters which do not find place in above list. Without considering these crucial matters, it would be difficult for the auditor to properly plan his attendance at inventory count process in accordance with relevant SA. Discuss such matters. **(4 Marks)**

- (c) The auditor should decide whether relevant information is properly disclosed in the financial statements. Explain with reference to scope of audit. **(3 Marks)**
- (d) SQC 1 dwells upon engagement quality control review (EQCR) as part of system of quality control in a firm. Why is such a review required? For which type of engagements EQCR is mandatory?

What should be approach of firm for engagements for which EQCR is not mandatory? **(3 Marks)**

5. (a) WTE Private Limited is engaged in business of manufacturing a product liable to GST @ 5%. The input raw materials for manufacturing this product are liable to GST @ 12% and 18%. As a result, at the end of financial year, ITC on inputs amounting to ₹ 60 lacs is accumulated in Electronic Credit ledger and refundable to company under provisions of GST law. How would above amount of ₹ 60 lacs be reflected and classified in balance sheet of company? State few audit procedures to be performed by you for verification of abovesaid balance. **(4 Marks)**

- (b) The objective of an auditor in accordance with SA 315 is to identify and assess risks of material misstatement at financial statement level and assertion level. Which specific activities an auditor is required to perform for the purpose of identifying and assessing risks of material misstatement? **(4 Marks)**
- (c) You have been appointed as an auditor of ABC Hotel, a three star hotel, for Financial Year 2022-23. As an auditor what are the special points that need to be considered in verifying the Inventories in the nature of food and beverages? **(3 Marks)**
- (d) Professional Behaviour is one of the fundamental principles governing professional ethics. Explain its meaning. Also, give example of a situation where a Chartered Accountant fails to follow this principle. **(3 Marks)**
6. (a) CA Z is appointed as statutory auditor of BETA Private Limited for the year 2023-24. There exists an internal audit function in the company headed by its Chief Internal Auditor, CA K. Valuation of trade receivables of company is assessed as area of higher risk by statutory auditor. He wants to take direct assistance of Chief Internal Auditor in respect of above matter. Discuss along with reasons whether it would be proper for statutory auditor to: -
- (i) assign checking of accuracy of aging of trade receivables to Chief Internal Auditor?
- (ii) assign evaluation of adequacy of provision based on aging of trade receivables to Chief Internal Auditor? **(4 Marks)**
- (b) The audit of Government expenditure is one of the major components of Government audit. Briefly explain the basic standards set in relation to audit of Government expenditure. **(4 Marks)**

**OR**

Cinescreen Multiplex Ltd. is operating cinemas in different locations in Mumbai and has appointed you as an internal auditor. What are the areas that need to be verified in relation to receipts from sale of Tickets? **(4 Marks)**

- (c) Given below is a table containing Column A and Column B. Column A contains description of certain controls in an automated environment. Complete Column B by stating appropriate type of control.

<b>Column A (Description of control in an automated environment)</b>	<b>Column B (Type of control)</b>
Reasonableness checks	?
Controls over Data centre and network operations	?

Controls over application system acquisition, development and maintenance	?
Program change controls	?

**(3 Marks)**

- (d) An engagement partner takes overall responsibility for maintaining audit quality in an audit engagement in accordance with SA 220. What are his objectives in taking and emphasizing such responsibility? **(3 Marks)**