

MODEL TEST PAPER 8
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

Renu & Associates have been appointed as the auditors for Kailash Ltd., a manufacturing industry, for the financial year 2023-24. During the audit, one of the Engagement Partner CA. Renu noticed a significant increase in raw material consumption in comparison to previous years, despite a decrease in production volumes. This raised concerns, instigating a detailed review of the vendors supplying these raw materials. Upon inquiry, the management explained that the company had transitioned to a new vendor offering premium materials to improve product quality.

Additionally, CA Renu observed that several credit notes were issued after the end of the accounting period.

During the verification of immovable properties, she discovered that Kailash Ltd. had pledged one of its commercial properties as security for a bank loan. However, the company did not possess the original title deeds for that property.

Further, CA. Renu conducted a stock audit of a borrower availing a cash credit facility of ₹100 lacs from a bank branch. The cash credit facility was secured against paid stocks and debtors up to 90 days, with a margin of 25% for stocks and 40% for debtors. She observed that the computed drawing power of ₹82.50 lacs was incorrect, based on the following information as on 31.12.2023:

Value of stocks	₹ 125 lacs
Value of stocks (fully damaged) included in above	5 lacs
Value of debtors	50 lacs
Value of debtors exceeding 90 days included in above	10 lacs
Value of creditors for goods	50 lacs

CA. Renu also served as the statutory auditor for a multiplex cinema. During the audit, Madhu, an articled trainee, identified discrepancies between ticket sales and recorded revenue. She also noted that certain complimentary tickets were not properly accounted for.

Based on above case give answer to the following questions: -

1. What audit procedure should auditor perform to check ownership of commercial property discussed in the scenario?
 - (a) The auditor should request management to obtain confirmation from the bank for holding original title deeds of pledged immovable property are held as security.
 - (b) The auditor can obtain a list of immovable properties from management at Kailash Ltd, along with management's representation regarding the ownership of these properties.
 - (c) If the auditor is unable to verify the original title deeds of the pledged property, they may need to qualify the audit report accordingly.
 - (d) The auditor can assume ownership of immovable properties without obtaining a written representation from management, as long as there is a general understanding of the assets.
2. Which assertion is the auditor evaluating while verifying the existence of vendors and the actual receipt of goods or raw materials by the company?
 - (a) Occurrence
 - (b) Completeness
 - (c) Measurement
 - (d) Existence
3. What could be the possible reasons for issuing credit notes after the end of the accounting period as mentioned in the above case?
 - (a) Fictitious sales by the sales team to meet targets and cancel out those sales later with a credit note.
 - (b) Ensuring necessary corrections are reflected in the financial records for accuracy.
 - (c) When issues arise that lead to customer dissatisfaction, credit notes may be issued to resolve these disputes amicably.
 - (d) Such adjustments may be made based on negotiations or changes in market conditions that occurred post-period.
4. What procedure should the auditor perform to reconcile discrepancies in ticket sales?
 - (a) Compare issued ticket stubs with recorded online sales data.
 - (b) Rely on management's estimates for ticket sales.
 - (c) Ignore complimentary ticket records.
 - (d) Verify only cash sales, not online transactions.
5. In the given case, CA. Renu found that the drawing power calculated was incorrect. What should be the correct drawing power?
 - (a) ₹ 75.00 lakhs
 - (b) ₹ 76.50 lakhs

(c) ₹ 78.00 lakhs

(d) ₹ 74.50 lakhs

(5 MCQs x 2 Marks each = 10 Marks)

Case Scenario 2

CA Neel has accepted offer of appointment of auditor of an entity. As business carried on by the entity is new to him, he wants to gain an understanding about the entity and its environment including its internal control. In this regard, he has performed procedures to obtain audit evidence about design and implementation of relevant controls. He has performed various procedures like inquiry, inspection and observation in this regard.

He wants reasonable assurance that accounting system is adequate and that all accounting information which should be recorded has, in fact, been recorded.

Further, during the course of audit, he has noticed as under: -

- As required by the management, bank reconciliation is required to be performed monthly. However, the same is not carried out as stipulated due to time constraints faced by accountant.
- The entity has a system of procuring its raw material supplies on the basis of valid purchase orders issued by the entity. However, purchase orders are not numbered in a sequence properly.
- Wage sheets are not verified by a responsible official as required by management.
- Staff of the entity is responsible for bringing cash from centers in nearby areas to entity's premises from where it is deposited into entity's bank account. However, concerned officer has not renewed insurance for cash in transit.

Based on above, answer the following questions: -

- 6 The auditor has performed procedures to obtain audit evidence about design and implementation of controls. Which of the following procedures is more reliable to obtain audit evidence relating to application of a control?
 - (a) Observing application of control
 - (b) Inspecting documentation pertaining to control
 - (c) Inquiry about application of control
 - (d) Studying design of control
- 7 Examination and evaluation of internal control is indispensable for CA Neel. It provides him necessary comfort relating to completeness of accounting information. However, review of internal controls of the entity will not enable him to know _____
 - (a) whether errors or frauds are likely to be located in ordinary course of operations of business
 - (b) whether an effective internal audit department is operating
 - (c) whether his opinion needs modification
 - (d) whether any administrative control has bearing on his work

8. As regards weaknesses identified by the auditor in control system, which of the following represent(s) significant deficiencies in internal control?
- (a) Not performing bank reconciliation timely and not verifying wage sheets by responsible official only
 - (b) Not performing bank reconciliation timely and lack of proper sequence in purchase orders only
 - (c) Not performing bank reconciliation timely, lack of proper sequence in purchase orders, not verifying wage sheets by responsible official and lack of insurance for cash in transit
 - (d) Lack of insurance for cash in transit only
9. Which of the following is most appropriate regarding auditor's responsibility in accordance with SA 265?
- (a) To communicate significant deficiencies in internal control to management
 - (b) To communicate significant deficiencies in internal control along with explanation of their potential effects to management
 - (c) To communicate significant deficiencies in internal control along with explanation of their potential effects, to provide sufficient information to understand context of communication to management and express opinion on effectiveness of internal control
 - (d) To communicate significant deficiencies in internal control along with explanation of their potential effects and to provide sufficient information to understand context of communication to management.

(4 MCQs x 2 Marks each = 10 Marks)

Case Scenario 3

Hill Ltd., a company engaged in the business of trekking essentials, appointed CA Gagan as the Statutory Auditor for the year. Due to the large volume of transactions of the company, the audit engagement team of CA Gagan realized that it would not be feasible to audit each transaction separately during the financial year under audit. Therefore, Engagement Partner decided to apply following audit sampling techniques:

- Random number tables were used for selection of sample for power, telephone, and fuel charges.
- No structured method of sampling was used for office stationery.
- Transactions exceeding ₹ 8,000 were selected for travel expenses.
- The first 200 sales invoices from the sales book for the month of July were selected for sales.

Mr. Kush, one of the team members, compared the salary expenses incurred by the company during the current year with those of the previous five years. He noticed a significant percentage increase in the expenses. This unusual increase raised doubts in his mind. He decided to compare such an increase in salary expenses with the increase in the number of employees.

The company is having warehouse at 2 locations. CA Gagan is planning to attend the physical inventory count process. The inventory includes finished products such as trekking jackets, bags, shoes etc., and raw materials like leather, cloth, chemicals, etc. Some of the inventory is also held by a third party.

Based on above, answer the following questions: -

10. Which of the sampling techniques were used for the following transactions:
- (i) Power, telephone and fuel charges;
 - (ii) Office Stationery;
 - (iii) Travel expenses; and
 - (iv) Sales.
- (Answer in the given order)
- (a) Random sampling, Systematic sampling, Monetary unit sampling, Block sampling.
 - (b) Systematic sampling, Random sampling, Block sampling, Haphazard sampling.
 - (c) Random sampling, Haphazard sampling, Monetary unit sampling and Block sampling.
 - (d) Random sampling, Haphazard sampling, Monetary unit sampling and Systematic sampling.
11. Which audit procedure was Mr. Kush intended to perform by comparing salary expenses?
- (a) Test of details.
 - (b) Test of balances.
 - (c) Test of control.
 - (d) Substantive analytical procedure.
12. Which of the following is not part of CA Gagan's responsibility with respect to the inventories held by the third parties?
- (a) CA Gagan should request confirmation from the third party regarding the quantity and condition of the inventory held by them.
 - (b) CA Gagan should perform an independent valuation of the inventory based solely on the company's internal records.
 - (c) CA Gagan should request the third party to allow him to physically inspect the inventories held by them.
 - (d) CA Gagan should review the terms of the agreement between the company and the third party to understand the responsibilities related to inventory management.
- (3 MCQs x 2 Marks each = 6 Marks)**

MCQs

13. Which of the following is not included in an audit programme normally?
- (a) Extent of checking

- (b) Date of checking
 - (c) Nature or type of procedure
 - (d) Planning of risk assessment procedures **(2 Marks)**
14. Which of the following is TRUE about Engagement Standards?
- (a) Engagement standards ensure proper rights to practitioners in course of performance of their duties.
 - (b) Engagement standards ensure preparation and presentation of financial statements in a standardized manner.
 - (c) Engagement standards ensure uniformity by practitioners in course of performance of their duties.
 - (d) Engagement standards ensure savings in resources of clients. **(2 Marks)**
15. CA Jai is conducting an audit for ABC Ltd., a large client. He is informed by the client's CFO that if they report certain deficiencies, the auditor's firm may not be considered for future engagements. Which type of threat does this scenario represent?
- (a) Familiarity Threat
 - (b) Intimidation Threat
 - (c) Self-interest Threat
 - (d) Advocacy Threat **(2 Marks)**

PART II - Descriptive Questions

Question No. 1 is compulsory.

Attempt any four questions from the Rest.

1. (a) APR & Associates, a Chartered Accountant firm, are appointed as the auditors of Time Ltd. and Bakes Ltd. The volume and nature of business of both the companies are entirely different. CA R is the engagement partner for Bakes Ltd. CA P is the engagement partner for Time Ltd. CA R formulates an Audit Programme for conducting the audit of Bakes Ltd. He suggests CA P to use the same audit programme for Time Ltd. But CA P is of the opinion that this audit programme will not be useful for the audit of Time Ltd.
- In light of the above, mention the matters that should generally be considered while preparing an Audit Programme. Is CA P correct in emphasizing for a different Audit Programme for Time Ltd.? **(4 Marks)**
- (b) ABC & Co. are in the business of manufacturing toys. The stock taking process has been done by the company as on 31.3.2024. The company has used FIFO method for valuation of its inventories. The cost of inventory as on 31.3.24 is ₹ 25,25,000/- and the net realizable value of the inventory on the same date is ₹ 25,24,000/-.

The cost of inventory includes the following:

- (1) Material purchase cost - ₹ 25,05,000/-
- (2) Allocated transport cost - ₹ 18,000/-
- (3) Abnormal wastage - ₹ 2,000/-

The management seeks your advice in arriving at the value of inventory to be shown in the financial statements of the company. What should be the value of inventory in accordance with AS-2? **(4 Marks)**

- (c) Mr. Z, at the time of appointment as an independent director in EF Ltd. a listed company, came to know that the Companies Act, 2013 has placed a greater emphasis on the effective implementation and reporting on internal controls for a listed Company. He wants to know the responsibilities as casted under Companies Act, 2013 with regards to Internal Financial Control for (1) Directors (2) Independent directors and (3) Audit committee as per section 134(5)(e), 149(8) & 177(4) (vii) respectively of the Companies Act, 2013. **(3 Marks)**
 - (d) CA B, an auditor, after the completion of busy audit season, was occupied in assembling of final audit files of one of his client. First of all, he started preparing various documents of that client and then kept those documents in various folders. He was preparing documents as well as audit file in paper form because he believed that it is mandatory. He could complete documentation as well as assembling of final audit file of that client after three months from the date of audit report. Generally, he retains audit file of the clients for 4 years from the date of audit report. Check the validity of the action of CA B. **(3 Marks)**
2. (a) CA Q is the engagement partner for the audit of a Departmental store. As a part of the risk assessment procedure, he wants to make inquiries of the management and others within the entity. What kind of information can the auditor get by inquiring from the following?
- (i) Internal audit personnel
 - (ii) In-house legal counsel
 - (iii) Marketing or sales personnel
 - (iv) Information systems personnel **(4 Marks)**
- (b) CA Z, the auditor of MNO Ltd., during the course of audit, assesses a risk of material misstatements regarding the litigations and claims involving the company. CA Z is not convinced with the management's explanations regarding the status of the litigations or claims. It is considered unlikely that the entity's external legal counsel will respond appropriately to a letter of general enquiry. The auditor sent a letter of specific enquiry requesting the entity's external legal counsel to communicate directly with the auditor. List out the inclusions in the letter of specific enquiry.

In certain circumstances the auditor may judge it necessary to meet with entity's external legal counsel to discuss the likely outcome of the litigations or claims. What will be auditor's reporting responsibility if the

management refuses to give permission to the auditor to communicate or meet with the external legal counsel? **(4 Marks)**

- (c) JK Ltd. was having a 'Pager' manufacturing plant and looking at the demand it was of the view that the company will grow continuously in future. But, with the introduction of mobile phones in the market, the plant was shut down completely. The shareholders of the company were of the view that auditor failed to perform their duty and have not informed to them about the company's inability to continue its business, otherwise they might not have suffered the loss. List down the factors giving rise to the inherent limitations due to which auditor cannot provide a guarantee that the financial statements are free from material misstatement due to fraud or error. **(3 Marks)**
- (d) B Ltd. is a company manufacturing bed-sheets and pillow covers. They have appointed M/s C & Co., Chartered Accountants, as their auditors. The auditor is establishing audit strategy with his team members. As the work progressed, they came to know that the company has diversified its business and now they are also planning to manufacture wooden furniture. The auditor, in his professional judgement, considers this to be a significant factor in directing the engagement team's efforts. Give examples of factors that, in auditor's professional judgement, are significant in directing the engagement team's efforts. **(3 Marks)**
3. (a) CA E is auditor of LM Ltd. Before commencing with current year's audit, he initiated planning for the audit. Planning includes the need to consider certain matters, prior to the identification and assessment of the risk of material misstatements. Enumerate such matters. **(4 Marks)**
- (b) The management of PQ Ltd. changed during the period under audit. Mr. G an auditor, at the time of receiving written representation on the management responsibilities from the management, was in a dilemma related to the date of and period(s) covered by the written representation. Further, new management was of the view that they can give written representation from the date they took over and not for the prior period when old management were managing affairs of the company. Guide the auditor & the management in this respect. **(4 Marks)**
- (c) You are appointed as the auditor of a company manufacturing paints. The company has a robust system of internal control. Most of the controls in the company are automated and they are working effectively. However, in certain situations, manual elements in internal controls are more suitable. What are the circumstances where manual elements in internal controls may be more suitable? **(3 Marks)**
- (d) M/s PSR & Associates are the auditors of The Saturn Hotel, a chain of five-star hotels. Since the nature of their business is prone to frauds, the company has appointed internal auditors at various locations. The company has also devised a system of effective and efficient internal controls. The auditors, M/s PSR & Associates, want to use the work of the internal auditors. In order to ensure effectiveness, what kind of coordination should be there between the external auditor and the internal audit function? **(3 Marks)**

4. (a) M/s KLM & Co. Chartered Accountants, a partnership firm, while designing tests of controls and tests of details in MN Ltd. has to determine the items for testing that can be effective in meeting the purpose of the audit procedure. For this, they decided to select specific items from a population. State the factors that can be considered by the audit firm for selecting specific items from a population and also state the specific items that can be included for such testing. **(4 Marks)**
- (b) Mr. L is a principal auditor of OP Ltd. There are several divisions of OP Ltd. that are audited by other auditors. State the procedures Mr. L should ordinarily perform to obtain sufficient and appropriate audit evidence that the work of other auditors is adequate for the principal auditor's purpose in the context of this assignment. **(4 Marks)**
- (c) LD Ltd. has given below loans to the following borrowers during the financial year 2023-24. Mr. B an auditor wants your guidance regarding additional regulatory information required to be provided under the Companies Act, 2013:

Borrowers	Maximum Loan granted during the year 2023-2024 (₹ in Lakh)	Outstanding Loan as at 31/03/2024 (₹ in Lakh)
X (Promoter)	20	15
Y (Director)	30	25
Z (KMP)	10	05
A (Related Party)	20	10
Others	80	65
Total	160	120

- (3 Marks)**
- (d) Communicating Key Audit Matter is not a substitute for disclosure in the Financial Statements rather Communicating key audit matters in the auditor's report is in the context of the Auditor having formed an opinion on the financial statements as a whole. Analyse. **(3 Marks)**
5. (a) PQ & Co. want to diversify its business and for that purpose they want to raise money by issuing shares to the general public. The face value of the shares is ₹ 100 but the directors of the company propose to issue the shares at a discounted rate of ₹ 95/- so as to receive more response. The statutory auditor, however, objects to the same as it is not allowed as per the Companies Act, 2013. State the provisions of Section 53 of the Companies Act, 2013 with reference to shares issued at a discount and the consequences where the company fails to comply with the provisions of this section. **(4 Marks)**
- (b) HR & Associates are the auditors of a large manufacturing company. The company has recently invested huge amount in Property, Plant and Equipment (PPE) for its new unit. They have added many incidental expenses to the cost of PPE. The junior audit team members are not sure about which costs should be excluded from the cost of PPE. Give examples of costs that should not form part of costs of PPE. **(4 Marks)**

- (c) A professional accountant is expected to comply with the fundamental principles of professional ethics at all times. Explain which fundamental principle governing professional ethics is violated in the following situations?
- (1) A chartered accountant in practice accepted the appointment as an auditor of a firm in which his sister was a partner.
 - (2) A chartered accountant in practice was approached by his friend to seek some insider information about a company, which was a client of the chartered accountant. He could not refuse his friend's request.
 - (3) A chartered accountant in practice failed to inform his client about the change in laws applicable to his client. **(3 Marks)**
- (d) You have been appointed as the statutory auditor of a limited company. The company is registered as a Nidhi company. What are the reporting requirements of a Nidhi company under the Companies Auditor's Report Order, 2020? **(3 Marks)**
6. (a) CA M is the engagement partner of the firm M/s Y2Z LLP and he is auditing the financial statements of a listed entity ABC Ltd. The audit firm has determined that an engagement quality control review is required for this assignment. Discuss the responsibilities of CA M as an engagement partner for engagement quality control review as per SA-220. **(4 Marks)**

OR

- (a) Sanskar Foundation is a Non-Governmental Organisation (NGO) for orphan children. They have received voluntary contribution of ₹ 50 lacs from the promoters, specifying that ₹ 20 lacs are towards the Corpus contribution and ₹ 30 lacs are towards Revolving fund. Explain the terms "Corpus contribution" and "Revolving fund". **(4 Marks)**
- (b) MNB bank advanced certain loans guaranteed by government. State the prudential norms for asset classification and income recognition of such loans. **(4 Marks)**
- (c) Mr. D an auditor, while auditing ACE Ltd., identified certain misstatements in relation to particular class of transactions and account balances. He had communicated same to those charged with governance and also taken written representation for the same. State the audit documentation required by the auditor regarding misstatements identified during the audit. **(3 Marks)**
- (d) JK Ltd. has opened a new manufacturing unit and for that they want plant & machinery. Since the capital outflow will be huge, they are considering of taking it on lease. They have approached several parties and have shortlisted one of them who is ready to give the plant on lease for 11 years, which is approximately the estimated economic life of the asset. As per the agreement, JK Ltd. will bear the insurance and maintenance expenses of the asset. Which kind of lease agreement have JK Ltd. entered into and what is the ownership status, the accounting treatment and the tax benefits of the same? **(3 Marks)**