PAPER – 5:
AUDITING AND ETHICS

QUESTIONS

PART – I: Multiple Choice Questions based on Case Scenarios

Case Scenario

Mohan & Associates were offered the statutory audit of Simi Pvt. Ltd. for the financial year 2024–25. In line with professional requirements, the firm communicated with the outgoing auditor, Veer & Co., to inquire whether there were any professional or other reasons that would preclude them from accepting the appointment. However, no response was received from Veer & Co. for the same.

During the audit, Mr. A, a partner of Mohan & Associates, relied solely on a management representation letter to support the accounting treatment of certain tax matters that were under appeal and no additional audit procedures were performed to verify the appropriateness of management's treatment of these matters in the financial statements, which may raise concerns regarding the sufficiency and appropriateness of audit evidence obtained.

As Simi Pvt. Ltd. had recently appointed a new accountant who lacked adequate knowledge of the accounting standards applicable to the company, the management requested Mr. A to assist with accounting and bookkeeping services. However, Mr. A declined the request, recognising that providing such services could impair his independence as an auditor.

Meanwhile, Mr. Raj, an investor in Simi Pvt. Ltd., placed full reliance on the audited financial statements, believing they indicated a strong financial position. He assumed that the audit guaranteed the safety of his investment, without any risk of loss.

While finalising the audit documentation, Mr. A prepared the working papers in physical form, under the belief that paper documentation was mandatory.

Based on the above facts, answer the following MCQs:

1. The previous auditors, Veer & Co. did not reply to the communication of Mohan & Associates. Which fundamental principle of professional ethics is not followed by them?

   (a) Objectivity.

   (b) Integrity.

   (c) Professional behaviour.

   (d) Professional competence and due care.

2. The auditor did not carry out any other audit procedures to justify management's treatment of the said tax matters under appeal in the financial statements. What is lacking on part of auditor in such a situation?

   (a) Professional Skepticism.

   (b) Objectivity.

   (c) Integrity.

   (d) Professional Behaviour.

3. Mr. A was requested to provide accounting & bookkeeping services to Simi Pvt. Ltd. Identify the type of threat to Independence that may be involved in acceptance of such an engagement.

   (a) Self- interest threat.

   (b) Self- review threat.

   (c) Confidentiality.

   (d) Intimidation threat.

4. Mr. Raj is confident that investment made by him is completely secure and there is no risk of any loss. Select the correct statement in this regards:

   (a) Audited Financial statements provide absolute assurance therefore money invested by Mr. Raj is absolutely safe.

   (b) Audited Financial statements provide reasonable assurance. It doesn't guarantee complete accuracy.

   (c) Neither (a) nor (b) is correct.

   (d) Both (a) and (b) are correct.

5. Mr. A was preparing the documents and audit file in physical (paper) form, believing that it is compulsory to do so. Is Mr. A's understanding, correct? Identify the correct statement regarding the form of an audit file.

   (a) Audit file should be kept in both physical & electronic form.

   (b) Audit file should be kept in physical form only.

   (c) Audit file may be kept in physical or electronic form.

   (d) Audit file should be kept in electronic form only.

General MCQs

6. While auditing Happy Pvt. Ltd., CA M reviews a large number of invoices collected by the audit team. However, noticing that only a few have third-party confirmations, CA M reminds the team that simply having more documents doesn't ensure strong audit evidence and explained that reliability or quality matters too. What CA M is trying to explain in the given situation?

   (a) Sufficiency relates to quality; appropriateness relates to quantity.

   (b) Internal documents are always sufficient and appropriate.

   (c) More documents mean better audit evidence.

   (d) Sufficiency refers to quantity; appropriateness refers to quality.

7. As per SA 560, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:

(a) Modify the opinion in accordance with SA 705 and provide the amended auditor's report.

(b) Discuss the matter with management and determine whether the financial statements need amendment.

(c) Notify shareholders directly to prevent reliance on the auditor's report.

(d) Withdraw from the engagement and disclaim an opinion.

8. Supriya has taken a loan from a bank by pledging her NSC (National Savings Certificate), which is eligible for surrender. The loan account currently shows no signs of repayment delay, and the bank confirms that an adequate margin is available in the accounts. However, the loan has technically become overdue. How should the bank classify this loan account?

(a) The account must be classified as an NPA due to overdue status.

(b) The account should not be classified as an NPA since the adequate margin is available in the accounts.

(c) The account must be written off immediately.

(d) The account classification depends on the borrower's repayment history.

PART II – Descriptive Questions

Chapter 1 - Nature, Objective and Scope of Audit

9. Mini & Associates, Chartered Accountants, were appointed as the auditor of CIN Ltd., a construction company. During the audit, CA Mini, a Partner of the firm noticed the following:

- The company has several ongoing projects, but only selected project revenues have been reported.

- Several expense vouchers are either missing or are handwritten and lack proper authorisation.
- The company has changed its depreciation method from the straight-line method to the written-down value method without adequate disclosure in the financial statements.

These matters were brought to the attention of management. However, management argued that these issues fall outside the auditor's scope of responsibility. Whether contention of the management is correct?

Chapter 2 - Audit Strategy, Audit Planning and Audit Programme

10. CA Rishu is appointed as an auditor of a manufacturing company with a complex supply chain, multiple inventory locations, and recently introduced financial reporting requirements. Some article assistants and an expert assigned for inventory verification are forming part of audit team of CA Rishu. To ensure that audit risk is reduced to an acceptably low level, CA Rishu is focused on developing an effective and efficient audit plan. Explain the benefits of adequate audit planning in the audit of financial statements.

Chapter 3 - Risk Assessment and Internal Control

11. During the audit of Apex Ltd., the auditor plans to place reliance on the internal controls related to the revenue recognition process, which appear well-designed based on the preliminary assessment. However, due to materiality of revenue and the inherent risk of overstatement, the auditor concludes that more persuasive audit evidence is needed to evaluate the effectiveness of these controls. Discuss the matters the auditor may consider in determining the extent of test of controls.

Chapter 4 - Audit Evidence

12. Bold Ltd. supplies navy uniforms across the country. The company has 5 warehouses at different locations throughout the India and 4 warehouses at the borders. The major stocks are generally supplied from the borders. Bold Ltd. appointed M/s KPM & Co. to conduct its audit for the financial year 2024-25. Mr. P, partner of M/s KPM & Co., attended all the physical inventory counting conducted throughout the India but could not attend the same at borders due to some unavoidable reason.

You are required to advise M/s KPM & Co.,

(a) How sufficient appropriate audit evidence regarding the existence and condition of inventory may be obtained?

(b) How is an auditor supposed to deal when attendance at physical inventory counting is impracticable?

13. CA Rimi is appointed as an auditor of ASI Pvt. Ltd. During the audit, she decided to use various audit procedures to gather sufficient and appropriate audit evidence such as:

i. While verifying the fixed asset, she examined factory equipment and verified the presence of each item.

ii. To verify the company's accounts receivable, she directly sends balance confirmations to some of the customers.

iii. CA Rimi examined purchase invoices, contracts, and authorisation records to assess the validity of payments and the approval process.

iv. She independently performs the bank reconciliation that was originally carried out by the accounts department.

v. She also checked the accuracy of depreciation calculations made by the client.

Identify and explain the type of abovementioned audit procedure performed by CA Rimi in accordance with relevant SA.

Chapter 5 - Audit of Items of Financial Statements

14. Identify and explain the assertions that the auditor will check by performing the following audit procedures:

(i) Employee benefit expenses recognised during the period relates to the current accounting period only.

(ii) Employee benefit expenses in respect of all personnel have been fully accounted for.

(iii) Any inventory held by the entity on behalf of another entity has not been recognised as part of inventory of the entity.

(iv) Recorded sales represent goods which were ordered by valid customers and were despatched and invoiced in the period.

Chapter 6 - Audit Documentation

15. CA Shilpi, the engagement partner at MN Associates, is assigned the audit of following two companies:

- Zed Ltd., a small family-run business with straightforward operations, minimal internal controls, and low transaction volume.
- Ted Ltd., a large multinational corporation with complex operations, multiple subsidiaries, high transaction volumes.

During the audit planning stage, CA Shilpi highlights that the form, content, and extent of audit documentation must be customised for each client based on specific factors. Discuss those factors on which form, content, and extent of audit documentation depends.

Chapter 7 - Completion and Review

16. During the audit of Cryst Ltd. for the financial year ended 31st March 2025, the auditor, CA Z was in the process of finalising the audit report dated 30th May 2025. The engagement partner emphasised that CA Z shall perform audit procedure designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report, that requires adjustment of, or disclosure in, the financial statements have been identified. What audit procedures, in accordance with SA 560, should the auditor CA. Z perform based on risk assessment to identify events occurring between the date of the financial statements and the date of the auditor's report that require adjustment or disclosure?

Chapter 8 - Audit Report

17. Auditors do not always issue an unmodified opinion on financial statements. In cases where there are material misstatements or limitations in obtaining sufficient audit evidence, a modified opinion may be necessary.

Discuss the types of modified audit opinions an auditor can issue? Explain how these opinions differ based on the concepts of materiality and pervasiveness of the issue.

Chapter 9 - Special Features of Audit of Different Type of Entities

18. You are appointed as an auditor of M/s Shine & Co., a partnership firm. During your review, you observed that:

    - The audit appointment was informal and not documented properly.
    - The firm started a new business activity which is not covered in the partnership deed.
    - Major financial decisions were made without proper records.

    As an auditor, briefly explain the matters that should be specially considered by you while auditing the accounts of the partnership firm, M/s Shine & Co.

Chapter 10 - Audit of Banks

19. M/s JKL & Associates, Chartered Accountants, are the statutory auditors of M/s IBS Bank Limited for the financial year 2024-25. During the audit, they observed the following items included under interest income in the financial statements of the bank:

    - An amount of ₹ 5 lakh relating to a short-term crop loan, where the instalment was overdue for one crop season.
    - An amount of ₹ 7 lakh relating to an advance guaranteed equally by the Government of India and the Government of Tamil Nadu, where the instalment has been overdue for more than six months.

    From the above facts and details, what should be the correct treatment of the above interest income in the bank's financial statements? State the amount that can be recognised as interest income with appropriate reasoning. Also, determine the amount to be classified as Non-Performing Asset (NPA), with reference to applicable RBI norms.

Chapter 11 - Ethics and Terms of Audit Engagements

20. CA Rohit is conducting the audit of Taste Ltd., a food production company, for the last two years. Before commencing the audit for the year, he observed that the company has undergone a major shift in its product line by expanding into pharmaceuticals. Besides this, the company is now subject to new regulatory reporting requirements. These developments were not present at the time of accepting the initial

audit engagement. CA Rohit is of the view that there is no need to issue a new audit engagement letter. Examine whether the viewpoint of CA Rohit is appropriate in accordance with the relevant Standards on Auditing.

SUGGESTED ANSWERS

PART – I: Answers to Multiple Choice Questions

MCQ No.	Answer
1.	(c)
2.	(a)
3.	(b)
4.	(b)
5.	(c)
6.	(d)
7.	(b)
8.	(b)

PART – II: Answers to Descriptive Questions

9. **The following points are included in scope of audit of financial statements:**

(1) Coverage of all aspects of entity

Audit of financial statements should be organised adequately to cover all aspects of the entity relevant to the financial statements being audited.

(2) Reliability and sufficiency of financial information

The auditor should be reasonably satisfied that information contained in underlying accounting records and other *source* data (like bills, vouchers, documents etc.) is reliable and sufficient basis for preparation of financial statements.

The auditor makes a judgment of reliability and sufficiency of financial information by making a study and assessment of accounting systems and internal controls and by carrying out appropriate tests, enquiries and procedures.

(3) Proper disclosure of financial information

The auditor should also decide whether relevant information is properly disclosed in the financial statements. He should also keep in mind applicable statutory requirements in this regard.

It is done by ensuring that financial statements properly summarize transactions and events recorded therein and by considering the judgments made by management in preparation of financial statements.

In view of above, the management's contention is not correct. The matters identified by CA Mini such as incomplete revenue recognition, missing or unauthorised expense vouchers, and inadequate disclosure of changes in accounting policy are well within the scope of the audit of financial statements, as they impact the reliability, completeness, and proper presentation of financial information.

10. Adequate planning benefits the audit of financial statements in the several ways, including the following:

1. Helping the auditor to devote appropriate attention to important areas of the audit.
2. Helping the auditor identify and resolve potential problems on a timely basis.
3. Helping the auditor properly organise and manage the audit engagement so that it is performed in an effective and efficient manner.
4. Assisting in the selection of engagement team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.
5. Facilitating the direction and supervision of engagement team members and the review of their work.

6. Assisting, where applicable, in coordination of work done by others such as experts

Therefore, planning an audit ensures that audit risk is reduced to an acceptable low level. When audit work is adequately and properly planned, it reduces the risk of inappropriate opinion by the auditor.

11. When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control as well as the degree of reliance on controls. Matters the auditor may consider in determining the extent of test of controls include the following:

- The frequency of the performance of the control by the entity during the period.
- The length of time during the audit period that the auditor is relying on the operating effectiveness of the control.
- The expected rate of deviation from a control.
- The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level.
- The extent to which audit evidence is obtained from tests of other controls related to the assertion.

12. (a) As per SA 501 "Audit Evidence- Specific Considerations for Selected Items", when inventory is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by:

(1) Attendance at physical inventory counting, unless impracticable, to:

(i) Evaluate management's instructions and procedures for recording and controlling the results of the entity's physical inventory counting;

(ii) Observe the performance of management's count procedures;

(iii) Inspect the inventory; and

(iv) Perform test counts.

(2) Performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results.

(b) Attendance at Physical Inventory Counting Not Practicable: In some cases, attendance at physical inventory counting may be impracticable. This may be due to factors such as the nature and location of the inventory. For example - where inventory is held in a location that may pose threats to the safety of the auditor.

The matter of general inconvenience to the auditor, however, is not sufficient to support a decision by the auditor that attendance is impracticable. Further, as explained in SA 200, the matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative or to be satisfied with audit evidence that is less than persuasive.

In some cases where attendance is impracticable, alternative audit procedures, for example inspection of documentation of the subsequent sale of specific inventory items acquired or purchased prior to the physical inventory counting, may provide sufficient appropriate audit evidence about the existence and condition of inventory.

In other cases, however, it may not be possible to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory by performing alternative audit procedures. In such cases, SA 705 requires the auditor to modify the opinion in the auditor's report as a result of the scope limitation.

13. As per SA 500, "Audit Evidence", auditor perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

(i) **Inspection:** Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.

(ii) **External Confirmation:** An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.

(iii) **Inspection:** Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.

(iv) **Reperformance:** Reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.

(v) **Recalculation:** Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

14. (i) The auditor will check the **cut-off** assertion to ensure that whether all income and expenses are reported in the-correct accounting period. Cut-off is a separate assertion because the substantive procedures to verify it are typically different from those applied to the other components of completeness.

(ii) The auditor will check the **completeness** assertion for the same to ensure that all transactions that were supposed to be recorded have been recognised in the financial statements. Transactions have not been omitted.

(iii) The auditor will check **rights & obligations** assertion to ensure that the entity has the right to assets i.e. (whether the entity has ownership and legal title to assets) and the liabilities recognised in the financial statements represent all the entity's obligations to repayment as at a given date.

(iv) The auditor will check the **occurrence** assertion for the same to ensure that transactions recognised in the financial statements have occurred and relate to the entity.

15. The form, content and extent of audit documentation depend on factors such as:

(i) The size and complexity of the entity.

(ii) The nature of the audit procedures to be performed.

(iii) The identified risks of material misstatement.

(iv) The significance of the audit evidence obtained.

(v) The nature and extent of exceptions identified.

(vi) The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.

(vii) The audit methodology and tools used.

16. Audit procedures relating to events occurring between the date of the financial statements and the date of the auditor's report:

The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following: -

(i) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.

(ii) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.

(iii) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.

(iv) Reading the entity's latest subsequent interim financial statements, if any.

17. There are three types of modified opinions, namely:

(i) A qualified opinion.

(ii) An adverse opinion.

(iii) A disclaimer of opinion.

Qualified Opinion:

The auditor shall express a qualified opinion when:

(a) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

Adverse Opinion: The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Disclaimer of Opinion: The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive.

The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

18. While auditing the accounts of M/s Shine & Co., a partnership firm, it is important to ensure that they have formal appointment. Further, deviation from the partnership deed, and absence of documentation for key decisions raise concerns about the validity, transparency, and legal compliance of the firm's operations. Thus, the auditor should specially consider the following matters in the audit of accounts of a partnership:

(i) **Letter of Appointment:** Confirming that the letter of appointment, signed by a partner, duly authorised, clearly states the nature and scope of audit contemplated by the partners, specially the limitation, if any, under which the auditor shall have to function.

(ii) **Partnership Documents:** Studying the minute book, if any, maintained to record the policy decision taken by partners specially the minutes relating to authorisation of extraordinary and capital expenditure, raising of loans; purchase of assets, extraordinary contracts entered into and other such matters as are not of a routine nature.

(iii) **Objects of Partnership:** Verifying that the business in which the partnership is engaged is authorised by the partnership agreement; or by any extension or modification thereof agreed to subsequently.

(iv) **Books of Account:** Examining whether books of account appear to be reasonable and are considered adequate in relation to the nature of the business of the partnership.

(v) **Mutual Interest:** Verifying generally that the interest of no partner has suffered prejudicially by an activity engaged in by the partnership which, it was not authorised to do under the partnership deed or by any violation of a provision in the partnership agreements.

(vi) **Provision for Taxes:** Confirming that a provision for the firm's tax payable by the partnership has been made in the accounts before arriving at the amount of profit divisible among the partners.

(vii) **Division of Profits:** Verifying that the profits and losses have been divided among the partners in their agreed profit-sharing ratio.

19. (b) Classification of Non-Performing Asset (NPA) & Treatment of Interest Income:

(i) Short-Term Crop Loan: As per RBI norms, a loan granted for short-duration crops is to be classified as NPA only if the installment remains overdue for two crop seasons.

In the given case, the installment is overdue for only one crop season, hence, the account is not classified as NPA. Therefore, the interest income of ₹ 5 lakh can be recognised in the financial statements.

(ii) Advance Guaranteed Equally by Government of India and Government of Tamil Nadu: If an advance is guaranteed by the Central Government, it need not be classified as NPA until the guarantee is invoked and repudiated. Thus, Central Government guaranteed Advances, where the guarantee is not invoked/ repudiated would be classified as Standard Assets but regarded as NPA for Income Recognition purpose. The situation would be different if the advance is guaranteed by the State Government, where advance is to be considered NPA if it remains overdue for more than 90 days for both Provisioning and Income recognition purposes.

In the given case, since the guarantee is shared equally between the Central Government and the State Government (Tamil Nadu), and the installment is overdue for more than 6 months, the portion of loan guaranteed by the Central Government (50%) is not to be classified as NPA unless the guarantee is invoked and repudiated. The remaining 50%, guaranteed by the State Government, must be classified as NPA as the installment is overdue for more than 90 days.

Thus, Amount to be classified as NPA will be ₹ 3.5 lakh (i.e., 50% of ₹ 7 lakh) and amount of interest income to be recognised will be ₹ 5 lakh.

20. As per SA 210, "Agreeing the terms of audit engagements", recurring audit is an audit which is performed by an auditor over years. In case of recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement.

The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

(i) Any indication that the entity misunderstands the objective and scope of the audit.

(ii) Any revised or special terms of the audit engagement.

(iii) A recent change of senior management.

(iv) A significant change in ownership.

(v) A significant change in nature or size of the entity's business.

(vi) A change in legal or regulatory requirements.

(vii) A change in the financial reporting framework adopted in the preparation of the financial statements.

(viii) A change in other reporting requirements.

In the given case, Taste Ltd., a food production company, has undergone a major shift in its product line by expanding into Pharmaceuticals and the company is also subject to new regulatory reporting requirements. In view of the abovementioned factors, it is appropriate to revise the terms of the audit engagement in accordance with SA 210. Thus, the viewpoint of CA Rohit regarding no need for issuance of a new engagement letter is not correct, CA Rohit is required to send the revise audit engagement letter.