

Mock Test Paper - Series II: April 2025

Date of Paper: 5th April 2025

Time of Paper: 10 A.M. – 1 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

Star Ltd., a leading manufacturer of windmills in India, appointed M/s Shahi & Co., LLP of Chartered Accountants, as its statutory auditors for F.Y. 2023-24. During the audit, one of the audit team members, CA Ritik, was asked by the engagement partner to verify the ownership assertion of the company's inventories. To accomplish this, CA Ritik requested the concerned official of company to arrange for the audit team to attend the physical inventory count being conducted by the company. CA Ritik believed that attending the inventory count was the only way to check the ownership assertion related to the company's inventory. He discussed the matter with another audit team member, CA Pari. She had a different perspective. According to CA Pari, the correct course of action would be CA Ritik verifying the purchase requisition, purchase order, receiving reports, vendor invoices, inventory records, and payment files etc. as ownership assertion could not be verified simply by attending the physical inventory count.

While verifying the creditors and purchases balances, CA Pari, have been satisfied with the internal control procedures related to purchases and creditors, and decides to check the creditors balance on a sample basis. She requested the management to provide a list of all the creditors, which included a total of 550 creditors. To determine the sample, CA Pari chose a sampling interval of every 11th creditor's balance, which results in a sample size of 50 creditors balances for the audit.

During the audit, while verifying the share capital balance of the company, CA Ritik and CA Pari observed that there has been no change in the share capital raised by the company. CA Pari

was of the view that since there has been no change in the share capital of the company, the audit team is not required to obtain any evidence with respect to the share capital balance. However, CA Ritik is of the opinion that they should obtain audit evidence even if there is no change in the company's capital structure during the year. According to him, such evidence can be a written confirmation from the accounts manager.

Before finalising the audit report, the engagement partner asked CA Ritik to coordinate with the client company to request a written representation from management regarding their responsibilities and the information provided. However, CA Ritik refused to accept the representation, as it contained a qualifying language to the effect that representations are made to the best of its knowledge and belief, which according to him was not reasonable to accept.

Based on the above facts, answer the following:

1. What is the best course of action for CA Ritik for verification of the assertion with respect to the inventory of the company, as asked by the engagement partner?
 - (a) CA Ritik should ask the management to provide a written representation in this regard as it is in itself a sufficient and appropriate audit evidence.
 - (b) CA Ritik should perform test count and inspection while attending the physical inventory count in order to verify the assertion as asked by the engagement partner.
 - (c) CA Ritik should attend the physical inventory count as the only audit procedure.
 - (d) CA Ritik should agree to CA Pari and follow the course of action as suggested by her.
2. While verifying the inventory as asked by the engagement partner, which specific assertion can be best verified by following the specific audit procedure considered appropriate by CA Ritik?
 - (a) Existence and Condition.
 - (b) Rights and Obligations.
 - (c) Presentation & Disclosure.
 - (d) Valuation.
3. Which method of sampling has CA Pari applied while selecting the sample for verification of creditors?
 - (a) Simple random sampling.

- (b) Systematic sampling.
 - (c) Haphazard sampling.
 - (d) Stratified sampling.
4. Which of the following is the most appropriate, with respect to verification of share capital balance of the company?
- (a) The point of view of CA Pari is correct.
 - (b) The point of view of CA Ritik is correct.
 - (c) The point of view of CA Pari is partly correct as no evidence is required to be obtained if the same audit firm has conducted the audit of the previous year thereby verifying the closing balance of share capital in the previous year which becomes the opening balance of the share capital for the year under audit.
 - (d) The point of view of CA Ritik is partly correct as written confirmation should be obtained from the Company Secretary.
5. Whether non-acceptance of the written representation by CA Ritik is correct?
- (a) The non-acceptance of written representation by CA Ritik is not correct as management of the company has the sole discretion to decide as to what language is used or what limitations are imposed in the written representation provided to the auditor.
 - (b) The non-acceptance of written representation by CA Ritik is correct as it is not reasonable for the auditor to accept any qualifying language in the written representations given by the management.
 - (c) The non-acceptance of written representation by CA Ritik is not correct as it is reasonable for the auditor to accept such qualifying language if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.
 - (d) The non-acceptance of written representation by CA Ritik is correct as SA 580 requires the auditor to accept the written representation only if it is in the language as used in the letter of audit engagement.

Case Scenario 2

Raavi & Co., a Chartered Accountants firm, has been appointed as auditor of XYZ Ltd., a prospective new client. CA Sukanya, one of the firm's partner, is handling the potential client. During a meeting with the company's officers, she discovers that Sushant, the company's CFO, is a former classmate. They had both started their Chartered Accountancy (CA) journey together, but Sushant left the program halfway due to repeated failures and later pursued an MBA in finance from a prestigious institution.

During initial discussions, the company reveals plans to launch a new service in the "weather-forecasting" sector. These services will be available on website of company, and users can access micro weather information for a fee. The company requests that the audit firm be visibly associated with their marketing efforts.

Assuming the firm accepts the offer, they send a letter to the previous auditor, Royal & Co., requesting any professional reasons that might prevent them from taking on the assignment. However, Royal & Co. does not respond to the inquiry.

While planning the audit, Raavi & Co. also learn that the company has acquired all shares of another company, which requires the financial statements of both companies to be consolidated and audited, according to applicable laws. Despite this information, Raavi & Co. fails to advise the client on the necessity of auditing the consolidated financial statements.

Firm is also reviewing internal controls of XYZ Ltd. He verifies following things:

- Are tenders called before placing orders?
- Are the purchases made on the basis of a written order?
- Is the purchase order form standardised?
- Are purchase order forms pre-numbered?

Based on the above facts, answer the following:

6. Keeping in view request of the company to be visibly associated with company's new services, identify which type of threat is being faced by audit firm.
 - (a) Self-interest threat.
 - (b) Familiarity threat.
 - (c) Self-review threat.
 - (d) Advocacy threat.

7. The previous auditors, Royal & Co., have not replied to communication of Raavi & Co. Which fundamental principle of professional ethics is not followed by them?
- (a) Objectivity.
 - (b) Professional behaviour.
 - (c) Professional competence and due care.
 - (d) Integrity.
8. Raavi & Co. have failed to advise the company regarding audit of consolidated financial statements. Which fundamental principle of professional ethics is being violated by Raavi & Co.?
- (a) Professional behaviour.
 - (b) Integrity.
 - (c) Objectivity.
 - (d) Professional competence and due care.
9. Which method is Raavi & Co. using to facilitate the accumulation of the information necessary for the proper review and evaluation of internal controls?
- (a) Narrative record.
 - (b) Flow chart.
 - (c) Check List.
 - (d) Internal Control questionnaire.

Case Scenario 3

CA Misha is appointed as the statutory audit of a branch of FDH Bank. During the audit, the following issues were observed:

The bank provides "Kisan Credit Card" loans to farmers to meet their short-term credit needs for crop cultivation. One such loan, with an outstanding balance of ₹ 20 lakh at the year end, had no transactions for the past 90 days. The loan was granted for paddy cultivation, which typically takes 3-4 months from sowing to harvest. The branch has classified the loan as a "Standard Asset".

It was also noted that the account of a borrower with a cash credit limit of ₹ 50 lakh, which was taken over from another bank, was sanctioned by the branch manager instead of the immediate higher authority, as required in bank's "Manual of Delegation of Powers".

CA Misha also served as the statutory auditor for a multiplex cinema. During the audit, CA Misha observed that the revenue of company has fallen from ₹ 50 crore in last year to ₹ 5 crore in current year (for which financial statements have been received for audit) due to lack of demand in the market for company's products.

Based on the above facts, answer the following:

10. As regards description of agricultural advance, which of the following statements is most appropriate in this regard?
 - (a) The branch has erred in making classification as per RBI norms. It is a "Sub-standard" asset.
 - (b) The classification made by branch is proper. However, there are no transactions in account since last 90 days, it is SMA.
 - (c) The classification made by branch is proper.
 - (d) The branch has erred in making classification as per RBI norms. It is a "doubtful" asset.
11. Regarding taken over account from another bank, which of the following statements is most appropriate?
 - (a) It is a serious violation of laid down procedures of bank for sanction of advances and should be reported by auditor without fail.
 - (b) It is an internal issue of Bank. However, the auditor may, at his discretion, report it.
 - (c) It is an internal issue of Bank and auditor is not concerned with it.
 - (d) There is no issue involved as credit facility was properly sanctioned.
12. Regarding drastic fall in revenue of the company, which of the following is an audit risk?
 - (a) Fall in revenue would result in fall of profits for the company.
 - (b) Drastic fall in revenue may imply that company is not able to carry out its operations in foreseeable future due to lack of demand in the market for company's products. There is a risk that going concern disclosure is omitted to be made in financial statements.
 - (c) The company can explore some new line of activity, if demand of its products is falling.
 - (d) Fall in revenue would mean lower tax liabilities for the company.

MCQs

13. CA Radha is appointed as an auditor of a PVC Ltd. for the first time. A detailed set of instructions has been prepared by her office and handed over to assistants in engagement team. During the course of audit, she noticed that company is also producing substantial quantities of scrap generated during manufacturing process. However, no instructions have been given to engagement team in this regard. What should be proper course of action by CA Radha?
- (a) She should ignore this information as audit has already begun.
 - (b) She should modify earlier set of instructions.
 - (c) She should leave the matter to wisdom of engagement team.
 - (d) She should put the ball in court of management as she was not provided with complete information earlier.
14. The management of a company has approached its bankers and requested for enhancement in working capital credit facilities. The bank manager requested for financial statements of the company for half year along with report providing assurance in this respect duly signed by CA. It also requires projected financial statements for coming years along with a report from CA providing assurance regarding these projections to consider request of management. Which of the following standards issued by ICAI are relevant for CA P in such a situation, if any?
- (a) Standards on Review Engagements.
 - (b) There are no standards for issuing such type of reports.
 - (c) Standards on Related Services.
 - (d) Standards on Assurance Engagements.
15. While conducting the audit of receipts of Government Company, which of the following area is to be covered as part of Audit of Receipts?
- 1. Whether all revenues or other debts due to government have been correctly assessed, realised and credited to government account by the designated authorities of Government Company.
 - 2. Whether adequate checks are imposed to ensure the prompt detection and investigation of irregularities, double refunds, fraudulent or forged refund vouchers or other loss of revenue through fraud or wilful omission or negligence to levy or collect taxes or to issue refunds.

3. Whether the expenditure incurred has been on the purpose for which the grant and appropriation had been provided and that the amount of such expenditure does not exceed the appropriation made.
 4. Whether the various schemes/projects are executed and their operations conducted economically and whether they are yielding the results expected of them.
- (a) Only statement 1 is correct.
 - (b) Statements 1 & 2 are correct.
 - (c) Statements 1, 2, 3, 4 are correct.
 - (d) Statements 1, 2, 3 are correct.

PART II - Descriptive Questions (70 Marks)

Question No. 1 is compulsory.

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

1. (a) Identify and briefly explain the component of risks of material misstatement involved in the following situations:
 - (i) GHK Private Limited is a start-up engaged in providing comprehensive solutions to the issue of paddy stubble burning, mainly catering to the needs of farmers of North-western India. Due to the importance given by governments to this issue, companies have entered the market in the past few years. Many of these companies have not been successful and have gone bust.
 - (ii) A company has devised a control that its inventory of perishable goods is stored in appropriate conditions in a controlled environment to prevent any damage to inventory. Responsibility is fixed on two people to monitor the environment using sensors and to report on deviations.
 - (iii) Shree Foods Private Limited is engaged in the manufacturing of garlic bread. The auditors of the company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that the misstatements in revenue recognition are not identified by planned audit procedures. **(5 Marks)**

- (b) The assistant of CA Bhavik is assigned responsibility of drafting “audit programme” relating to purchases appearing in financial statements of Arya Industries, a partnership firm for F.Y. 2023-24. The said firm is a GST registered taxpayer and is engaged in manufacturing of packing boxes from a special type of paper taxable under GST. Draft a sample audit programme for purchases.

(5 Marks)

- (c) Identify and explain briefly the audit procedure used by the auditor to obtain audit evidence in following situations:

- (i) While auditing the books of accounts of ANT Limited for the financial year 2023-24, the auditor checked the complete documents and records of the company in detail to obtain audit evidence.
- (ii) Mr. M, auditor of company, looks at the process of inventory counting by the entity’s personnel and of the performance of control activities.
- (iii) XYZ Ltd. is engaged in export of goods to Europe. The sales invoices raised in Euros are converted into Indian rupees as per applicable norms. The auditor wants to verify whether conversion of foreign currency into Indian rupees is proper or not.
- (iv) CA Isha is appointed as auditor of TUV Ltd., during the initial stage of audit, she reviewed the Gross Profit Ratio of the company. She also compared GP ratio of TUV Ltd. with the other companies operating in similar industry.

(4 Marks)

2. (a) Identify and explain the assertions that the auditor will check by performing the following audit procedures-

- (i) Inventory recognised in the balance sheet actually existed as at the period end.
- (ii) All the items of inventory pertaining to the relevant year shall be included regardless of the location.
- (iii) All goods dispatched prior to the period/ year-end have been invoiced and included in debtors on a test check basis.
- (iv) Examine client correspondence, sales and receivables records, purchase documents.
- (v) Verifying that the entity has charged depreciation on all items of PPE unless any item of PPE is non-depreciable like freehold land. **(5 Marks)**

- (b) While planning the audit of an NGO, the auditor may focus on knowledge of the NGO's work, its mission and vision, updating knowledge of relevant statutes especially with regard to recent amendments, circulars etc. Explain the other relevant points the auditor needs to focus while planning the audit of NGO. **(5 Marks)**
- (c) CA Tina, the auditor of SKY Ltd., asks its finance and audit head to prepare audit strategy for conducting audit of SKY Ltd. CA Tina also insists him to draw detailed audit procedures. In response to the auditor's request, the finance head of the company completes the audit strategy as well as audit procedures. Subsequently, the auditor realises that the effectiveness of the audit is compromised and it was his responsibility to prepare the overall audit strategy. Comment. **(4 Marks)**
3. (a) While auditing a renowned four-star hotel in Pune, CA Shrey observes a gift shop operating within the hotel premises. On further enquiries, he comes to know that stocks in gift shop belong to gift shop owner and hotel receives rent for letting out this space. Discuss, how, auditor can verify payment of common amenities used by gift shop owner to the hotel. **(5 Marks)**
- (b) Auditors are required to obtain an understanding of internal control relevant to the audit when identifying and assessing its effectiveness and risk of material misstatement. PDC Ltd. appointed CA Nikhil as auditor for the F.Y. 2023-24. During the audit, he observed that significant deficiency exists in the internal control system and he wants to ascertain the same. Elucidate the various indicators of significant deficiencies which will help you in assessing the efficiency of internal control system of the organisation. **(5 Marks)**
- (c) Wire Limited, a company engaged in manufacturing of electric equipment, gets some part of its production processes outsourced from third parties. During the audit, the company had sent raw material to third parties for carrying out certain processes on these raw materials and such inventories worth ₹ 1.50 crores (material to financial statements) were lying with different third parties as at year end. How can auditor obtain sufficient appropriate audit evidence in respect of existence and condition of inventories lying with third parties? **(4 Marks)**
4. (a) The senior member of the firm Soni & Associates, Chartered Accountants, informed to its auditing staff that at the time of audit reporting regarding corresponding figures, when corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in specified circumstances. What are those exceptional circumstances? **(5 Marks)**

- (b) The auditor shall plan and perform an audit with professional skepticism recognising that circumstances may exist that cause the financial statements to be materially misstated. Discuss any five examples of professional skepticism.
(5 Marks)
- (c) During the audit of Jimjam Ltd., CA Arjun, 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 requires adjustment of, or disclosure in, the financial statements have been identified. With reference to Standards on Auditing, what specific audit procedures should CA Arjun include in his risk assessment to address subsequent events effectively?
(4 Marks)
5. (a) As per Multi-state Co-operative Societies Act, 2002, the auditor shall make a report to the members of the multi-state co-operative society on the accounts examined by him and on every balance sheet and profit and loss account and on every other document required to be part of or annexed to the balance sheet or profit and loss account. Explain.
(5 Marks)
- (b) During the audit of Grace Pvt. Ltd., CA Tanu notices that significant amount of depreciation and amortisation charges are reflected in financial statements of the company. Which attributes need to be considered by him while verifying such depreciation and amortisation charges?
(5 Marks)
- (c) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. Explain.
(4 Marks)
6. (a) The auditor has a responsibility to perform audit procedures to identify, assess and respond to the risks of material misstatement arising from the entity's failure to appropriately account for related party relationships, transactions or balances.
During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the records or documents that may provide information about related party relationships and transactions. Explain in detail with examples.
(5 Marks)
- (b) While it is true that companies can benefit immensely from the use of data analysis in terms of increased profitability, better customer service, etc. Analyse various functions that an auditor can perform using Data Analytics tools and techniques to obtain good results.
(5 Marks)

- (c) 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. Communicating key audit matters in the auditor's report is not considered as a substitute or alternative for a number of important items. What are those items in view of above?

(4 Marks)

OR

CAR Ltd., an automotive parts manufacturer, appointed Amit & Associates as auditors for F.Y. 2023-24. During the audit, CA Amit noticed a significant rise in raw material consumption (steel and aluminium) despite a decrease in production. This discrepancy led to detailed reviews of vendors supplying these raw materials. While verifying the existence of vendors and the actual receipt of goods or raw materials by the company, which assertion is being verified by CA Amit. Explain the procedure for the same.

(4 Marks)