

**Mock Test Paper - Series I: July 2025**

**Date of Paper: 25<sup>th</sup> July, 2025**

**Time of Paper: 10 A.M. to 1 P.M.**

**INTERMEDIATE: GROUP – II**  
**PAPER – 5: AUDITING AND ETHICS**  
**SUGGESTED ANSWERS / HINTS**  
**Part I - Multiple Choice Questions**

1. (c)
2. (b)
3. (b)
4. (b)
5. (a)
6. (c)
7. (b)
8. (a)
9. (a)
10. (c)
11. (d)
12. (b)
13. (b)
14. (c)
15. (b)

**Part II - Descriptive Answers**

1. (a) CA Aditi is contemplating using internal control questionnaire as method for evaluating internal controls. A set of questions regarding controls operating for creditors are given as under: -
  - (i) (a) Are suppliers' invoices routed direct to the Accounts Department?

- (b) Are they entered in a Bill register before submitting them to other departments for check and/or approval?
  - (c) Are advance and partial payments entered on the invoices before they are submitted to other departments?
- (ii) Does the system ensure that all invoices are duly processed?
- (iii) In respect of raw material and supplies, are reconciliations made of quantities and/or values received as shown by purchase invoices with receipt into stock records?
- (iv) Does the Accounts Department match the invoices of supplies with Goods Received Notes and purchase orders?
- (v) Do all invoices bear evidence of being checked for prices, freight, terms etc.?
- (vi) Are all advance payments duly authorized by persons competent to authorize such payments?
- (vii) Are duplicate invoices marked immediately on receipt to avoid payment against them?
- (viii) Are all supplier's statements compared with ledger accounts?
- (ix) Is there any follow-up action to investigate difference, if any, between the suppliers' statements and the ledger accounts?
- (x) Is a list of unpaid creditors prepared and reconciled periodically?
- (b)**
  - (i) Planning is not a discrete phase of an audit, but rather a continual and iterative process that begins shortly after the completion of the previous audit and continues until the completion of the current audit engagement.  
  
In the given situation, planning of the audit of financial statements for the year 2024-25 would have commenced right after completion of audit of preceding year in June 2024. It would have continued till completion of audit of year 2024-25.
  - (ii) The auditor shall update and change the overall audit strategy and the audit plan as necessary during the audit. As a result of unexpected events, changes in conditions, or the audit evidence obtained from the results of audit procedures, the auditor may need to modify the overall audit strategy

and audit plan and thereby the resulting planned nature, timing and extent of further audit procedures, based on the revised consideration of assessed risks. This may be the case when information comes to the auditor's attention that differs significantly from the information available when the auditor planned the audit procedures. For example, audit evidence obtained through on detailed checking may contradict the audit evidence obtained through testing internal controls.

(c) As per SA 505, "External Confirmations", if management refuses to allow the auditor to send a confirmation request, the auditor shall:

- (i) Inquire as to management's reasons for the refusal and seek audit evidence as to their validity and reasonableness;
- (ii) Evaluate the implications of management's refusal on the auditor's assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures; and
- (iii) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those charged with governance in accordance with SA 260.

The auditor shall also determine the implications for the audit and the auditor's opinion in accordance with SA 705.

In the given case, CA Q wants to send external confirmation requests to selected trade receivables but the management of XY Ltd. refused the same. Thus, CA Q shall take above actions.

2. (a) To ensure revenue from sales of goods and services performed during the period is not overstated, CA Rajveer, would perform the following audit procedures:

- ◆ Check whether a single sales invoice is recorded twice or a cancelled sales invoice could also be recorded.
- ◆ Test check few invoices with their relevant entries in sales journal.
- ◆ Obtain confirmation from few customers to ensure genuineness of sales transaction

- ◆ Whether any fictitious customers and sales have been recorded.
- ◆ Whether any shipments were done without the consent and agreement of the customer, especially at the year end to inflate the sales figure
- ◆ Whether unearned revenue recorded as earned.
- ◆ Whether any substantial uncertainty exists about collectability
- ◆ Whether customer obligations are contingent on other actions (financing, resale etc.)

(b) The computation of Drawing power is as under: -

Particulars	Amount (₹)
Value of stocks as on 31.12.24	150 lacs
Less: value of damaged stocks	<u>30 lacs</u>
	120 lacs
Less: creditors for goods as on 31.12.24	<u>60 lacs</u>
Value of Paid stocks	60 lacs
Less: Margin @ 30%	<u>18 lacs</u>
<b>Drawing power (A)</b>	<b>42 lacs</b>
Value of debtors as on 31.12.24	55 lacs
Less: debtors exceeding 90 days	<u>15 lacs</u>
	40 lacs
Less: Margin @ 40%	<u>16 lacs</u>
<b>Drawing Power (B)</b>	<b>24 lacs</b>
<b>Drawing Power (A+B)</b>	<b>66 lacs</b>

**Conclusion: Drawing Power should be ₹ 66 lacs.**

(c) As per SA 300, "Planning an Audit of Financial Statements", planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:

- (i) The analytical procedures to be applied as risk assessment procedures.
  - (ii) Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
  - (iii) The determination of materiality.
  - (iv) The involvement of experts.
  - (v) The performance of other risk assessment procedures.
3. (a) The special step or audit procedures an auditor should apply while auditing the transactions of hospital are:
- (i) **Register of Patients:** Vouch the Register of patients with copies of bills issued to them. Verify bills for a selected period with the patients' attendance record to see that the bills have been correctly prepared. Also see that bills have been issued to all patients from whom an amount was recoverable according to the rules of the hospital.
  - (ii) **Collection of Cash:** Check cash collections as entered in the Cash Book with the receipts, counterfoils and other evidence for example, copies of patients bills, counterfoils of dividend and other interest warrants, copies of rent bills, etc.
  - (iii) **Income from Investments, Rent etc:** See with reference to the property and Investment Register that all income that should have been received by way of rent on properties, dividends, and interest on securities have been collected.
  - (iv) **Legacies and Donations:** Ascertain that legacies and donations received for a specific purpose have been applied in the manner agreed upon.
  - (v) **Reconciliation of Subscriptions:** Trace all collections of subscription and donations from the Cash Book to the respective Registers. Reconcile the total subscriptions due (as shown by the Subscription Register and the amount collected and that still outstanding).
  - (vi) **Authorisation and Sanctions:** Vouch all purchases and expenses and verify that the capital expenditure was incurred only with the prior sanction of the Trustees or the Managing Committee and that appointments and increments to staff have been duly authorised.
  - (vii) **Grants and TDS:** Verify that grants, if any, received from Government or local authority has been duly accounted for. Also, that refund in respect of taxes deducted at source has been claimed.

- (viii) **Budgets:** Compare the totals of various items of expenditure and income with the amount budgeted for them and report to the Trustees or the Managing Committee, significant variations which have taken place.
  - (ix) **Internal Check:** Examine the internal check as regards the receipt and issue of stores; medicines, linen, apparatus, clothing, instruments, etc. so as to ensure that purchases have been properly recorded in the Inventory Register and that issues have been made only against proper authorisation.
  - (x) **Depreciation:** See that depreciation has been written off against all the assets at the appropriate rates.
  - (xi) **Registers:** Inspect the bonds, share scrips, title deeds of properties and compare their particulars with those entered in the property and Investment Registers.
  - (xii) **Inventories:** Obtain inventories, especially of stocks and stores as at the end of the year and check a percentage of the items physically; also compare their total values with respective ledger balances.
  - (xiii) **Management Representation and Certificate:** Get proper Management Representation and Certificate with respect to various aspects covered during the course of audit.
- (b) As per SA 570, "Going Concern", if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern through performing additional audit procedures, including consideration of mitigating factors. These procedures shall include:
- (i) Where management has not yet performed an assessment of the entity's ability to continue as a going concern, requesting management to make its assessment.
  - (ii) Evaluating management's plans for future actions in relation to its going concern assessment, whether the outcome of these plans is likely to improve the situation and whether management's plans are feasible in the circumstances.
  - (iii) Where the entity has prepared a cash flow forecast, and analysis of the forecast is a significant factor in considering the future outcome of events or conditions in the evaluation of management's plans for future actions: -

- (I) Evaluating the reliability of the underlying data generated to prepare the forecast; and
  - (II) Determining whether there is adequate support for the assumptions underlying the forecast.
- (iv) Considering whether any additional facts or information have become available since the date on which management made its assessment.
- (v) Requesting written representations from management and, where appropriate, those charged with governance, regarding their plans for future actions and the feasibility of these plans.
- (c) As per SA 299, "Joint Audit of Financial Statements", in respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures. On the other hand, all the joint auditors shall be jointly and severally responsible for:
  - (i) the audit work which is not divided among the joint auditors and is carried out by all joint auditors;
  - (ii) decisions taken by all the joint auditors under audit planning in respect of common audit areas;
  - (iii) matters which are brought to the notice of the joint auditors by any one of them and there is an agreement among the joint auditors on such matters;
  - (iv) examining that the financial statements of the entity comply with the requirements of the relevant statutes;
  - (v) presentation and disclosure of the financial statements as required by the applicable financial reporting framework;
  - (vi) ensuring that the audit report complies with the requirements of the relevant statutes, applicable Standards on Auditing and other relevant pronouncements issued by ICAI.
- 4. (a) The auditor has to make inquiries on following matters under section 143(1) of the Companies Act, 2013:-
  - (i) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;

- (ii) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
  - (iii) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
  - (iv) whether loans and advances made by the company have been shown as deposits;
  - (v) whether personal expenses have been charged to revenue account;
  - (vi) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.
- (b) SA 210, "Agreeing the Terms of Audit Engagement", requires the auditor to obtain the agreement of management that it acknowledges and understands its responsibility: -
- (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework including where relevant their fair representation.
  - (ii) For such internal control as management considers necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
  - (iii) To provide the auditor with:
    - Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters
    - Additional information that the auditor may request management for the purpose of the audit and
    - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.
- (c) **Other Written Representation:** As per SA 580, "Written Representations", the written representations requiring fulfilment of management responsibilities in relation to above draw on the agreed acknowledgement and understanding of



management of its responsibilities in the terms of the audit engagement by requesting confirmation that it has fulfilled them. The auditor, CA Keshav of PKT Ltd, may also ask management of PKT Ltd to reconfirm its acknowledgement and understanding of those responsibilities in written representations. This is particularly appropriate when:

- (i) Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
- (ii) The terms of the audit engagement were prepared in a previous year;
- (iii) There is any indication that management misunderstands those responsibilities; or
- (iv) Changes in circumstances make it appropriate to do so.

5. (a) To verify that inventories of raw material & consumables and work-in-progress have been valued appropriately and as per generally accepted accounting policies and practices, the following procedures should be performed by CA Naitik:

**For Raw materials and consumables:**

- Ascertain what elements of cost are included e.g. carriage inward, non-refundable duties etc.
- If standard costs are used, enquire into basis of standards; how these are compared with actual costs and how variances are analysed and accounted for/ treated in accounting records.
- Test check cost prices used with purchase invoices received in the month(s) prior to counting.
- Follow up valuation of all damaged or obsolete inventories noted during observance of physical counting with a view to establishing a realistic net realizable value.

**For Work in Progress:**

- Ascertain how the various stages of production/ value additions are measured and in case estimates are made, understand the basis for such estimates.
- Ascertain what elements of cost are included. If overheads are included, ascertain the basis on which they are included and compare such basis with the available costing and financial data/ information maintained by the entity.
- Ensure that material costs exclude any abnormal wastage factors.

- (b) In the given situation, the audit programme should include the following specific points for audit of receipts and remittances of donation.

**Receipt of Donations:**

- (i) **Internal Control System:** Existence of internal control system particularly with reference to division of responsibilities in respect of authorised collection of donations, custody of receipt books and safe custody of money.
- (ii) **Custody of Receipt Books:** Existence of system regarding issue of receipt books, whether unused receipt books are returned and the same are verified physically including checking of number of receipt books and sequence of numbering therein.
- (iii) **Receipt of Cheques:** Receipt Book should have carbon copy for duplicate receipt and signed by a responsible official. All details relating to date of cheque, bank's name, date, amount, etc. should be clearly stated.
- (iv) **Bank Reconciliation:** Reconciliation of bank statements with reference to all cash deposits not only with reference to date and amount but also with reference to receipt book.
- (v) **Cash Receipts:** Register of cash donations to be vouched more extensively. If addresses are available of donors who had given cash, the same may be cross-checked by asking entity to post thank you letters mentioning amount, date and receipt number.
- (vi) **Foreign Contributions,** if any, to receive special attention to compliance with applicable laws and regulations.

**Remittance of Donations to Different NGOs:**

- (i) **Mode of Sending Remittance:** All remittances are through account payee cheques. Remittances through Demand Draft would also need to be scrutinised thoroughly with reference to recipient.
- (ii) **Confirming Receipt of Remittance:** All remittances are supported by receipts and acknowledgements.
- (iii) **Identity:** Recipient NGO is a genuine entity. Verify address, 80G Registration Number, etc.
- (iv) **Direct Confirmation Procedure:** Send confirmation letters to entities to whom donations have been paid.
- (v) **Donation Utilisation:** Utilisation of donations for providing relief to Tsunami victims and not for any other purpose.

- (vi) **System of NGOs' Selection:** System for selecting NGO to whom donations have been sent.
- (c) The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the activities Relating to Internal Control:
  - (i) **Evaluation of internal control:** The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit.
  - (ii) **Examination of financial and operating information:** The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
  - (iii) **Review of operating activities:** The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including nonfinancial activities of an entity.
  - (vi) **Review of compliance with laws and regulations:** The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

Internal audit has a very strong relation with internal control of a company. Internal Audit analyzes the effectiveness with which the internal control of a company is operating and also makes suggestions for improvement in that internal control.

- 6. (a) In conducting audit of financial statements, objectives of auditor in accordance with SA-200 "Overall Objectives of the Independent auditor and the conduct of an audit in accordance with Standards on Auditing" are:
  - (i) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

- (ii) To report on the financial statements, and communicate as required by the SAs, in accordance with the auditor's findings.

Audit of financial statements is carried out by the auditor with professional competence and skills in accordance with Standards on Auditing. Audit procedures are applied in accordance with SAs, audit evidence is obtained and evaluated. On basis of that, conclusions are drawn, and opinion is formed. It leads to high level of assurance which is called as reasonable assurance, but it is not absolute assurance.

It may be noted that absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements. However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance, but it is not complete assurance.

Misstatements in financial statements can occur due to fraud or error or both. The auditor seeks to obtain reasonable assurance whether financial statements as a whole are free from material misstatements caused by fraud or error.

In the given case, Mr. Jai, CEO of JEN Ltd., questions the auditor's ability to detect all material misstatements and insists that auditor should provide absolute assurance. As per SA 200, the auditor's objective is to obtain reasonable assurance. Therefore, contention of the CEO Mr. Jai is not correct.

- (b) As per SA 315, "Identifying and Assessing Risks of Material Misstatement Through Understanding the Entity and Its Environment", As part of the risk assessment, the auditor shall determine whether any of the risks identified are, in the auditor's judgment, a significant risk. In exercising judgment as to which risks are significant risks, the auditor shall consider the following factors at least that:
  - (i) Whether the risk is a risk of fraud;
  - (ii) Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;
  - (iii) The complexity of transactions;
  - (iv) Whether the risk involves significant transactions with related parties;
  - (v) The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and
  - (vi) Whether the risk involves significant transactions that are outside the

normal course of business for the entity, or that otherwise appear to be unusual.

**(c) The auditor is required to report under Clause (vii) of Paragraph 3 of CARO 2020 that:**

- (a) whether the company is regular in depositing undisputed statutory dues including Goods and Services Tax, provident fund, employees' state insurance, income tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues to the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as on the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;
- (b) where statutory dues referred to in sub-clause (a) have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned (a mere representation to the concerned Department shall not be treated as a dispute).

**OR**

- (c)** Computer software and patents are examples of intangible assets. The value of intangible assets may diminish due to efflux of time, use and/ or obsolescence. The diminution of the value represents cost to the entity for earning revenue during a given period. Unless this cost in the form of amortization is charged to the accounts, the profit or loss would not be correctly ascertained, and the values of intangible asset would be shown at higher amounts.

The auditor should: -

- Verify that the entity has charged amortization on all intangible assets;
- Verify that the amortization method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity.
- The auditor should also verify whether the management has done an impairment assessment to determine whether an intangible asset is impaired. For this purpose, the auditor needs to verify whether the entity has applied AS 28 Impairment of Assets for determining the manner of reviewing the carrying amount of its intangible asset, determining the recoverable amount of the asset determine impairment loss, if any.