

**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 I**

MNO Ltd., incorporated in the financial year 1980-81, is a distinguished company specialising in the manufacturing of nickel-based batteries. As one of the oldest manufacturing companies in this sector, MNO Ltd. operates with two manufacturing plants and a comprehensive distribution network that spans across India. Remarkably, MNO Ltd. was among the first companies to be listed on the stock exchange, underscoring its longstanding presence in the market. The company has consistently adhered to the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations 2015, ensuring compliance with all regulatory standards.

M/s KP & Co. were the statutory auditor in the previous year and resigned from the role of statutory auditor. M/s JKL & Co. has been appointed as a statutory auditor of MNO Ltd. in the FY 2023-24. In conducting initial audit engagement, M/s JKL & Co. has simply placed reliance on the closing balances of preceding period.

During the audit, the auditor observed that the company is unable to pay its creditors on time. The company is also not able to properly comply with the terms of the loan agreement with the banks. Moreover, several key ratios are also adverse. In view of the above, the auditor asked management to provide assessment of going concern, however the management did not provide the same. Despite following up, the management did not provide the requested assessment. As a result, the auditor documented the request and follow-up regarding the going concern assessment in the working papers.

Apart from the above, the company has one accounting software for maintaining its books of accounts, which does not have any feature of edit log (Audit Trail). Accordingly, the auditor reported the said fact of not having the facility of edit log under the heading Other Legal & Regulatory Requirements-Rule 11(g) of the Companies (Audit and Auditors) Rules, 2014 in the main audit report.

Apart from above facts, the several important financial information of MNO Limited during the year ended 31st March 2024 are tabulated as below:

S No.	Particulars	Amount (₹ in crore)
1.	Paid Up Share Capital	10
2.	Deficit balance in Profit & Loss Account	11.47
3.	Turnover	85
4.	Inventory*	15
5.	Cash Loss	2.95
6.	Operating Loss	1.97

\*Out of Total inventory as above, inventory amounting to ₹ 12.35 Crore are lying with third party.

Based on above facts, answer the following MCQs

1. As per the requirement of SA 570, how auditor should deal in the matter of unwillingness of management to provide for the assessment relating to going concern?

(a) Auditor should report such matters in the section of Key Audit Matter.

- (b) The auditor should properly document evidence relating to asking management and its subsequent follow up with the management for assessment on going concern and accordingly should express unmodified opinion.
  - (c) Auditor should report such matters in Emphasis of Matter Paragraph Section.
  - (d) Auditor should express qualified/disclaimer of opinion in his audit report.
2. As per SA 501, what is the correct audit procedure to be followed regarding the existence and condition of inventory wherein an inventory valued ₹ 12.35 crore is lying with the third party?
- (a) The auditor should rely on the management explanation regarding the inventory lying with the third party.
  - (b) The auditor should request confirmation from third party as to the quantities and condition of the inventory held with them or perform inspection or other audit procedures as appropriate.
  - (c) The auditor should verify the inventory lying with the company.
  - (d) The auditor should take written representation only from the management regarding the inventory lying with the third party.
3. State the amount required to be reported by the auditor of MNL Ltd., under clause 3(xvii) of Para 3 of CARO, 2020 on account of losses during the year under consideration.
- (a) ₹ 4.92 Crore
  - (b) ₹ 1.97 Crore
  - (c) ₹ 2.95 Crore
  - (d) ₹ 11.47 Crore
4. According to SA 510, which of the following audit procedures can be implemented by M/s JKL & Co. to obtain sufficient and appropriate audit evidence on the opening balances about whether it contain any material misstatement that could affect financial statements of current year?
- (i) Closing balances of the preceding period have been correctly brought forward to the current period.
  - (ii) Performing specific audit procedures to obtain evidence regarding its opening balances.
  - (iii) Determining whether the opening balances reflects the application of appropriate accounting policies.
- (a) Only (i)
  - (b) Only (iii)
  - (c) Only (i) and (iii)
  - (d) (i), (ii) and (iii)

### Case Scenario 2

ABC Limited is a public company listed on the National Stock Exchange, having its registered office in Delhi. The company is primarily engaged in the manufacturing of pharmaceutical products. During the preceding financial year, the company recorded a remarkable turnover of ₹ 5000 crores, accompanied by a net profit of ₹ 805 crores. Additionally, the company has secured a loan facility from the State Bank of India amounting to ₹ 1000 crores.

PQR & Co., a firm of chartered accountants based in Delhi, has been appointed as a joint auditor along with PK & Co. and XYZ & Co., an esteemed chartered accountant's firm in the same location i.e. Delhi. ABC Limited has already completed the appointment-related formalities as well as they have also signed engagement letters. The engagement letter contains the details on the objective and scope of the audit, responsibilities of the auditors, management, and identification of the framework applicable. Moreover, while planning the audit, joint auditors have divided the responsibility for conducting audit in accordance with SA 299. Further, the audit team has established ₹ 50 Crore as the materiality threshold, calculated at 1% of turnover.

Now, during the audit, PK & Co. came to know that one of the employees of the company had been involved in fraud amounting to ₹ 201 Lakhs.

Additionally, as a part of the audit procedure, the auditor has also sent confirmation requests to 100 suppliers to confirm the year end balance. The said requests were designed in such a way that the supplier will directly respond

to the auditor indicating that the supplier agrees or disagrees with the same. However, in this regard the confirmation responses were received only from 37 Suppliers.

Moreover, as a part of the audit procedure, auditors of the ABC Limited also wants external confirmation from the 37 Debtors to confirm the year end balance, however in this process, the management refuses auditors to allow to send the confirmation and after asking the reason for such refusal, auditors came to the conclusion that, such refusal is unreasonable and the auditor is also unable to obtain relevant and reliable audit evidence from alternative audit procedures.

In addition, while forming an opinion, PQR & Co. had a different opinion on the valuation of inventories, but PK & Co. and XYZ & Co. had the same opinion and accordingly, given their majority stance, both PK & Co. and XYZ & Co. assert that PQR & Co. must endorse a Common audit report aligned with their opinion.

Apart from this, XY Private Limited, an associate enterprise of ABC Limited, the company XY Private Limited appoint ZMR & Co., another firm of chartered accountants located in Rajasthan as a statutory auditor of XY Private Limited for the first time for the current financial year. The financial statement of XY Private Limited was audited by its predecessor auditor in the previous financial year. During the audit for the current financial year, ZMR & Co. came across a material misstatement in the opening balance, that affects the current year financial statement. In this regard, the auditor also discusses the said facts with the 4 management. However, the management does not accurately pay attention to the same and does not either adequately account during the year or disclose or present the same in the financial statement of current year.

The Other Important financial information of XY Private Limited is as below: (₹ in Crores)

S No.	Particulars	Current Year	Previous Year
1	Paid up Share capital	2.00	2.00
2	Credit Balance of Profit & Loss Account	1.75	0.75
3	Turnover	35.00	25.00
4	Borrowing from Banks and Financial Institution	3.50	2.50

On the basis of the above-mentioned facts, you are required to answer the following MCQs,

5. In the above given case, what should be the next course of action on the part of auditors of ABC Limited when the auditors conclude that the reason for management's refusal to allow to send the confirmation to the debtors is unreasonable and auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures?
  - (a) Auditor should have included the reason for refusal by the management and fact of inability to obtain the relevant and reliable audit evidence from alternative audit procedure in the Key Audit Matter Paragraph as per SA 701.
  - (b) Auditor should have included the reason for refusal by the management in the written representation received as per SA 580.
  - (c) Auditor shall communicate the matter with TCWG and also determine the implications for the Audit and Auditor's opinion in accordance with SA 705.
  - (d) Auditor should have included the reason for refusal by the management and fact of inability to obtain the relevant and reliable audit evidence from alternative audit procedure in the Emphasis on Matter Paragraph as per SA 706.
6. Whether PQR & Co. should adhere to the opinion formulated by PK & Co. and XYZ & Co. or explore alternative options.
  - (a) PQR & Co. will have to go with the opinion framed by the majority of auditors.

- (b) PQR & Co. has the option to incorporate a distinct audit opinion paragraph within the Common audit report, accentuating its importance through the emphasis of the matter paragraph.
- (c) PQR & Co. can align with the opinion formed by the majority of auditors. However, any dissenting viewpoint held by PQR & Co. should be prominently highlighted within the emphasis of the matter paragraph.
- (d) PQR & Co. has the discretion to issue a distinct audit report independently. In such a scenario, the reference to the other audit report issued by the majority of auditors should be noted.

7. In the above given case, what should be the course of the action on the part of ZMR & Co., when they found material misstatement which has not been accurately accounted or presented or disclosed in the financial statement of current year?
- (a) ZMR & Co. should not pay attention to the material misstatement found in the opening balance, since they were not auditors for the previous financial year.
  - (b) ZMR & Co. should express a qualified opinion or an adverse opinion, as appropriate, in accordance with SA 705(Revised).
  - (c) ZMR & Co. should take such matter in the written representation received from the management and no need to report such fact in audit report.
  - (d) ZMR & Co. should disclose such a fact in the Emphasis of Matter paragraph section in the audit report.

### Case Study 3

AK Limited is engaged in manufacturing and distribution of furniture. Such kind of customisable range home office furniture has gained lot of importance in past few years. The company was able to perform well over the years and the same is reflected in their financials.

During year 2023-24, audit firm of BB and Associates was reappointed as their auditor. The engagement team consisted of CA SHUBHAM (partner) and five articulated assistants. One of the assistants was new to this engagement. Considering huge volume of transactions, the partner asked him to go through files of last year and auditor's report to gain an understanding of issues which arose in last year i.e. 2022-23.

While going through summary page of file of last year, he noticed that below points were under discussion with the partner before audit finalisation:

Point 1: For employee benefit expenses, following points were verified by the team:

- The employee benefit expenses shown in the books were actually incurred during the relevant period.
- The expenses in respect of all personnel were accounted for.
- The expense recognised during year 2022-23 related to this year only.

Point 2: It was noted that dividend to equity shareholders for the year 2022-23, was declared on 15.04.2023. As the dividend related to the year 2022-23, the same was recognised as liability in the same year.

Point 3: Debtors constitute one of the major components of company's financials. As part of audit procedures, verification was made whether company had made allowance for those debtors which were doubtful. In this regard, list of debtors under litigation was also obtained and scrutinized.

Based on above, answer the following questions:

8. In point 1 relating to Employee benefits, which among the following assertions are discussed respectively (in same order as described in point 1)?
- i. Valuation
  - ii. Occurrence
  - iii. Cut-off
  - iv. Completeness

Choose the correct combination from below: -

- (a) (i),(ii) and (iv)
- (b) (ii), (iv) and (iii)
- (c) (ii), (iii) and (iv)
- (d) (i),(ii) and (iii)

9. Do you think the amount of dividend recognised as liability in the year 2022- 23 as given in point 2 appropriate?
- (a) Yes. As the amount of dividend related to year 2022-23, it should be recognised in the same year irrespective of the year of declaration.
  - (b) No. The amount should be recognised equally between two financial years.
  - (c) No. The amount should not be recognised as liability in year 2022-23. But it needed to be disclosed in the notes to accounts of that year.
  - (d) No. The amount should not be recognised as liability. Further, no disclosure was needed in the financials of that year.
10. In relation to matter described in para 3 pertaining to debtors, which of the following assertions was verified by auditors?
- (a) Valuation
  - (b) Rights and obligations
  - (c) Existence
  - (d) Completeness

#### Case Study 4

M/s JKL & Associates, Chartered Accountants were acting as the statutory auditors of M/s IBS Bank Limited. During the statutory audit for the relevant financial year, the following observations were made:

Interest income included the following:

- ₹ 5 lakh relating to a short-term crop loan where instalment was overdue for one crop season.
- ₹ 7 lakh relating to an advance (guaranteed equally by Government of India & Government of Tamil Nadu) where the instalment was due for more than six months.

On the basis of the abovementioned facts, you are required to choose the most appropriate answer for the following MCQs:

11. From the above facts and details, what is the correct amount of interest which the bank should account in its financial statements?
- (a) Nil.
  - (b) Rs. 8.5 lakh.
  - (c) Rs. 5 lakh.
  - (d) Rs. 3.5 lakh.
12. What could be the possible amount classified as NPA relating to the accounts with respect to observation regarding the inclusion of interest income given below:
- Rs. 5 lakh relating to a short-term crop loan where instalment was overdue for one crop season.
  - Rs. 7 lakh relating to an advance (guaranteed equally by Government of India & Government of Tamil Nadu) where the instalment was due for more than six months.
- (a) Rs. 12 lakh.
  - (b) 8.5 lakh.
  - (c) Rs. 7 lakh.
  - (d) Rs. 3.5 lakh.

## MCQs

13. Moon Group of companies is a retail chain involved in the selling of daily consumer needs directly to the customer. They are in the process of appointing an audit firm for the audit of their accounts for the financial year 2021-22. Moon Group is a South Indian based consumer store having a total of 16 outlets across 4 cities in South India. Sumant & Co. is appointed as the principal auditor for the entire group. Companies Act 2013 prescribes in detail the terms of this audit engagement.

As per SA 210 – Agreeing the Terms of Audit Engagement, which of the following statement is correct?

- (a) Though law prescribes in sufficient detail the terms of the audit engagement, the auditor still needs to record them in a written agreement and also seek written agreement from management that it acknowledges and understands that it has responsibility for the preparation of financial statements.
  - (b) Since law prescribes in sufficient detail the terms of the audit engagement, the auditor need not record them in a written agreement except for the fact that law or regulation applies and also seek written agreement from management that it acknowledges and understands that it has responsibility for the preparation of financial statements.
  - (c) The auditor has to take an extract of the law prescribing the details of the terms of the audit engagement and obtain the counter signature of the management in it.
  - (d) Though law prescribes in sufficient detail the terms of the audit engagement, the auditor still needs to record them in a written agreement, however it need not seek written agreement from management that it acknowledges and understands that it has responsibility for the preparation of financial statements.
14. A practicing Chartered Accountant is appointed by a company to perform certain agreed-upon procedures relating to its trade payables. Such agreed upon procedures include verifying listing with books of accounts, sending confirmation letters and reporting factual discrepancies to company management. Which of statements is correct in this context?
- (a) The practicing CA shall perform work in accordance with Standards on Related Services and SA 220.
  - (b) The practicing CA shall perform work in accordance with Standards on Related Services and SQC 1.
  - (c) The practicing CA shall perform work in accordance with Standards on Auditing including SA 220.
  - (d) The practicing CA shall perform work in accordance with Standards on Assurance Engagements and SQC 1.
15. Virat & Associates, a sole proprietor firm of Akaay, is offered appointment as auditor of a company engaged in manufacturing of automobile components for the first time. She is checking the facts about the integrity of promoters of the company and key managerial persons. Matters such as the competence of staff to perform the engagement are also considered by her. The appointment is subsequently accepted by her. What is CA Akaay trying to do by checking such facts?
- (a) CA Akaay is establishing an audit strategy.
  - (b) CA Akaay is conducting preliminary engagement activities.
  - (c) CA Akaay is designing audit plan.
  - (d) CA Akaay is checking her compliance of ethical requirements.

## PART II - Descriptive Questions

Question No. 1 is compulsory.

Attempt any **four** questions from the Rest

1.

- (a) CA Karan is statutory auditor of Derma Private Limited for the year 2023-24. The company has four plants in India. He is nearing completion of audit procedures relating to financial statements for the year under audit and has yet to sign audit report. Meanwhile, a huge fire had broken out in one of plants of the company located near Pune on 26<sup>th</sup> June, 2024 damaging substantial part of machinery and work-in-process resulting in loss of about ₹ 10 crores. Unaware of the incident, he is in process of finalizing his report in first fortnight of July 2024.

State few audit procedures to be performed by him to obtain sufficient appropriate evidence for identifying such events. Also explain auditor's responsibilities in this situation.

(4 Marks)

- (b) The reliability of audit evidence depends on its source, nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance. Although exceptions may exist, few generalisations can be made about reliability of audit evidence. Considering above discuss such generalisations that can be made about the reliability of audit evidence.

(4 Marks)

- (c) "An audit is independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon." Explain how the person conducting this task should take care to ensure that financial statements would not mislead anybody.

(3 Marks)

- (d) You are appointed as a Statutory Auditor of SDA Limited for the year 2023-24 in the place of CA T. During audit you found that CA T resigned due to non-recording of various material transactions by the company. Is there any reporting responsibility casted on you regarding the above matter under CARO, 2020 for the year 2023-24?

(3 Marks)

2.

- (a) 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. Discuss the matters the auditor may consider in determining the extent of test of controls.

(4 Marks)

- (b) 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. Discuss the audit procedures to be applied by the auditor to ensure that Intangible assets have been valued appropriately and as per generally accepted accounting policies and practices.

(4 Marks)

- (c) Proceedings have been initiated against Bad Limited for holding benami property under the Benami Transactions (Prohibition) Act, 1988 (45 of 1988) and the rules made thereunder, but such property is not recorded in books of accounts. As a consultant to the company, what will you advice to the company as far as disclosure requirements are concerned in relation to said proceedings?

(3 Marks)

(d) During the audit of Arihant Ltd., a medium-sized manufacturing company, the engagement partner is responsible for directing and supervising the work of the engagement team. The team includes both experienced members and several new trainees. Additionally, certain areas of the audit have been identified as high-risk, such as revenue recognition and inventory valuation, due to recent changes in Arihant Ltd.'s accounting policies. What factors should the engagement team members consider when determining the nature, timing, and extent of direction, supervision, and review of the engagement team's work?

**(3 Marks)**

**3.**

(a) Obtaining an understanding of the entity and its environment, including the entity's internal control, is a continuous, dynamic process of gathering, updating and analysing information throughout the audit. Analyse and explain giving examples.

**(4 Marks)**

(b) CA Nakul, statutory auditor of Sand Limited, is in the process of final assembly of audit file. Under what circumstances, a statutory auditor can make changes to audit documentation during final assembly process of audit file? Give a few examples of such changes.

**(4 Marks)**

(c) During the course of statutory branch audit of a nationalized bank, CA Amrish is performing audit procedures in relation to the advances. He has verified the selected sample of borrower accounts representing advances and found nothing unusual. In a banking environment, there exist documentary evidence containing observations/comments on advances which can be useful to the statutory branch auditor in performing an effective audit. List out few such documentary evidence which can be made use of by CA Amrish.

**(3 Marks)**

(d) CA Harshit is auditing financials of Chennai Express Pvt Ltd. He is doubtful on deciding extent of checking while drawing a sample. Explain the factors that should be considered for deciding upon the extent of checking on a sampling plan.

**(3 Marks)**

**4.**

(a) Rose Ltd., a rapidly growing manufacturing company, appointed Sidhi & Co., as statutory auditor. The engagement team of Sidhi & Co. identified key areas requiring scrutiny, such as revenue recognition, inventory valuation, and related party transactions. Based on his professional judgment, CA Kavi, the engagement partner, directed the engagement team to focus on these critical areas, emphasising the need for detailed testing to ensure accuracy and compliance. Give some examples of the factors need to be considered by CA Kavi for establishing the audit strategy.

**(4 Marks)**

(b) Profit and Loss account of an organization shows various types of expenses like rent, power and fuel, repairs and maintenance, insurance, travelling, miscellaneous expenses etc., that are essential and incidental to running of business operations. What are the attributes that an auditor generally prefers for vouching these types of expenses?

**(4 Marks)**

(c) The first section of the auditor's report shall include the auditor's opinion, and shall have the heading "Opinion." The Opinion section of the auditor's report shall also identify the entity whose financial statements have been audited. Apart from the above, explain the other relevant points to be included in opinion section.

**(3 Marks)**

(d) Freedom LLP is formed during the year 2023-24. They are not sure about the type of books of accounts to be maintained. What are the books of accounts that the LLP is required to maintain?

**(3 Marks)**

**5.**

(a) The assistant of CA Kumar is assigned responsibility of drafting “audit programme” relating to sales appearing in financial statements of “Narrow Industries”, a partnership firm. The said firm is a GST registered tax payer and is engaged in manufacturing of packing boxes from a special type of paper taxable under GST. Help him by drafting a sample audit programme for sales.

**(4 Marks)**

(b) CA Diljeet while conducting an audit of Happy Home Ltd. found a considerable increase in sales as compared to the previous year, he doubts that few fictitious sales have been recorded by the company to overstate its revenues. Discuss any four audit procedures to be undertaken by the auditor to ensure revenue from sales of goods and services performed during the period is not overstated?

**(4 Marks)**

(c) CA Dipender is auditor of financial statement of online food delivery company, Zwigato Ltd. List the points that an auditor should consider to obtain an understanding of the Company’s automated environment.

**(3 Marks)**

(d) CA Deepak has accepted audit of financial statements of an entity. According to the Standards on Auditing, the auditor is required to send an audit engagement letter to the entity. What are the key areas that should be included in the audit engagement letter? Under what circumstances is the auditor not required to record the terms of engagement in such a written agreement?

**(3 Marks)**

**6.**

While verifying provisions of advances of a branch of Union Bank as part of statutory branch audit, CA Zipper notices that credit facilities consisting of term loan to BB Enterprises have been classified under doubtful asset (D1) category. The outstanding balance in above term loan account as on 31.3.2024 is ₹ 60 lakhs. Value of security held in account is ₹ 50 lakhs. The branch has made provision of ₹8.50 lakhs. Is provision made by branch proper? Discuss.

**(4 Marks)**

**OR**

List out some matters that the auditor may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a “significant deficiency”.

**(4 Marks)**

(a) CA Majnu (engagement partner) based at New Delhi is external auditor of Beauty of Life, a firm, since last three years. The firm is engaged in business of providing tourism services including holiday packages to its club members. It has also provided auditor including his team members free holiday for a week every year in one of its premium resorts in Mussoorie in the State of Uttarakhand. The company has also booked free air travel for engagement team members during all these years. Discuss why Chartered Accountant is not acting ethically. How are familiarity threats created in above situation?

**(4 Marks)**

(b) CA Popat is the auditor of Jetha Ltd. While scrutinising the accounts of Jetha Ltd., he observed that the company had large volume of Trade payable outstanding in the Balance sheet as on 31st March, 2024 for which external confirmations are not available, CA Popat wants to send external confirmation request to

selected Trade payables but management of Jetha Ltd . refused for the same. Discuss how CA Popat should deal in this regard as per relevant Standard on Auditing.

**(3 Marks)**

(c) KS & Co. has been appointed as auditor of ITC Hotels, Agra. As an auditor, explain the areas of consideration while auditing the element of ROOM SALES during the audit of a 5-Star Hotel.

**(3 Marks)**

