

Mock Test Paper - Series II: April, 2024

Date of Paper: 12 April, 2024

Time of Paper: 2 P.M. to 5 P.M.

INTERMEDIATE GROUP – II

PAPER – 5: AUDITING AND ETHICS

Time Allowed – 3 Hours

Maximum Marks – 100

Division A- Multiple Choice Questions

Case Scenario 1 carries 10 Marks

Case Scenario 2 carries 8 Marks

Case Scenario 3 carries 6 Marks

General MCQs (3 MCQs x 2 Marks each = 6 Marks)

Total 30 Marks

Case Scenario 1

Pluto Limited is engaged in manufacturing and distribution of ergonomic 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 S.J. and Associates was reappointed as their auditor. The engagement team consisted of CA Sneha (partner) and five articled 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.

Point 4: Asset additions during the year amounted to ₹ 50 lakhs. The payment in respect of these assets were made through bank account of the company. However, on scrutiny, it was found that some of invoices were not in the name of the company but in name of one of directors.

Point 5: The company was maintaining few bank accounts including one foreign currency account. There was included in previous year file a paper converting foreign currency amount held in a bank account to Indian Rupees at closing exchange rate.

Based on above, answer the following questions:

1.1 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)

1.2 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.

1.3 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

1.4 Read Point 4 and choose which assertion is not proved in this case.

- (a) Existence

- (b) Rights and obligation
- (c) Completeness
- (d) Measurement/Valuation

1.5 Choose the correct statement from below pertaining to matter described in Point 5.

- (a) The company was required to restate said amount in accordance with requirements of AS 1. By verifying it, auditor had verified existence assertion.
- (b) The company was required to restate said amount in accordance with requirements of AS 11. By verifying it, auditor had verified completeness assertion.
- (c) There was no responsibility of company to restate said amount. It was auditor's responsibility to restate said amount in accordance with requirements of AS 11. No assertion was, therefore, verified by auditor.
- (d) The company was required to restate said amount in accordance with requirements of AS 11. By verifying it, auditor had verified valuation assertion.

(5 MCQs x 2 Marks each = 10 Marks)

Case Scenario 2

Watch IT India Private Limited is a company engaged in business of manufacturing smart watches. The company had a slow start in the beginning as company's products were gaining traction with customers. However, momentum has picked up during the year. The company wants to appoint M/s Tripathi & Associates, a CA firm as their auditor for year 2023-24 by replacing their existing auditors M/s Sreepath and Co. M/s Tripathi & Associates are willing to accept the engagement. They communicated with previous auditors before accepting the engagement. However, M/s Sreepath and Co. have failed to respond.

CA Kishan, partner of M/s Tripathi & Associates explained to his team members about importance of Engagement letter. He also arranged a team discussion on matters relating to acceptance of terms of engagement.

First point of consideration was concerning preconditions for an audit. Mr. Arun, a team member could recollect few of them. Those included determining whether financial reporting framework used in the preparation of financial statement is acceptable, management providing auditor with access to all relevant information and additional information upon auditor's request. It was further elaborated by Arun that management has to provide unrestricted access to employees within entity as may be required by auditor for obtaining audit evidence. Team members were asked to list factors that may necessitate revision of Engagement letter in case of recurring audits. Mr. Kumar, another team member replied that revision may be required in cases involving significant change in ownership, recent changes in senior management, change in financial reporting framework adopted in preparation of financial Statements, modest change in nature or size of the entity's business, change in legal and regulatory requirements etc.

Mr. Ram, one of the team members raised a doubt. He enquired regarding recourse available to incoming auditor in case management makes it clear before acceptance of engagement by auditor regarding its inability in providing support to him in respect of certain procedures expected to be performed during course of audit. In this respect, specific question was raised relating to sending of confirmation requests to material trade payables reflecting in financial statements of a company. Trade payables pertain to material input and input services acquired and utilised by company during the year. Lack of support by management in such a case would, in effect, signify management's refusal to allow auditor to send confirmation requests at the outset before engagement is accepted by auditor.

Based on above, answer the following questions:

2.1 As regards doubt of Mr. Ram described in last para of case scenario, which of the following statements is likely to be in accordance with Standards on Auditing?

- (a) The auditor needs to inquire into management's reasons for the refusal and perform alternative audit procedures to obtain relevant and reliable audit evidence.
- (b) The auditor needs to evaluate implications of management's refusal on auditor's assessment of risk of material misstatement and perform alternative audit procedures to obtain relevant and reliable audit evidence.
- (c) The auditor should not accept such an engagement.
- (d) The auditor needs to evaluate implications of management's refusal on risk of fraud and perform alternative audit procedures to obtain relevant and reliable audit evidence.

2.2 When CA Kishan, the partner, asked about preconditions for an audit, Mr. Arun could recollect only few of them. Read the passage and find out which among the following points were missed.

- (i) Obtaining management responsibility on specific legal aspects governing the organisation.
- (ii) Obtaining management responsibility on Standards on Auditing applicable to the organisation.
- (iii) Obtaining management responsibility for the preparation of financial statements as per applicable financial reporting framework.
- (iv) Obtaining management responsibility on necessary Internal controls to enable preparation of financial statements which are free from material misstatement whether due to error or fraud.

Choose the correct answer from below options.

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

- 2.3 From what Mr. Kumar replied about the factors requiring a revision of Engagement letter one point was incorrect. Read the passage and find that incorrect factor.
- (a) A significant change in ownership
 - (b) A recent change in management
 - (c) A change in financial reporting framework adopted in preparation of Financial Statements
 - (d) A modest change in nature or size of the entity's business
- 2.4 M/s Sreepath & Co. have failed to respond to incoming auditors. In this regard, choose the most appropriate option: -
- (a) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of objectivity governing professional ethics.
 - (b) It was ethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It does not involve violation of any of fundamental principles governing professional ethics.
 - (c) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of Professional competence and due care governing professional ethics.
 - (d) It was unethical on part of outgoing auditors for failing to respond to communication made by incoming auditors. It is violation of principle of professional behaviour governing professional ethics.

(4 MCQs x 2 Marks each = 8 Marks)

Case Scenario 3

In accordance with requirements of Standards on Auditing, CA Tina (a freshly qualified professional) wants to obtain sufficient appropriate audit evidence in an audit engagement pertaining to financial statements of a partnership firm for year 2022-23. The firm is trading in FMCG goods. Appointed in May, 2023, she needs evidence to obtain information for arriving at her judgment. Clearly remembering fundamentals that an auditor has to obtain sufficient appropriate audit evidence to draw reasonable conclusions on financial statements, she proceeded in accordance with audit plan prepared by her.

During the year 2022-23, firm was maintaining a current account with a branch of a public sector bank. Her audit plan had included procedure of confirming balance of current account directly from bank. As at 28th March, 2023, the firm had an urgent need to pay its utility bill amounting to ₹1.00 lacs. However, due to insufficiency of funds, it had requested branch manager to get cheque drawn on utility company cleared. Therefore, balance in current account of firm in books of bank branch stood at ₹0.92 lacs (Debit). The firm had also issued cheques in evening of 31st March, 2023 in anticipation of funds on next working day i.e. 3rd April, 2023. It had also certain cheques dated 27th March, 2023 from its debtors lying with it which were deposited in afternoon of 31st March, 2023 in bank branch at request of debtors.

Her plan also included performance of certain procedures pertaining to verification of inventories. Inventories of FMCG goods were material to financial statements. Her assistant, Tisha, had her own notion about understanding of sufficient appropriate audit evidence. She further feels that when audit evidence is obtained from available records of an entity, it is known as internal evidence like purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law. She is also of the view that audit evidence obtained by auditor is final and conclusive.

Based upon above, answer the following questions: -

- 3.1 As regards matter of balance in current account and related issues is concerned, which of following statements is likely to be most appropriate?
- (a) Amount of ₹ 0.92 lac is required to be classified under cash & bank balances in financial statements of firm. Procedure of confirming balance directly from the bank alone is likely to constitute sufficient appropriate audit evidence.
 - (b) Amount of ₹ 0.92 lac is required to be classified under cash & bank balances in financial statements of firm. Procedure of confirming balance directly from the bank alone is not likely to constitute sufficient appropriate audit evidence.
 - (c) Amount of ₹ 0.92 lac is required to be classified under current liabilities in financial statements of firm. Procedure of confirming balance directly from the bank alone is likely to constitute sufficient appropriate audit evidence.
 - (d) Amount of ₹ 0.92 lac is required to be classified under current liabilities in financial statements of firm. Procedure of confirming balance directly from the bank alone is not likely to constitute sufficient appropriate audit evidence.
- 3.2 Considering matter of verification of inventories, which of following statements is based on facts described in the situation and also in essence of Standards on Auditing?
- (a) She should verify subsequent sale invoices of inventory items lying in stocks as at year end. Besides, she should also review stock records of year 2022-23 and subsequent period. Such evidence may constitute sufficient appropriate audit evidence.
 - (b) She should verify subsequent sale invoices of inventory items lying in stocks as at year end. Besides, she should also review stock records of year 2022-23 and subsequent period. She should attend physical inventory count at year end in above situation. Such evidence may constitute sufficient appropriate audit evidence.
 - (c) She should verify purchase invoices of inventory items lying in stocks as at year end. Stock records are not required to be verified. Such evidence is likely to constitute sufficient appropriate audit evidence.

- (d) She should verify purchase invoices of inventory items lying in stocks as at year end. She should attend physical inventory count at year end in above situation. Such evidence may constitute sufficient appropriate audit evidence.

3.3 Identify correct statement on the basis of description provided in case scenario: -

- (a) Purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are all examples of internal evidence. Audit evidence obtained by auditor is final and conclusive.
- (b) Purchase bills of FMCG goods, debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are all examples of internal evidence. Audit evidence obtained by auditor is persuasive.
- (c) Only debit notes issued by firm on debtors for GST short charged earlier during the year and credit notes issued by firm during the year on debtors to account for extra price charged in accordance with provisions of GST law are examples of internal evidence. Audit evidence obtained by auditor is persuasive.
- (d) Only debit notes issued by firm on debtors for GST short charged earlier during the year is an example of internal evidence. Audit evidence obtained by auditor is persuasive.

(3 MCQs x 2 Marks each = 6 Marks)

MCQs

1. CA D, during the course of audit of a company engaged in export business, notices that credit facilities taken by company during the year from a bank for ₹10 crores have almost been fully utilized during the year. On going through sanction letter provided by bank to company, it is observed that rate of interest stipulated in sanction letter is 8% p.a. Financial statements of company show bank interest amounting to ₹60.00 lacs. Which type of substantive analytical procedure is being used by CA D?
- (a) Trend analysis
- (b) Ratio analysis
- (c) Reasonableness tests
- (d) Structural modelling
2. An auditor of a company has found that accountant of a company has entered bogus purchase bills for ₹50 lacs in its books of accounts. Which of following is most appropriate regarding auditor's duty as far as reporting is concerned under Companies Act, 2013?
- (a) Report the matter to jurisdictional ROC

- (b) Report the matter to Secretary, MCA
(c) Report the matter to Board of Directors of company
(d) Report the matter to jurisdictional ROC as well as GST authority
3. During course of audit of a company, it is noticed by auditor that Profit before tax of company is Rs. 5 lakhs. Depreciation on building reflected in Schedule of PPE forming part of financial statements has been computed for Rs.10 lacs. The correct depreciation, according to him, should be Rs.25 lacs. The above description as a whole is an example of _____?
- (a) Misstatement
(b) Assertion
(c) Sampling method
(d) Audit risk

Division B - Descriptive Questions

Question No. 1 is compulsory.

Attempt any four questions from the Rest.

1. (a) Sanjeev, an articled clerk in an audit firm, is part of an engagement team conducting audit of a company for year 2023-24. It is a small company having a turnover of about ₹25 crores. During the course of audit, he notices that senior team member has taken following approach for selecting items for testing reflected in financial statements to obtain audit evidence: -
- He has selected to test items debited under the head "Machinery repair & maintenance" as expenditure relating to it during year 23-24 has increased considerably as compared to last year.
 - Out of purchases, he has selected to test purchases from related parties amounting to ₹ 5 crores.
 - He has also selected to test all individual items of expenditure exceeding ₹5 lakhs.
 - Besides, he has also selected amount of ₹0.50 lakhs debited under head "legal expenses" to know purpose of payment made to external legal counsel.
- Sanjeev understands that senior team member is using "audit sampling" for selecting items for testing. Do you agree with him? Which risk is involved in above approach? Discuss with reasons. **(4 Marks)**
- (b) Following is the extract from Schedule no. 10 of Advances as appearing in financial statements of branch of a nationalized bank for year ending 31st March, 2024.

Schedule 10 - Advances

S. No.	Particulars	Amount (In ₹ Crores) rounded off
1.	Bills Purchased and Discounted	50.00
2.	Cash credits, overdrafts and loans repayable on demand	150.00
3.	Term Loans	75.00
	Total	275.00

In carrying out audit of above advances as part of statutory audit of branch, a statutory auditor would obtain evidence about certain matters. State those matters. **(4 Marks)**

- (c) CA J is working as internal auditor in JKL Limited, a non-listed company. The responsibilities of internal auditor include reviewing financial information and performing detailed tests on transactions and balances. He is also responsible for compliance with laws, regulations and external requirements.

During the year 2022-23, services of an employee of company were terminated. The said employee had filed a suit against the company in respect of certain compensation dues amounting to ₹ 10 lakhs which were not paid to him. Based upon advice of legal counsel, the company had made a provision of ₹ 10 lacs in financial statements for year 2022-23. However, somewhere in June 2023, there is an out of court settlement between company and employee for ₹ 6 lakhs. The statutory audit of company is under progress and audit report has not yet been finalized. How internal auditor should have proceeded in situation?

(3 Marks)

- (d) KST Limited is engaged in manufacturing business. It appoints CA T to provide it an assurance report on its financial statements prepared on the basis of historical financial information. The characteristic of such an engagement is that it involves gathering of sufficient appropriate evidence on basis of which limited conclusions can be drawn up by practitioner. Identify type of engagement. Which are two other features of such an engagement? **(3 Marks)**

2. (a) Written representation about management's responsibilities involves confirmation of fulfilment of management's responsibilities in the preparation of the financial statements providing the relevant information and also informing about completeness of transactions. Explain.

(4 Marks)

- (b) Planning 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, certain matters. Discuss those matters.

(4 Marks)

- (c) In an initial audit engagement, in the case of inventories, the current period's audit procedures on the closing inventory balance provide little audit evidence regarding inventory on hand at the beginning of the period. Therefore, in such a case, additional audit procedures become necessary so that auditor may obtain sufficient appropriate audit evidence. Discuss those additional audit procedures. **(3 Marks)**

- (d) Internal Control Questionnaire is a comprehensive series of questions concerning internal control. A company is engaged in business of manufacturing of chemicals. It has two plant locations in city "A" and one plant location in city "B" involving huge value of assets. Building at three locations is owned by the company. The company earns handsome profits and does not want to suffer losses due to business interruptions. It has a dedicated department for looking after insurance matters. As an auditor, prepare an internal control questionnaire concerning this department for obtaining staff responses. **(3 Marks)**

3. (a) Tisa Industries Private Limited has prepared its financial statements for year 2023-24. The financial statements and notes to accounts show following information and disclosure in respect of trade receivables of the company: -

S. No.	Particulars	Amount (in ₹ lacs)
1.	Trade Receivables	240.00

Trade receivables ageing schedule.

Outstandings for following periods from due date of payment

(in ₹ lacs)

Particulars	Less than 1 year	1-2 years	2-3 years	More than 3 years	Total
MSME	150.00	30.00	10.00	XXX	190.00
Others	40.00	XXX	XXX	XXX	40.00
Disputed dues-MSME	XXX	XXX	XXX	XXX	XXX
Disputed dues-others	10.00	XXX	XXX	XXX	10.00

You are part of engagement team conducting audit of the company. Point out discrepancies including omissions in above disclosure. (Do not prepare another table). **(4 Marks)**

- (b) Being statutory auditor of JAL Limited, a company engaged in manufacturing of chemicals, CA Gopika has understood that company is expected to have material work-in-progress as on 31st March, 2024.

State few audit procedures to verify existence and valuation assertions for work-in-progress. **(4 Marks)**

- (c) The ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications. Give three instances to explain. **(3 Marks)**
- (d) One of the factors affecting the form, content and extent of audit documentation relates to size and complexity of the entity. State six other factors in this respect. **(3 Marks)**
4. (a) It is important to carry out the Tests of Controls for checking effectiveness of internal control over sales as a part of the debtors' audit procedure. In above context, state the points which need to be considered in respect of trade receivables. **(4 Marks)**
- (b) M/s S R & Associates are the Statutory Auditors of Vanee Textile and Garments Ltd., a company engaged in the business of manufacturing of various textile products. The auditor has completed the audit and is in the process of forming an opinion on the financial statements for the F.Y. 2023-2024. CA S, the engagement partner, wants to conclude whether the financial statements as a whole are free from material misstatements, whether due to fraud or error. Guide him about the factors he should consider to reach that conclusion. **(4 Marks)**
- (c) Nature of financial reporting itself is one of causes of inherent limitations of audit of financial statements. Explain. **(3 Marks)**
- (d) Discuss the objective of the auditor as per Standard on Auditing (SA) 705 "Modifications to The Opinion in The Independent Auditor's Report". **(3 Marks)**
5. (a) Column A describes description of certain terms used in banking industry. Complete Column B by suggesting term appropriate to description given.

Column A	Column B
Audit of borrower client of bank carried out at bank's request to verify borrower's current assets	?
Limit up to which an entity can withdraw from sanctioned working capital limit	?
Statutory right of a creditor to adjust debit balance in debtor's account against any credit balance lying in another account of debtor	?
Creation of security in a bank branch by mere delivery of title deeds by a prospective borrower of funds	?

(4 Marks)

- (b) 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. The understanding establishes a frame of reference within which the auditor plans the audit and exercises professional judgment throughout the audit. State few areas in which such an understanding is helpful to auditor. **(4 Marks)**
- (c) You are auditor of a college running different courses operating in your city. During audit of a year, it is noticed that fees concessions to students have been provided in substantial number of cases. Discuss, how, you as an auditor, would proceed to verify the same and also explain two other points to verify fees from students. **(3 Marks)**
- (d) The auditor shall agree the terms of the audit engagement with management or those charged with governance, as appropriate. The agreed terms of the audit engagement shall be recorded in an audit *engagement letter* or other suitable form of written agreement. Who gives engagement letter to whom and what is included in such a letter? **(3 Marks)**
6. (a) Auditor of Sunshine Ltd. is of the view that due to greater management intervention to specify accounting treatment, the risk of material misstatement is greater for non-routine transactions. Is view of the auditor correct? Specify the other matters due to which the risk of material misstatement is greater for significant non-routine transactions. **(4 Marks)**
- (b) On reviewing internal control over accounting for sales as part of statutory audit of A Ltd, auditor finds certain deficiencies in segregation of duties, authorization of sales orders, preparation of invoices, preparation and authorization of debit/credit notes etc. and non-following of standard procedures as stipulated by the management. The auditor finds these lapses to be significant deficiencies in internal control over sales.
- He points it out to the management in a one-liner as under: -
- "Instructions on internal control related to sales are not properly followed by the staff."
- Is above communication by the auditor proper? **(4 Marks)**
- OR
- (c) Audit against propriety seeks to ensure that expenditure conforms to certain principles which have for long been recognised as standards of financial propriety. Explain those principles.

- (d) The auditor needs to direct efforts of engagement team towards matters that in his professional judgment are significant. Preliminary identification of material classes of transactions, account balances and disclosures help auditor in establishing overall audit strategy. More energies need to be devoted to significant matters to obtain desired outcomes. Give three examples to explain the above situation.

(3 Marks)

- (e) CA. Ravi Patnaik is conducting audit of a company for which reporting requirements under CARO, 2020 are applicable. He finds that cash credit facilities amounting to ₹ 4 crores were released to the company by branch of a bank for meeting its working capital requirements. He finds that out of above funds, ₹ 1 crore have been used by company for installing effluent treatment plant to meet State pollution control Board requirements.

Is there any reporting obligation upon him under CARO,2020?

(3 Marks)

Leader in CA/CMA/ACCA