

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

**Date of Paper: 17<sup>th</sup> March 2025**

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

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

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

**Part II - Descriptive Answers**

1. (a) **CA T should undertake the following audit procedure to establish Rights and Obligations of the entity over PPE:**
  - During the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity.
  - For all additions to land and building in particular, the auditor should check the conveyance deed/ sale deed to verify whether the entity is the legal and valid owner or not.

- The auditor should insist and verify the original title deeds for all immovable properties held as at the balance sheet date.
  - In case the entity has given such immovable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immovable property as security.
  - In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.
- (b)** A firm before accepting an engagement should acquire vital information about the client. Such an information should help firm to decide about:
- Integrity of Client
  - Competence (including capabilities, time and resources) to perform engagement
  - Compliance with ethical requirements

With regard to the integrity of a client, matters that the firm considers include, for example:

- The identity and business reputation of the client's principal owners, key management, related parties and those charged with its governance.
- The nature of the client's operations, including its business practices.
- Information concerning the attitude of the client's principal owners, key management and those charged with its governance towards such matters as aggressive interpretation of accounting standards and the internal control environment.
- Whether the client is aggressively concerned with maintaining the firm's fees as low as possible.
- Indications of an inappropriate limitation in the scope of work.
- Indications that the client might be involved in money laundering or other criminal activities.
- The reasons for the proposed appointment of the firm and non-reappointment of the previous firm.

- (c) In the given case, the auditor has come to know of legal claim against the company before issue of audit report. It has also come to his knowledge that management of the company has agreed to an out of court settlement of Rs.5 crore. It is an example of subsequent event between the date of the financial statements and the date of the auditor's report as per SA 560.

**Auditor's responsibilities regarding subsequent events between the date of the financial statements and the date of the auditor's report are as under:**

- Perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.
  - If such subsequent events that require adjustment of, or disclosure in, the financial statements have been identified, it shall be determined whether each such event is appropriately reflected in those financial statements.
  - Obtain a written representation from management or those charged with governance that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed.
2. (a) 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 at least the following:
- (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.

**(b) Inspection of Multi-State Co-operative societies under Section 79**

**When:** The Central Registrar may, on a request from

- federal co-operative to which a Multi- State Co-operative society is affiliated or a creditor or
- not less than one-third of the members of the board or
- not less than one-fifth of the total number of members of a Multi-State co-operative society

**How:** By general or special order in writing in this behalf inspect or direct any person authorized by him by order in writing in this behalf to make an inspection into the constitution, working and financial condition of a Multi-State co-operative society.

**Opportunity of Being heard:** No inspection shall be made unless a notice of not less than fifteen days has been given to the multi-state co-operative society.

**Powers available:** The Central Registrar or the person authorized by him shall have the following powers:

- (i) He shall at all times have access to all books, accounts, papers, vouchers, securities, stock and other property of that society and may, in the event of serious irregularities discovered during inspection, take them into custody and shall have power to verify the cash balance of the society and subject to the general or special order of the central registrar to call a meeting of the society where such general meeting is, in his opinion necessary.
- (ii) Every officer or member of a Multi-State Co-operative society shall furnish such information with regard to the working of the society as the central registrar or the person making such inspection may require.

**Inspection Report:** A copy of the report of inspection under this section shall be communicated to the Multi-State Co-operative society within a period of three months from the date of completion of such inspection.

**(c) The advantages of an audit programme are:**

- (i) It provides the assistant carrying out the audit with total and clear set of instructions of the work generally to be done.
- (ii) It is essential, particularly for major audits, to provide a total perspective of the work to be performed.
- (iii) Selection of assistants for the jobs on the basis of capability becomes easier when the work is rationally planned, defined and segregated.

- (iv) Without a written and pre-determined programme, work is necessarily to be carried out on the basis of some 'mental' plan. In such a situation there is always a danger of ignoring or overlooking certain books and records. Under a properly framed programme, such danger is significantly less, and the audit can proceed systematically.
- (v) The assistants, by putting their signature on programme, accept the responsibility for the work carried out by them individually and, if necessary, the work done may be traced back to the assistant.
- (vi) The principal can control the progress of the various audits in hand by examination of audit programmes initiated by the assistants deputed to the jobs for completed work.
- (vii) It serves as a guide for audits to be carried out in the succeeding year.
- (viii) A properly drawn up audit programme serves as evidence in the event of any charge of negligence being brought against the auditor. It may be of considerable value in establishing that he exercised reasonable skill and care that was expected of professional auditor.

3. (a) **Audit against Rules & Orders** - Audit against rules and orders aims to ensure that the expenditure conforms to the relevant provisions of the Constitution and of the laws and rules made thereunder. It also seeks to satisfy that the expenditure is in accordance with the financial rules, regulations and orders issued by a competent authority. Audit of expenditure against regularity is of a quasi-judicial type of work performed by the audit authorities. It involves interpretation of the Constitution, statutes, rules, regulations and orders. The final power of interpretation of these, however, does not vest with the C&AG.

These rules, regulations and orders against which regularity audit is conducted mainly fall under the following categories:

- (i) Rules and orders regulating the powers to incur and sanction expenditure from the Consolidated Fund of India or of a State (and the Contingency Fund of India or of a State);
- (ii) Rules and orders dealing with the mode of presentation of claims against government, withdrawing moneys from the Consolidated Fund, Contingency Fund and Public Accounts of the Government of the India and of the States, and in general the financial rules prescribing the detailed procedure to be followed by government servants in dealing with government transactions; and

- (iii) Rules and orders regulating the conditions of service, pay and allowances, and pensions of government servants.

It is the function of the executive government to frame rules, regulations and orders, which are to be observed by its subordinate authorities. The job of audit is to see that these rules, regulations and orders are applied properly by the subordinate authorities. It is, however, not the function of audit to prescribe what such rules, regulations and orders shall be.

But, it is the function of audit to carry out examination of the various rules, regulations and orders issued by the executive authorities to see that:

- (a) they are not inconsistent with any provisions of the Constitution or any laws made thereunder;
- (b) they are consistent with the essential requirements of audit and accounts as determined by the C&AG;
- (c) they do not come in conflict with the orders of, or rules made by, any higher authority; and
- (d) in case they have not been separately approved by competent authority, the issuing authority possesses the necessary rule-making power.

**(b) Examples of indicators of significant deficiencies in internal control are as follows:**

- Evidence of ineffective aspects of the control environment, such as:
  - Indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with governance.
  - Identification of management fraud, whether or not material, that was not prevented by the entity's internal control.
  - Management's failure to implement appropriate remedial action on significant deficiencies previously communicated.
- Absence of a risk assessment process within the entity where such a process would ordinarily be expected to have been established.
- Evidence of an ineffective entity risk assessment process, such as management's failure to identify a risk of material misstatement that the auditor would expect the entity's risk assessment process to have identified.

- Evidence of an ineffective response to identified significant risks (e.g., absence of controls over such a risk).
- Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the entity's internal control.
- Disclosure of a material misstatement due to error or fraud as prior period items in the current year's Statement of Profit and Loss.
- Evidence of management's inability to oversee the preparation of the financial statements.

- (c) During the audit of MNT Ltd., CA Shubh identifies an issue with stock valuation. To ensure the accuracy and reliability of his observations, it is crucial for him to document the audit procedures performed, the evidence obtained, and his findings in a structured manner.

Audit documentation plays a vital role in supporting CA Shubh's findings in accordance with the Standards on Auditing. Its key purposes include:

1. Assisting the engagement team to plan and perform the audit.
2. Assisting members of the engagement team to direct and supervise the audit work, and to discharge their review responsibilities.
3. Enabling the engagement team to be accountable for its work.
4. Retaining a record of matters of continuing significance to future audits.
5. Enabling the conduct of quality control reviews and inspections in accordance with SQC 1.
6. Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements.

4. (a) **Responsibilities for the Financial Statements:** The auditor's report shall include a section with a heading "Responsibilities of Management for the Financial Statements."

SA 200 explains the premise, relating to the responsibilities of management and, where appropriate, those charged with governance, on which an audit in accordance with SAs is conducted. Management and, where appropriate, those charged with governance accept responsibility for the preparation of the financial statements. Management also accepts responsibility for such internal control as it determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error. The description of

management's responsibilities in the auditor's report includes reference to both responsibilities as it helps to explain to users the premise on which an audit is conducted.

**This section of the auditor's report shall describe management's responsibility for:**

- (i) **Preparing the financial statements** in accordance with the applicable financial reporting framework, **and for such internal control** as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; [because of the possible effects of fraud on other aspects of the audit, materiality does not apply to management's acknowledgement regarding its responsibility for the design, implementation, and maintenance of internal control (or for establishing and maintaining effective internal control over financial reporting) to prevent and detect fraud.] and
  - (ii) **Assessing the entity's ability to continue as a going concern** and whether the use of the going concern basis of accounting is appropriate as well as disclosing, if applicable, matters relating to going concern. The explanation of management's responsibility for this assessment shall include a description of when the use of the going concern basis of accounting is appropriate.
- (b) Planning an audit is necessary to carry out it effectively in a timely manner. Besides ensuring compliance with professional standards, it helps in performing audit engagement effectively.

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

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



5. Facilitating the direction and supervision of engagement team members and the review of their work.
6. Assisting, where applicable, in coordination of work done by others such as experts.

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

**(c)** Inquiry, as a method of obtaining audit evidence, is explained in accordance with SA 500, "Audit Evidence," as follows:

- Inquiry consists of seeking information of knowledgeable persons, both financial and non- financial, within the entity or outside the entity. Inquiry is used extensively throughout the audit in addition to other audit procedures.
- Inquiries may range from formal written inquiries to informal oral inquiries. Evaluating responses to inquiries is an integral part of the inquiry process.
- Responses to inquiries may provide the auditor with information not previously possessed or with corroborative audit evidence. Alternatively, responses might provide information that differs significantly from other information that the auditor has obtained, for example, information regarding the possibility of management override of controls. In some cases, responses to inquiries provide a basis for the auditor to modify or perform additional audit procedures.
- Although corroboration of evidence obtained through inquiry is often of particular importance, in the case of inquiries about management intent, the information available to support management's intent may be limited. In these cases, understanding management's past history of carrying out its stated intentions, management's stated reasons for choosing a particular course of action, and management's ability to pursue a specific course of action may provide relevant information to corroborate the evidence obtained through inquiry.

5. **(a)** Advances generally constitute a major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of advances requires the major attention from the auditors.

**In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about the following:**

- (i) Amounts included in balance sheet in respect of advances which are outstanding at the date of the balance sheet.
- (ii) Advances represent amount due to the bank.
- (iii) Amounts due to the bank are appropriately supported by loan documents and other documents as applicable to the nature of advances.
- (iv) There are no unrecorded advances.
- (v) The stated basis of valuation of advances is appropriate and properly applied and the recoverability of advances is recognised in their valuation.
- (vi) The advances are disclosed, classified and described in accordance with recognised accounting policies and practices and relevant statutory and regulatory requirements.
- (vii) Appropriate provisions towards advances have been made as per the RBI norms, Accounting Standards and generally accepted accounting practices.

**(b) Application of Securities Premium Account:** The securities premium account may be applied by the Company:

- (i) towards the issue of unissued shares of the company to the members of the company as fully paid bonus shares;
- (ii) in writing off the preliminary expenses of the Company;
- (iii) in writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company;
- (iv) in providing for the premium payable on the redemption of any redeemable preference shares or of any debentures of the company; or
- (v) for the purchase of its own shares or other securities under section 68.

The auditor needs to verify whether the premium received on shares, if any, has been transferred to a "securities premium account" and whether the application of any amount out of the said "securities premium account" is only for the purposes mentioned above.

(c) **Difference between Reasonable Assurance Engagement and Limited Assurance Engagement:**

<b><i>Reasonable assurance engagement</i></b>	<b><i>Limited assurance engagement</i></b>
Reasonable assurance engagement provides high level of assurance.	Limited assurance engagement provides lower level of assurance than reasonable assurance engagement.
It performs elaborate and extensive procedures to obtain sufficient appropriate evidence.	It performs fewer procedures as compared to reasonable assurance engagement.
It draws reasonable conclusions on the basis of sufficient appropriate evidence.	It involves obtaining sufficient appropriate evidence to draw limited conclusions.
Example of reasonable assurance engagement is an audit engagement, Audit of financial statements.	Example of limited assurance engagement is review engagement, Review of financial statements.

6. (a) The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses. Therefore, designing a proper confirmation request by auditor is necessary.

Factors to be considered when designing confirmation requests include:

- (i) The assertions being addressed.
- (ii) Specific identified risks of material misstatement, including fraud risks.
- (iii) The layout and presentation of the confirmation request.
- (iv) Prior experience on the audit or similar engagements.
- (v) The method of communication (for example, in paper form, or by electronic or other medium).
- (vi) Management's authorisation or encouragement to the confirming parties to respond to the auditor. Confirming parties may only be willing to respond to a confirmation request containing management's authorisation.
- (vii) The ability of the intended confirming party to confirm or provide the requested information (for example, individual invoice amount versus total balance).

- (b) Inquiries of Management and Others Within the Entity:** Much of the information obtained by the auditor's inquiries is obtained from management and those responsible for financial reporting. However, the auditor may also obtain information, or a different perspective in identifying risks of material misstatement, through inquiries of others within the entity and other employees with different levels of authority.
- Inquiries directed toward internal audit personnel may provide information about internal audit procedures performed during the year relating to the design and effectiveness of the entity's internal control and whether management has satisfactorily responded to findings from those procedures.
  - Inquiries of employees involved in initiating, processing or recording complex or unusual transactions may help the auditor to evaluate the appropriateness of the selection and application of certain accounting policies.
  - Inquiries directed toward in-house legal counsel may provide information about such matters as litigation, compliance with laws and regulations, knowledge of fraud or suspected fraud affecting the entity, warranties, post-sales obligations, arrangements (such as joint ventures) with business partners and the meaning of contract.
  - Inquiries directed towards marketing or sales personnel may provide information about changes in the entity's marketing strategies, sales trends, or contractual arrangements with its customers.
  - Inquiries directed to the risk management function (or those performing such roles) may provide information about operational and regulatory risks that may affect financial reporting.
  - Inquiries directed to information systems personnel may provide information about system changes, system or control failures, or other information system- related risks.
- (c)** As per clause (ii) of Paragraph 3 of CARO, 2020 the auditor is required to report, in respect of physical verification of inventory and in respect of sanctioned working capital, that:
- (i) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in

the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account.

- (ii) whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details.

**OR**

- (c) In the given situation, the auditor is verifying Completeness assertion by ensuring that all goods dispatched prior to the year-end have been invoiced.

Audit procedures to be adopted by the auditor to verify the Completeness assertion are as under:

- Check that in respect of invoices raised in last few days nearing the cut-off date, goods have been actually dispatched and not lying with the company.
- Test invoices listed in receivable report. Select few invoices from the accounts receivable ageing report and compare them to supporting documentation to see if they were billed with the correct amounts, to the correct customers, and on the correct dates.
- Match invoices to shipping/ dispatch log. Match invoice dates to the shipment dates for those items in the shipping/ dispatch log, to see if sales are being recorded in the correct accounting period. This can include an examination of invoices issued subsequent to the period being audited, to see if they should have been included in the period under audit.
- Assess bill and hold sales. If there is a situation where the Company is billing customers for sales despite still retaining the goods on-site (known as "bill and hold"), examine supporting documentation to determine whether a sale has actually taken place or not.
- Review the receiving log to see if the Company has recorded an inordinately large amount of customer returns after the audit period, which would suggest that the Company may have shipped more goods near the end of the audit period than what the customers had authorized to inflate the profits of the company.
- Review the process of giving discounts/ incentives and check whether the same were given as per the Company's policy/ general industry trends.