

**INTERMEDIATE GROUP – II
PAPER – 5: AUDITING AND ETHICS**

Time Allowed – 3 Hours

Maximum Marks – 100

PART I - Case Scenario based MCQs (30 Marks)

Write the most appropriate answer to each of the following multiple-choice questions by choosing one of the four options given. All MCQs are compulsory and carries 2 Marks each.

Case Scenario 1

Oval Services Ltd. appointed Rupa & Associates as the auditors for the financial year 2023-2024. The auditors believe that an audit program is crucial in providing clear and comprehensive instructions for the tasks to be carried out, offering a total perspective of the work involved. This is particularly important for large audits, and as such, they prepared an initial audit program based on the company's organisational structure and effective internal controls. During the audit, CA Nitin, Engagement Partner identified issues with the company's debt management practices, prompting the inclusion of a more detailed review of the loan agreements. However, in his opinion the planned review of petty cash was unnecessary due to the company's policy of limiting cash transactions. Thus, review procedure was removed from the audit programme.

To verify the balances of trade payables, the auditor decided to send external confirmation requests to the creditors of the company. These requests were made to verify the balances as on 20th March 2024, a date chosen deliberately to ensure the accuracy and completeness of the liabilities, free from any influence or prior knowledge of management. This approach was taken to maintain the integrity of the confirmation process. However, it was noted that M/s. Keshav Traders and M/s. Amrit Distributors did not respond to the confirmation requests.

Furthermore, the auditor noted that in the financial year 2023-2024, the company's Property, Plant, and Equipment (PPE) was revalued, resulting in an increase of 5% in the net carrying value of its machinery from ₹10 lakh to ₹10.5 lakh.

Also, due to the significant compliance burden, company is considering to convert into a Limited Liability Partnership (LLP). Management views the LLP structure as a hybrid business model that combines the advantages of both companies and

partnerships. Additionally, they believe this conversion would relieve them of mandatory audit requirements.

Based on the above facts, answer the following: -

1. Whether audit team is correct in excluding the planned review of petty cash from the audit programme?
 - (a) No. Because an audit programme should always include a petty cash review, regardless of company policy.
 - (b) Yes. Because the company's internal controls and policy of limiting cash transactions reduce the need for a petty cash review in the audit programme.
 - (c) No. Because the audit programme must cover all the areas of financial transactions, including petty cash, to ensure comprehensive auditing.
 - (d) Yes. Because the audit programme should only focus on areas with high financial risk, and petty cash is not a high-risk area.
2. Whether the decision of auditor to send the confirmation request to the creditors of the company as on 20th March 2024 justified?
 - (a) Yes, decision of the auditor is correct as the auditor is allowed to choose any date reasonably close to the balance sheet date for confirmation, and the selected date helps to ensure the accuracy of the liabilities without consultation from the management.
 - (b) No, decision of the auditor is not correct as the auditor should have sent the confirmation requests for the balance sheet date as this would accurately reflect the liabilities as on that date.
 - (c) Yes, decision of the auditor is correct as the auditor is allowed to choose any date which is reasonably close to the balance sheet date for confirmation, and the selected date should be decided in consultation with the management.
 - (d) No, decision of the auditor is not correct as confirmation should be asked within a week of the date of audit report.
3. Which of the following is not an appropriate procedure to verify the balances for M/s. Keshav Traders and M/s. Amrit Distributers?
 - (a) Breaking down the balance into individual transactions and making sure they actually happened.
 - (b) Checking payments made after the year-end to vendors who didn't respond to confirmation requests.
 - (c) Comparing the balance to the original invoices from the vendors.

- (d) Request a written representation from management confirming that all payables are accurately recorded and complete.
- 4. In the given case, is there any requirement for separate disclosure of the PPE revaluation?
 - (a) Yes, separate disclosure is required due to the 5% increase in carrying value.
 - (b) No, separate disclosure is not required as the change in carrying value is less than 10%.
 - (c) Yes, separate disclosure is required regardless of the percentage change.
 - (d) No, separate disclosure is not required unless the revaluation results in a material change in the carrying value.
- 5. What is your perspective on the management's view regarding the audit requirements for an LLP?
 - (a) An LLP is always required to conduct an audit, regardless of its turnover or capital contribution.
 - (b) An LLP is always required to conduct an audit if either the turnover exceeds ₹40 lakhs or the capital contribution exceeds ₹25 lakhs.
 - (c) An LLP is always required to conduct an audit if either the turnover exceeds ₹25 lakhs or the capital contribution exceeds ₹40 lakhs.
 - (d) An LLP is always required to conduct an audit if the capital contribution exceeds ₹25 lakhs and the turnover exceeds ₹40 lakhs.

Case Scenario 2

Shreyansh, a Chartered Accountancy student, is part of an engagement team conducting audit of the Coimbatore branch of XYZ Bank under the guidance of CA Dilip, the Engagement Partner. Shreyansh has been assigned the task of verifying provisions made for the branch's non-performing assets (NPAs) and classification of certain loans as on March 31, 2024, of which details are as under:

Non-Performing Assets (NPAs):

| Name of Account | NPA classification | Outstanding amount as on March 31st, 2024 (In ₹ lakhs) | Amount of provision made (In ₹ lakhs) | Security Available |
|-----------------|--------------------|--|---------------------------------------|---|
| AB Industries | Doubtful (D1) | 10.00 | 5.00 | Fully secured |
| Mars Traders | Substandard asset | 50.00 | 7.50 | Fully secured |
| RS Enterprises | Doubtful (D2) | 30.00 | 30.00 | Fully secured |
| NPS & Sons | Loss | 1.00 | 1.00 | Only personal guarantee of proprietor (Net worth ₹50 lakhs) |

Housing Loan and Car Loan

A borrower Mr. Shyam has availed following two loans from the branch:

- Housing Loan: EMIs are overdue for 120 days as on March 31, 2024.
- Car Loan: EMIs are overdue for 60 days as on March 31, 2024.

Agricultural Advances

The branch has provided a loan of ₹20 lakhs under the Kisan Credit Card (KCC) scheme to a farmer for the cultivation of paddy, which has a harvest period of 3–4 months. There has been no transaction in the account for the last 90 days. The branch has classified the loan as a Standard Asset.

CA Dilip has clarified that the NPA classification has been verified and is in accordance with RBI guidelines. He instructed Shreyansh to focus on evaluating the adequacy of the provisions, considering RBI Guidelines mandate specific percentages for provisioning based on the NPA classification and the nature of the security.

Based on the above facts, answer the following: -

6. Is the provision made for AB Industries (Doubtful—D1) appropriate?
- (a) Yes, as it exceeds the required 25% provisioning for secured assets.
 - (b) No, as it should be 40% of the outstanding amount.
 - (c) No, as the required provision is ₹ 2.50 lakhs (25% of ₹ 10.00 lakhs).
 - (d) Yes, as provisions for Doubtful assets can exceed the minimum requirement.

7. Considering the Housing Loan and Car Loan availed by the borrower Shyam, which of the following statements is appropriate?
- (a) Both Housing Loan and Car Loan should be classified as “Non-Performing Assets” in accordance with RBI norms on asset classification.
 - (b) Housing Loan should be classified as “Non-Performing Asset” in accordance with RBI norms. However, Car Loan should be classified as Standard Asset.
 - (c) Car Loan should be classified as “Non-Performing Asset.” However, Housing Loan should be classified as Standard Asset.
 - (d) Both Housing Loan and Car Loan should be classified as Standard Assets.
8. What is the minimum provision required for RS Enterprises (Doubtful—D2), considering the account is fully secured?
- (a) ₹30.00 lakhs
 - (b) ₹12.00 lakhs
 - (c) ₹15.00 lakhs
 - (d) ₹25.00 lakhs
9. As regards the description of the agricultural advance under Kisan Credit Card, which of the following statements is most appropriate?
- (a) The branch has erred in making classification as per RBI norms. It is a “Sub-standard” asset.
 - (b) The classification made by the branch is proper. However, since there are no transactions in the account for 90 days, it is an SMA (Special Mention Account).
 - (c) The classification made by the branch is proper.
 - (d) The branch has erred in making classification as per RBI norms. It is a “Doubtful” asset.

Case Scenario 3

M/s MCP Associates are having 3 partners namely CA Mahavir, CA Chandana and CA Prabha. CA Mahavir is about to conclude audit of a company. During the audit, he noticed that there is a shortage of important raw material supplies being imported from China due to prevailing geopolitical situation. The company has shared with him its plan to deal with the situation. He is satisfied with assessment of the company for dealing with the matter. The issue is disclosed in financial statements and considering management’s assessment, it is felt that use of going

concern assumption by company in preparation of financial statements is appropriate. He also verifies that all subsequent events have been accounted for and requests written representations from management, although the representations include qualifying language. Significant findings were communicated both orally and in writing to those charged with governance, with relevant communications documented.

CA Chandana is conducting an audit of a manufacturing company dealing in towels and bedspreads. The company's inventory is spread across its own locations and third-party premises. As part of audit procedures, she is performing many audit procedures required by different Standards on Auditing. She attends the physical inventory count, sends confirmation requests for trade receivables, and assesses controls. She relies on sampling extensively while auditing transactions, balances, and controls.

CA Prabha is auditing a firm's financial statements and performs detailed procedures to verify assertions. The firm is engaged in export of goods to Europe. The sales invoices raised in Euros are converted into Indian rupees as per applicable norms. She checks classification of expenses, ensures trade payables are genuine, compares current and past wages, examines title deeds for land, and check the accuracy of calculation of the conversion of foreign currency into Indian rupees for export invoices.

Based on the above facts, answer the following: -

10. Which of the following best describes CA Mahavir's responsibility for subsequent events as per SA 560?
 - (a) He has no obligation to perform audit procedures for events occurring between date of financial statements and date of auditor's report.
 - (b) He should perform necessary audit procedures to know about events occurring between the date of financial statements and date of auditor's report.
 - (c) He has no obligation to perform audit procedures after signing of auditor's report, even if he comes to know of an event, which if known to him earlier would have caused him to amend the audit report.
 - (d) He has to only rely upon written representation of management regarding subsequent events. He has no other means to know about such events.
11. Which is the most appropriate action CA Chandana should take for verifying inventories held at third-party premises?
 - (a) Request confirmation of the inventory's quantity and condition from third parties or inspect the inventory at their premises.

- (b) Inspect all inventories at third-party premises without requesting confirmation.
 - (c) Rely on management's written representation regarding inventories at third-party locations.
 - (d) Confirm the inventory's value along with its quantity and condition from third parties.
12. Which audit procedure CA Prabha performed to verify whether conversion of foreign currency into Indian rupees is proper or not?
- (a) Inspection
 - (b) Recalculation
 - (c) Observation
 - (d) Reperformance

MCQs

13. CA Kamal, a partner at KPS & Co., is conducting an audit of Ridhi Ltd., a manufacturing company. During the audit it was found that KPS & Co. generates 72% of its total revenue from Ridhi Ltd., raising concerns about the firm's financial dependence on this single client. Identify the kind of threat to independence that may be involved in this case.
- (a) Familiarity threat
 - (b) Self-interest threat
 - (c) Self-review threat
 - (d) Advocacy threat
14. The auditor is evaluating the most appropriate method to assess the internal control system of the company. The selected method should be widely recognised for gathering information about the existence, operation, and efficiency of internal controls, while also minimizing the risk of oversight of important review procedures. Furthermore, the method should facilitate easier interim reviews of controls. Which method would be most appropriate for evaluating internal control based on the description provided above?
- (a) Internal Control Questionnaire
 - (b) Flow Chart
 - (c) Check List
 - (d) Narrative Record

15. Gori told her friends that she had read a news report about how a company had misled its auditors by producing some fabricated documents. Which of the following statements seems to be appropriate in this regard?
- (a) Auditor has to conduct audit by exercising professional skill. But he is not an expert in discovering genuineness of documents. Hence, management consisting of dishonest persons may have led him to rely upon fabricated documents deliberately.
 - (b) It was wrong on the part of auditor to rely upon fabricated documents. He must have discovered it as the same falls within the scope of his duties.
 - (c) Management cannot mislead auditor due to high level of knowledge and expertise possessed by him. The above is an outlier case-one of the rare, odd cases.
 - (d) Although it was wrong on the part of auditor to rely upon fabricated documents, he cannot do anything in the matter. He has to report on the basis of documents provided to him. He has no duty in this regard.

PART II - Descriptive Questions

Question No. 1 is compulsory.

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

1. (a) ABC Pvt. Ltd., a manufacturing company, is facing significant financial difficulties due to downfall in market and increase in cost of production. CA Ram, the auditor of ABC Pvt. Ltd. has identified the following conditions:
- The company has defaulted on a major loan repayment.
 - Current liabilities exceed current assets by 50%.
 - Sales revenue has declined by 30% compared to the previous year.
- Management has not yet performed an assessment of the company's ability to continue as a going concern, but they provided assurance for implementing corrective measures, including cost-cutting initiatives and discussions with creditors for restructuring the loan.
- Which additional audit procedures need to be performed by CA Ram in accordance with SA 570 when such events or conditions are identified?
- (5 Marks)**
- (b) CA Rishi is appointed as an auditor of AIR Ltd. for the financial year ending on March 31, 2024. During the audit, he observed that the company's books of accounts reflect a significant number of trade payables and receivables as on the balance sheet date. To verify the

accuracy of the trade receivables, CA Rishi decided to send confirmation requests to some of trade receivables. However, the management refused to permit him to send these confirmation requests to the selected parties. How should the auditor proceed in the given situation? **(5 Marks)**

- (c) CA Tanuj, the auditor of Kiran Ltd., completed the audit work and issued the auditor's report on 18th August 2024 for the financial year ended on 31st March 2024. During the final assembly of the audit file, he discarded some supporting schedules as same were outdated and corrected cross-referencing errors of working papers. No new audit conclusions were drawn, and the final audit file was assembled on 10th October 2024.

On the basis of Standards on Auditing regarding audit documentation, comment on the action taken by CA Tanuj. **(4 Marks)**

2. (a) Deepa Ltd., initially requested an audit engagement for the financial year 2023-2024. However, midway through the audit process, the management claims that they are unable to provide complete supporting documentation for a significant portion of their receivables. As a result, the management asks the auditor to change the audit engagement to a review engagement, arguing that it would prevent the issuance of a qualified opinion.

The auditor is now facing challenge in determining whether this change is justified or not. Comment in accordance with relevant SA. **(5 Marks)**

- (b) CARO, 2020 shall apply to every company including foreign company. However, it specifically exempts certain class of companies. State which class of companies are specifically exempt from the applicability of CARO, 2020? **(5 Marks)**
- (c) RST Ltd., a mid-sized trading company, recently faced challenges in securing a bank loan due to doubts about the reliability of its financial statements. The management realised the importance of having audited accounts to build confidence among lenders and other stakeholders. Elucidate the benefits and need of an audit. **(4 Marks)**
3. (a) During the audit of Smile Bank, CA Sweety focused on understanding the risk management process of the bank. She reviewed how management developed controls and used performance indicators to monitor key business and financial risks. CA Sweety also assessed whether the risk management system effectively identified and mitigated risks in required areas. How should CA Sweety evaluate the adequacy of the bank's risk management controls? **(5 Marks)**
- (b) Aman Cooperative Society appointed FAB & Associates as an auditor for the financial year 2023-2024. During the audit, the auditors noted the following details:

| | |
|---|---------------------------|
| Number of shares | 1000 shares @ ₹ 10/- each |
| Net Profit before compulsory transfer to reserve fund | ₹ 10,000/- |
| Net Profit after compulsory transfer to reserve fund | ₹ 8000/- |

- (I) Mr. Dhairya, a member of society, holds 200 shares amounting to ₹ 2000 from the previous year.
- (II) Upon verifying the society's borrowings, the auditors found that Cooperative Society had accepted a loan from Mr. Shivam, a non-member. The auditors did not find any restrictions regarding this in the society's bye laws.

Comment on the above transactions of the society with reference to the Co-operative Societies Act, 1912. **(5 Marks)**

- (c) "In establishing the overall audit strategy, the auditor shall, among other considerations, ascertain the nature, timing and extent of resources necessary to perform the engagement". Explain those considerations in detail. **(4 Marks)**
4. (a) During the audit of HST Ltd., CA Mukund, the auditor, observed a significant volume of unsold electronic parts as inventory that had remained stagnant for more than two years. He noted that the company was facing difficulty selling these items due to the changes in the market. Additionally, some parts were damaged, and others were discontinued models. CA Mukund also ensured that the inventory was accurately valued to ensure proper financial reporting. You are required to outline the detailed audit procedures that are generally undertaken when auditing such inventories which at the time of observance of physical counting were noted as being damaged or obsolete. **(5 Marks)**
- (b) The engagement partner, of a firm of auditors, is explaining to his audit team, undergoing practical training, the inter relationship between audit strategy and audit plan. Discuss the points which the engagement partner will explain to his team in this regard. **(5 Marks)**
- (c) Calen Retail Ltd. is preparing its annual financial statements, and the auditors are tasked with determining materiality. The company has used revenue as the benchmark, as it is a key indicator of performance. However, Calen Retail has recently opened new stores and closed underperforming ones, which could significantly affect both revenue and profitability. As per given case, what factors should the auditors consider when selecting the most appropriate benchmark for materiality? **(4 Marks)**

5. (a) M/s AR & Associates have been appointed as statutory auditors of Future Limited, a company engaged in the business of manufacturing of hardware products. They are analyzing the monthly trends for other expenses like rent, power and fuel, repairs, etc. and are also verifying attributes of such types of expenses. List down the attributes for verifying such expenses. **(5 Marks)**
- (b) CA Kavita, auditor of Healthify Ltd., while assessing potential risks of material misstatement related to litigations at Healthify Ltd., identified a possible legal claim that could affect the financial statements. She sent a general inquiry letter to the company's external legal counsel, Mohit & Co., seeking clarification. However, Mohit & Co. informed her that their professional rules prohibited them from responding to these general inquiries. Guide CA Kavita that what other option is available to obtain the necessary information for the audit? **(5 Marks)**
- (c) Familiarity threats are self-evident, and occur when auditors form relationships with the client where they end up being too sympathetic to the client's interests. Explain. **(4 Marks)**
6. (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 **(5 Marks)**
- (b) ASD Limited's business has grown from one state of India to various countries of the world. Since the business has increased manifold, the management decided to appoint joint auditors for conducting the statutory audit of the company. They appointed three CA firms for it. For which audit work the joint auditors will be jointly & severally responsible? **(5 Marks)**
- (c) The management of PQ Ltd. changed during the period under audit. Mr. Govind, an auditor, at the time of receiving written representation on the management responsibilities from the management, was in a dilemma related to the date of and period(s) covered by the written representation. Further, new management was of the view that they can give written representation from the date they took over and not for the prior period when old management were managing affairs of the company. Guide the auditor and the management in this respect. **(4 Marks)**

OR

Knowledge of the Client's business play an important role in developing an overall audit. In fact, without adequate knowledge of the client's business, a proper audit is not possible. As per SA 315, "Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment", the auditor shall obtain an understanding of the relevant industry, regulatory and other external factors including the applicable financial reporting framework. Substantiate with the help of examples. **(4 Marks)**