



# CA Test Series.org (Since 2015)

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Question Paper	
ADV. Audit & Professional Ethics	Duration: 75
Details: Test – 1	Marks: 40

**Instructions:**

- All the questions are compulsory
- Properly mention test number and page number on your answer sheet, Try to upload sheets in arranged manner.
- In case of multiple choice questions, mention option number only Working notes are compulsory wherever required in support of your solution
- Do not copy any solution from any material. Attempt as much as you know to fairly judge your performance.

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## TEST-1 CH-2, 3, 5

SA- 600, 610, 620, 700, 701, 705, 706, 710, 720

**Q-1** You are the manager responsible for the audit of Worth Ltd. which has a year end of 31 March. This is the first year that your firm has undertaken the audit of Worth Ltd., having succeeded the previous auditors at the last annuals general meeting following a successful tender for the audit. Your firm has an office in Telangana and in 15 other location throughout the India.

You have had preliminary discussions with the management of Worth Ltd. and obtained some background information about the company. The company produces fertilizer in a factory on the outskirts of Liverpool. The head office is situated in Telangana. There are ten depots throughout the country which hold large stocks of fertilizer so that local demand for its products can be met quickly. Inventory records are not maintained and a full count is carried out at the year end.

You have also read recent government press release that indicates that 'L', a product which forms a major part of the company's sales, contains a chemical that has been identified as being potentially dangerous to those who handle it. An official government working party has been set up to review the situation.

### Requirement

**(A)** Identify the circumstances that should be taken into account when planning the audit of Worth Ltd., and set out your outline audit approach in these areas.

**(4 marks)**

**(B)** Explain the objectives of audit planning.

**(2 marks)**

**Q-2** CARO, 2020 requires the auditor of the company to report whether maintenance of cost records has been specified by the Central Government under section 148 of the Companies Act, 2013 and whether such accounts and records have been so made and maintained. You are required to briefly explain the audit procedure to be followed by the auditor and suggest the reporting pattern.

**(4 marks)**

**Q-3** Mr. Y, a practicing Chartered Accountant, has been appointed as an auditor of M/s Z Ltd on 12th June, 2018 for the year ended 31st March, 2019. The following persons have done following transactions in securities of M/s Z Ltd.:

- Daughter of Mr. Y: Purchase of Securities on 10th September, 2018 of face value of Rs 45,000 (market value Rs 90,000)
- Husband of daughter of Mr. Y: Purchase of Securities on 10th December, 2018 of face value of 90,000 (market value Rs 1,90,000).

All the above securities were sold on 10th March, 2019 for Rs 3,00,000. Discuss the implications of the above on the appointment of Mr. Y.

**(5 marks)**

**Q-4** You are the auditor of Vishakha Steel Pressing Limited, which manufactures small pressing from sheet-steel. The process generates scrap steel which is placed daily by the work force into a bin kept for that purpose in the yard. Every Friday a lorry arrives from a small local scrap merchant. The bin is loaded on to the lorry and replaced by an empty bin. The weight is obtained by the gatekeeper using the company weighbridge. He notes the weight in a book kept for that purpose in the gate office. Each month a cheque is received through the post from the scrap merchant accompanied by a remittance advice stating the weight of scrap collected

the price and the amount of the cheque. The cheque is banked by the cashier and the remittance advice is filed. There are no other procedures in this area: You are required to:

- (a) Suggest major improvements to be made in the internal control in this area.
- (b) Suggest key audit procedures under these circumstances to mitigate audit risk.

**(6 marks)**

**Q-5** While auditing Y Ltd., CA Max, the statutory auditor of Y Ltd. encounters exceptional circumstances that bring into question his ability to continue performing the audit. Considering it appropriate, CA Max resigned from the office of auditor of Y Ltd. Due to the resignation of the existing auditor, the Board of Directors of Y Ltd. itself appointed CA Mini, a practicing Chartered Accountant, as the statutory auditor till the conclusion of 6th meeting.

You are required to state the provisions related to filling of casual vacancy as per the Companies Act, 2013 and comment upon the validity of appointment made by the Board.

**(4 marks)**

**Q-6** OPQ Ltd is in the business of software consultancy. The company has had large balances of accounts receivables in the past years which have been assessed as area of high risk. For the year ended 31 March 2021, in respect of the valuation of accounts receivable, the statutory auditor has assigned the checking of the accuracy of the aging of the accounts receivables and provision based on ageing to the internal auditor providing direct assistance to him. Please advise.

**(5 marks)**

### Q-7 CASE STUDY BASED MCQs:-

ABC Ltd. is in the business of trading garments. Within a span of five years since its incorporation, the company has gained a good market reputation. Last year, in its Kochi warehouse the inventory was less than 1% of total inventory value, so the auditor instead of witnessing or performing the physical count of inventory relied upon the management's inventory confirmation and management in turn relied upon the warehouse keeper's stock register without verifying the actual count. The same year there was some difference between the store register and books of accounts closing balance. The management considered it to be an immaterial amount and wrote it off through "Miscellaneous Profit and Loss Account". In the current year, while performing analytical procedure, the auditor saw a significant reduction in sales through Kochi warehouse, whereas there was a spike in freight charges to Kochi. Through further examination, the auditor noticed that there was increase in number of shipments to Kochi and increase in number of invoice cancellation instances and sales return instances from the customers of GST unregistered category. However, this year the inventory lying at Kochi is 4.5% as per books. The Auditor enquired on the periodicity of physical verification and sales process through Kochi warehouse. The management gave the following response to the auditor:

1. The physical verification takes place every six months and the warehouse keeper is responsible for physical verification and sending records back to the head office.
2. Because of low operations in past years the warehouse keeper himself takes care of invoicing and dispatching the goods.
3. Monthly invoice details along with the monthly stock register is sent to the head office.
4. Further, this year too there is a substantial difference among inventory as per books, inventory as per stock register and inventory as per physical verification in descending order. The auditor decided to visit the Kochi warehouse and conduct the root cause analysis and get the correct closing value of the inventory. After the visit, the auditor concluded that the warehouse keeper was issuing the stocks with invoices, however on the sales return the credit

notes were issued to various customers and the entry was made in the stock register of “Goods received on sales return” but physically the goods were never returned. The Auditor also doubts that the same instance might have happened last year as well because of which there was a difference between physical stock and the books. On this information, the management has asked auditor that why this was not brought into notice last year and whether the audit not conducted properly then. Further, Aconsultant was appointed by the management for the overview of internal controls with regard to verification of inventory and suggest recommendations. Based on the above facts, answer the following:-

**1)** In the view of the above case scenario, which according to you is the correct statement?

- (a) Only the errors can be expected to be identified during the audit.
- (b) Only the statutory compliance can be expected out of a Statutory Audit.
- (c) The Auditor contends that last year the inventory levels in Kochi was not in the sampling materiality level and therefore, the issue was not identified. This is a part of the audit risk.
- (d) The Management is of the view that all the frauds and errors must be identified with the statutory audit.

**2)** Which components of audit risks are represented in the aforesaid scenario?

- (a) Inherent Risk & Control Risk – Inherent risk due to its nature of business or operations and Control risk due to inappropriate design and ineffective implementation of internal controls.
- (b) Control Risk & Detection risk- Control risk due to inappropriate design and ineffective implementation of internal controls and audit detection risk due to possibility of auditor not identifying risk of misstatement.
- (c) Fraud risk due to nature and size of operations and high likelihood of fraud due to its significance.



(d) Risk of Error because there was error in the presentation in the financial statement last year.

**3) Which Internal Control seems to have been compromised as the root cause here?**

(a) Lack in safeguarding the assets of company.

(b) Lapse in compliance controls leading to non-compliance of sharing inventory level with the GST department.

(c) Segregation of Duty.

(d) Inadequate Records and Documents leading to non recording of correct inventory value.

**(2×3=6 Marks)**

**4) GENERAL MCQs:-**

i. You are a manager in the audit department of Narang & Co, and you are dealing with several ethical and professional matters raised at recent management meetings, all of which relate to audit clients of your firm:

One of your client Bernwood Co has a year ending 31 March 2018.

During this year, the company established a pension plan for its employees, and this year end the company will be recognizing for the first time a pension deficit on the balance sheet, in accordance with Ind AS 19 Employee Benefits. The finance director of Bernwood Co has contacted the audit engagement partner, asking if your firm can provide an actuarial valuation service in respect of the amount recognized. Which of the following options need to be considered by the audit engagement partner?

(a) The issue is whether there is a self-review threat, as the valuation of the amount recognized would be recorded in the financial statements. The audit partner should decline the work of valuation service.

(b) The issue is whether the audit firm would be likely to possess the requisite competence to provide such a valuation service. The audit partner should decline since not professionally qualified to provide the valuation service.

(c) Narang & Co. needs to assess the materiality of the figure, and the degree of subjectivity involved. If it considers that safeguards like using separate personnel, performing a second partner review, could reduce the threat to an acceptable level, then it can go ahead with both the audit and the valuation service.

(d) The audit partner could go ahead with the valuation service and disclose the fact in its audit report about the service provided during the period. This will safeguard and reduce the threat to an acceptable level.

ii. During the financial year ended on 31/03/2021, LM Private Limited had borrowed from a Nationalized Bank, a term loan of Rs. 120 lakhs consisting of Rs. 100 lakhs for purchase of machinery for the new plant and Rs. 20 lakhs for erection expenses. As on the date of 31 March, 2021, the total of capital and free reserves of the Company was Rs. 50 lakhs and turnover for the year 2020-21 was Rs. 750 lakhs. The Bank paid Rs. 100 lakhs to the vendor of the Company for the supply of machinery on 31/12/2020. The machinery had reached the yard of the Company. On 28/02/2021, the Company had drawn the balance of loan viz. Rs. 20 lakhs to the credit of its current account maintained with the Bank and utilized the full amount for renovating its administrative office building. The machinery had been kept as capital stock under construction. Auditor is required to report the matter:

(a) Under Clause (vii) of paragraph 3 of the CARO, 2020.

(b) Under Clause (viii) of paragraph 3 of the CARO, 2020.



(c) Under Clause (ix) of paragraph 3 of the CARO, 2020.

(d) No reporting required under the requirements of CARO, 2020

iii. VAS Ltd, a subsidiary of KEP Ltd. is engaged in the business of manufacturing fertilizers. 15% shares of KEP Ltd are held by the Central Government, 25% by Kerala Government and 20% by Karnataka Government. M/s ABC & Associate, a firm of Chartered Accountants, has been appointed as first statutory auditor of VAS Ltd by its Board of Directors. You are required to suggest which of the following statements would be correct.

(a) The first auditor of VAS Ltd shall be appointed by the Comptroller and Auditor- General of India within 60 days from the date of registration.

(b) The first auditor of VAS Ltd shall be appointed by the Comptroller and Auditor- General of India within 180 days from the date of registration.

(c) The first auditor of VAS Ltd shall be appointed by members in EGM within 30 days from the date of registration.

(d) The first auditor of VAS Ltd shall be appointed by the Board of Directors within 30 days from the date of registration.

iv. BVM & Associates is an audit firm that employs large number of audit assistants. CA Mahesh, a partner pays extreme attention to briefing the audit assistants every day while the audit is continuing. All audit assistants are required to document their notes in the daily briefing and accordingly conduct the audit. CA Mahesh has made it very clear that any assistant who does not document the notes taken and the steps taken accordingly will be reprimanded as it will mean that the assistants are not creating their audit programmes on the job. The practice deployed by CA Mahesh can be termed as?

(a) Unacceptable as CA Mahesh being the auditor should be providing the audit programme and he cannot expect the team to take daily notes instead of performing the audit.

(b) Appropriate and in line with SA 230 as the audit programme must be prepared on the basis of documentation of auditor's briefing notes.

(c) Acceptable but incomplete as CA Mahesh has not given any audit programme to the audit assistants to follow.

(d) Inappropriate as CA Mahesh should not only provide the audit programme but also make sure that audit programme is formally approved by all partners of the firm.

**(1 × 4 = 4 Marks)**

