

**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 [MCQ 1-5]**

CA Trustworthy has accepted audit of financial statements of a company viz. Precision Industries Private Limited for year 2024-25. The company's annual turnover for year 2024-25 is approximately ₹ 250 crores. As he is conducting the audit of the company for the first time, he started gaining knowledge of the business and its internal controls to identify and assess the risk of material misstatement. In this regard, he has made inquiries from certain personnel including company's in house legal counsel and various departmental heads as such inquiries can divulge information that is likely to identify and assess risks of material misstatement due to fraud or error. The company is also having internal audit department headed by Mr. A. Precisely, he has inquired from following persons to identify and assess risks of material misstatement due to fraud or error.: -

- (i) Mr. A, Head of Internal Audit Department.
- (ii) Mr. John, in-house legal counsel.
- (iii) Mr. I, IT Systems Head.

Later, while conducting audit, he observed application of few controls in IT systems. He also made extensive inquiries from middle level IT personnel about application of various controls.

Based on information received from inquiry of Mr. John, risk of material misstatement in litigation or claims involving the company was assessed by him. It was also decided later to issue letter of inquiry to Mr. F who is external legal counsel of company.

He has also gone through internal audit reports submitted to the management and decided to use internal auditor to provide direct assistance to perform following procedures labelled as P, Q, R and S.

- (P) To vouch few expenses bills.
- (Q) To trace transactions through information system.
- (R) To verify accuracy of ageing of trade receivables.
- (S) To evaluate appropriateness of management's use of going concern assumption.

During the course of audit, he has verified samples of sales invoices with entries recorded in books of accounts and sent external confirmation requests to selected trade receivables. There were 100 trade receivables outstanding as at 31<sup>st</sup> March, 2025 and it was decided to send external confirmation requests to 20 trade receivables. He had chosen one trade receivable balance randomly and thereafter every 5<sup>th</sup> balance was chosen. The responses to external confirmation requests were duly received.

Based on the above facts, answer the following:

1. In context of inquiries made by CA Trustworthy, which of following statements is true?
  - (a) Inquires from John and F are in nature of risk assessment procedures.
  - (b) Inquiries from A, John and I are in nature of substantive procedures.
  - (c) Inquiries from A, John and I are in nature of risk assessment procedures.
  - (d) Inquiries from John and F are in nature of substantive procedures.
2. In which of following areas, CA Trustworthy is unlikely to use internal auditor to provide direct assistance to him?
  - (a) Work as stated at P.
  - (b) Work as stated at S.
  - (c) Work as stated at Q.
  - (d) Work as stated at R.
3. With regards to audit evidence obtained during the audit which of following statements is incorrect as discussed in case scenario?
  - (a) Sales invoice and responses to inquiries from middle level IT systems personnel are examples of internal evidence.
  - (b) Audit evidence obtained from inquiry of middle level IT systems personnel is more reliable than observation of application of few controls by CA Trustworthy.

- (c) Responses to external confirmation requests are examples of external evidence.
  - (d) Internal audit reports are an example of documentary evidence.
4. While selecting samples of trade receivables described in case scenario, which method is being used?
- (a) Block sampling.
  - (b) Systematic sampling.
  - (c) Monetary unit sampling.
  - (d) Stratified sampling.
5. Choose option showing correct values of population, sampling interval and sample size respectively from description given in case scenario: -
- (a) 100, 5, 20.
  - (b) 100, 20, 5.
  - (c) 20, 5, 20.
  - (d) 20, 5, 5.

**Case Scenario 2 [MCQ 6-9]**

CA Mahaveer, a partner at ANJ & Co., is conducting the statutory audit of a branch of Fair Bank for the year 2024-25. During the course of the audit, he made the following observations:

- (i) A loan of ₹ 12 lakhs was sanctioned to a farmer for cultivation of sugarcane, a crop that typically has a harvesting cycle of 10–12 months under the Kisan Credit Card (KCC) scheme. The account had no transactions since last 120 days, however, the branch continued to classify the loan as a Standard Asset as on 31<sup>st</sup> March 2025.
- (ii) The branch had taken over a term loan of ₹ 60 lakhs from another bank. However, the branch manager approved the proposal, even though such limits require sanction by the Zonal Credit Committee, as per the “Manual of Delegation of Powers” of Bank.
- (iii) It is noticed that head office of bank has flagged a saving account maintained in branch in which interest was wrongly paid at higher rate due to wrong data feeding entry. Now, situation has been rectified by debiting excess interest paid in the account. Since there was little balance in saving account, a debit balance of ₹ 1.35 lac was created in the said saving account due to above reversal. The matter was immediately informed to account holder. However, he has not turned up for payment since matter was informed to him about six months ago.

- (iv) Due to time constraints, CA Mahaveer is under pressure to issue an unmodified audit report in the limited time frame. He has insufficient time to properly perform or complete the relevant duties and issue appropriate audit report.

Based on the above facts, answer the following:

6. Which of the following is most appropriate regarding the sugarcane KCC loan?
- (a) The account is overdue beyond 90 days and must be classified as Sub-standard.
  - (b) The loan must be treated as NPA since no transaction has occurred for 90 days.
  - (c) Since the crop cycle exceeds 6 months, the account can still be Standard despite no transaction for 120 days.
  - (d) The account should be reported as "Doubtful".
7. Regarding the term loan takeover of ₹ 60 lakhs from another bank, which of the following is most appropriate?
- (a) It is a routine matter and auditor need not intervene.
  - (b) It reflects breach of sanctioning authority and should be reported in audit findings.
  - (c) The manager can exercise discretion up to ₹ 75 lakhs, so it is valid.
  - (d) Since the account was performing, the sanctioning irregularity is immaterial.
8. As regards debit balance of ₹ 1.35 lacs in Savings account, which of the following is correct from point of view of an auditor?
- (a) The debit balance of ₹ 1.35 lacs should be classified as NPA.
  - (b) The situation does not attract RBI norms on asset classification.
  - (c) The situation does not attract RBI norms on asset classification as no credit facility was granted.
  - (d) The bank cannot demand excess interest paid to account holder.
9. Which fundamental principle governing professional ethics is disregarded by CA Mahaveer by issuing unmodified audit report?
- (a) Professional competence and due care.
  - (b) Professional behaviour.
  - (c) Integrity.
  - (d) Objectivity.

### Case Scenario 3 [MCQ 10-12]

Arya Ltd. is a company engaged in the manufacture of stainless-steel household items such as hot pots, pressure cookers, bottles, and cutlery sets. The company is having its corporate office in Delhi and manufacturing plant in Ajmer, Rajasthan. To meet growing demand, Arya Ltd. planned to expand its manufacturing by setting up two new plants in Raipur district and also raised ₹ 5 crore by issuing Equity Shares of face value ₹ 10 at a premium of ₹ 5.

The company had Reserves and Surplus of ₹ 2 crore, which includes securities premium and general reserve. S.K. & Associates, statutory auditors since FY 2022–23, planned the audit and assigned roles accordingly:

- Riya, an articled assistant, was asked to perform analytical procedures on raw material inventory for obtaining evidence with respect to the overall reasonableness of purchase quantity and price of inventory. However, she collected the reports from the management for raw materials as a percentage of total stock and compared the same with the data of the previous year. She also discussed the reasons for the variations with the management.
- Shobhit, a paid CA, was assigned the physical verification of inventory. CA Shobhit was present at the physical inventory count but did not record dates or test counts, although he took some photos were taken.
- Audit documentation gaps were also observed regarding basis of materiality, and related party transactions which were discovered during the audit but not adequately documented.

Based on the above facts, answer the following:

10. Which of the following statements is incorrect regarding the use of the Securities Premium Account under Section 52 of the Companies Act, 2013?
- (a) Where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be transferred to a securities premium account.
  - (b) The securities premium account can be applied by the company in paying up unissued equity shares of the company to be issued to members of the company as fully paid bonus shares.
  - (c) The securities premium account cannot be applied by the company in writing off the expenses of or the commission paid or discount allowed on any issue of equity shares of the company.

- (d) The securities premium account can be used by the company for the purchase of its own shares or securities under section 68.
11. Which of the following should not be part of audit documentation for related party transactions?
- (a) Management representation letter in this regard.
  - (b) Related party transaction policy of the company.
  - (c) Documentation to show that such transactions are at arm's length basis.
  - (d) Documentation to show that such transactions are at close length basis.
12. Which of the following analytical procedures were performed by Ms. Riya to obtain audit evidence regarding raw material inventory?
- (a) Consumption Analysis.
  - (b) Stock Composition Analysis.
  - (c) Reasonableness test.
  - (d) Ratio analysis.

### MCQs

13. CA Neha is appointed as auditor of a newly incorporated textile company. Before starting the audit, she checks whether the firm meets ethical requirements or if there are any threats to independence. She also sends an audit engagement letter to the management. CA Neha is:
- (a) developing audit programme.
  - (b) performing preliminary engagement activities.
  - (c) performing substantive procedures.
  - (d) conducting audit documentation.
14. CA Meenal is approached by River Pvt. Ltd. to conduct the audit for F.Y. 2024–25. During the pre-engagement discussions, the management informs her that the scope of audit should exclude verification of inventory, as its already being reviewed by their internal audit team. Management also expects CA Meenal to rely on their reports. She agrees verbally to the engagement and begins planning, but no formal audit engagement letter is issued or signed. Choose the most appropriate option.
- (a) The auditor may proceed with the audit as its scope is discussed verbally.
  - (b) Auditor can accept internal audit verification as a substitute for her own work.

- (c) The auditor shall not accept audit where management imposes limitation on scope before the audit.
  - (d) The audit report can be issued with a disclaimer if issues arise later.
15. CA Rahul, the statutory auditor of Vishal Enterprises, is conducting the audit for the financial year 2024–25. As part of his audit procedures, he examines whether the accounting records are reliable, verify the sufficiency of supporting documents like bills and vouchers, and performs procedures to assess internal controls. He also checks if financial statements have been drawn with reference to entries in books and disclose financial information appropriately. The management, however, asks him to determine the physical condition of certain machinery and to forecast the company's profitability. Which of the following procedures falls within the scope of audit?
- (a) Auditor determining physical condition of machinery.
  - (b) Auditor ensuring proper disclosure of financial information.
  - (c) Auditor predicting future profitability of company.
  - (d) Auditor authenticating genuineness of legal contracts.

## **PART II - Descriptive Questions (70 Marks)**

*Question No. 1 is compulsory.*

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

1. (a) CA Aditi is in the process of evaluating the internal controls of a company by focussing on controls operating for creditors from whom various goods are being purchased by the company. In this respect, she wants to collect information about existence, operation and efficiency of internal controls in the company. She plans to prepare a set of questions to be circulated amongst the executives and employees of the company for their response. Which method is being contemplated by her for evaluating internal controls? Prepare a set of few questions regarding controls operating for creditors. **(5 Marks)**
- (b) CA Krish is planning the audit of financial statements of Black and White Limited for financial year 2024-25 with the objective of conducting it in an effective manner. He also carried out the audit of the previous year and the audit report was issued in month of June 2024. He started planning the audit procedures to ensure an effective and efficient audit for the current year. He is assisted by Mr. Shiv, an articled assistant, in the audit planning process. During the planning

discussions, Mr. Shiv raises a few queries regarding the audit planning stage. As a senior, help Mr. Shiv by resolving the following queries:

- (i) When does the planning for an audit actually start and end?
- (ii) Whether auditor can change planning decisions during the audit or not? If yes, what are those possible reasons. **(5 Marks)**
- (c) While scrutinising the accounts of XY Ltd., CA Q, the auditor of XY Ltd., observed that the company had a significant amount of trade receivables outstanding in the Balance Sheet as on 31st March, 2023 for which external confirmations are not available. CA Q wants to send external confirmation requests to selected trade receivables but the management of XY Ltd. refused the same. Discuss how CA Q should deal in this regard as per relevant Standard on Auditing. **(4 Marks)**
2. (a) During the audit of Venus Ltd., CA Rajveer found a considerable increase in sales as compared to the previous year. He suspected that a few fictitious sales have been recorded by the company to overstate its revenues. Discuss the audit procedures to be undertaken by the auditor to ensure revenue from sales of goods and services performed during the period is not overstated? **(5 Marks)**
- (b) CA Govind is conducting stock audit of a borrower availing cash credit facility of ₹ 120 lacs from branch of a bank. The cash credit facility is against security of paid stocks and debtors up to 90 days. Margin stipulated is 30% for stocks and 40% for debtors. Following further information is available as on 31.12.24: -

Particulars	Amount (₹)
Value of stocks	150 lacs
Value of stocks (fully damaged) included in above	30 lacs
Value of debtors	55 lacs
Value of debtors exceeding 90 days included in above	15 lacs
Value of creditors for goods	60 lacs

Compute the amount of drawing power. **(5 Marks)**

- (c) Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after the completion of the previous audit and continues until the completion of the current audit engagement. Planning includes the need to consider certain matters prior to the auditor's identification and assessment of the risks of material misstatement. Explain and discuss the key matters that need to be considered by the auditor prior to the identification and assessment of the risks of material misstatement. **(4 Marks)**

3. (a) Lifeline Hospital, a charitable healthcare institution, provides medical services at subsidised rates. During the audit for the financial year 2024–25, the auditor observed the following:
- Bills had not been issued to some patients even though they were recorded in the patient register.
  - Certain donations received for setting up a dialysis unit were utilised for general administrative expenses.
  - Grants received from a government health scheme were recorded, but supporting documentation or correspondence were missing.
  - The hospital maintained a large stock of medicines and medical supplies, however, there were no proper records or controls over their issue and use.
  - There were significant deviations between budgeted and actual expenditures, particularly in staff salaries and equipment maintenance, but no explanation was documented by the management.
- In view of above, discuss the special step or audit procedures an auditor should apply while auditing the transactions of hospital? **(5 Marks)**
- (b) During course of audit of a company, CA NP has noticed that company's financial position is precarious. The management is unable to pay creditors in agreed timelines and bankers are also not enhancing its credit facilities as key financial ratios are adverse. He is of the view that events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern. He wants to obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Which additional procedures need to be performed by him in this regard in accordance with SA 570? **(5 Marks)**
- (c) RJ Limited has expanded its operations from a single Indian state to multiple countries worldwide. Due to this significant growth, the management has decided to appoint joint auditors for the statutory audit and has engaged three chartered accountant firms. In this context, for which audit responsibilities will the joint auditors be jointly and severally liable? **(4 Marks)**
4. (a) The auditor is not required to report on the matters specified in sub-section (1) of Section 143 of the Companies Act, 2013 unless he has any special comments to make on any of the items referred to therein. If he is satisfied as a result of the inquiries, he has no further duty to report that he is so satisfied. Explain clearly

stating the matters for which the auditor has to perform his duty of inquiry under this section. **(5 Marks)**

- (b) CA Mira, before accepting audit of an educational society, wants to ensure that management of society acknowledges and understands its responsibility in respect of certain matters. Not only this, but she also wants to confirm that management is in agreement with these matters required in connection with Standards on Auditing. Discuss such matters. **(5 Marks)**
- (c) CA Keshav has been re-appointed as the auditor of PKT Ltd. In order to re-confirm certain matters, he has requested the management to provide written representations. Under what circumstances can an auditor request the management to reconfirm its acknowledgement and understanding of its responsibilities through written representations? **(4 Marks)**
5. (a) During the audit of Quick Productions Private Limited, CA Naitik notices that inventories of raw materials & consumables and work-in- progress amounting ₹ 3.50 crores and ₹ 0.35 crores appear in the financial statements of the company as on March 31<sup>st</sup>, 2025. He wants to verify that the above-mentioned inventories have been valued appropriately and as per generally accepted accounting policies and practices. How should he proceed to verify the above? **(5 Marks)**
- (b) Serving Fingers Foundation, a registered NGO based in Delhi, launched a nationwide donation drive during the year 2024–25 to support victims of a flood in Assam. The NGO received substantial donations from individuals, corporates, and international donors. These funds were then sent to to different NGOs operating in Assam, who were actively involved in flood relief work. Serving Fingers Foundation has appointed you to audit its accounts for the year in which it collected and remitted donations for flood victims. Draft audit programme for audit of receipts of donations and remittance of the collected amount to different NGOs. Mention three points each, peculiar to the situation, which you will like to incorporate in your audit programme for audit of said receipts and remittances of donations. **(5 Marks)**
- (c) Dream Build Ltd. is an established player in the Real estate sector and has developed strong internal controls across most areas. You are appointed as the head of the Internal Audit team and you have a close relationship with the internal control system of the company, as it evaluates the effectiveness of internal controls and also suggests improvements in that internal control. Explain, clearly stating the activities related to internal control. **(4 Marks)**

6. (a) You are auditing the financial statements of JEN Ltd., a manufacturing company. During a meeting, Mr. Jai CEO questions the auditor's ability to detect all material misstatements, including those caused by fraud. He insists that since the auditor is a professional, the audit should provide absolute assurance on the accuracy of the financial statements. Is the contention of Mr. Jai correct. Discuss the objectives of auditor in accordance with relevant SA. **(5 Marks)**
- (b) As part of the risk assessment procedure, an auditor is required to determine whether any of the identified risks are, in their professional judgment, significant risks. In making this determination, the auditor must consider several key factors. Explain the factors that an auditor should consider while determining whether an identified risk qualifies as a significant risk, as per the relevant standards on auditing. **(5 Marks)**
- (c) You have been appointed as the statutory auditor of AMRO Ltd., a listed entity. During the audit for the year ended 31st March 2025, you noticed that there are undisputed dues relating to GST and Provident Fund which have been outstanding for more than six months. Additionally, the company has not deposited certain amounts of income tax and excise duty which are under litigation before various appellate authorities. Discuss the reporting requirements of the auditor under Clause (vii) of CARO, 2020. **(4 Marks)**

**OR**

CA Sohail, while conducting statutory audit of a company, has noticed that there are items such as computer software, patents appearing in its books of accounts. These are identifiable non-monetary assets, without physical substance, held for use in the production or supply of goods or services, for rental to others, or for administrative purposes. He wants to ensure that such items are properly valued in financial statements of the company. Suggest few audit procedures to be performed by him in this regard. **(4 Marks)**