

INTER COURSE: GROUP II
PAPER-5: AUDITING AND ETHICS

(MTP 4: Ch. 3 – Risk Assessment and Internal Control)

Time Allowed- 20 Minutes

Maximum Marks-10

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 carry 2 Marks each.

1. **Statement I:** Program change controls help ensure that any modifications to the application software are properly authorised, tested, and implemented to prevent unintended impact on financial reporting.

Statement II: Access security controls ensure that only authorised personnel have the ability to modify critical system configurations, thereby reducing the risk of unauthorised alterations affecting financial data.

Which of the following is correct?

- (a) Both Statement I and Statement II are correct.
(b) Statement I is correct, but Statement II is incorrect.
(c) Statement I is incorrect, but Statement II is correct.
(d) Both Statement I and Statement II are incorrect.

Case Scenario [MCQ 2-5]

Suryanet Electronics Pvt. Ltd. ("the Company"), incorporated in 2014, is a medium-sized enterprise manufacturing home-automation devices such as smart plugs, Wi-Fi controllers and smart thermostats. The Company operates through one manufacturing unit located in Pune and sells through a network of distributors across India and through its own e-commerce website.

During FY 2023-24, the Company experienced rapid growth in online sales, accounting for 45% of total revenue (previous year: 28%). Online orders are received through the ERP-integrated website. Payment gateways are directly linked with the ERP system, and once payment is confirmed, the order is auto-approved. Dispatch, packing and invoice generation processes are automated, relying heavily on IT-system based controls.

The Company upgraded its ERP in August 2023 with the stated intention of improving real-time inventory tracking. However, during the transition, the internal audit reports noted mismatches in stock records, delays in updating stock quantities, and failure of automated reorder triggers. Two stores assistants resigned during this period, and newly hired personnel were still under training.

Suryanet also launched a new product line – “Smart Thermo Ultra” – which involves complex temperature-reading technology requiring estimation of warranty provisions due to chances of device overheating. The Company expects warranty claims of around 3.5% of sales of this new product. Management determined this rate based on internal testing but did not have sufficient past data, as this was the first year of launch.

Financial performance as per draft financials:

- Revenue: ₹154 crore (previous year: ₹102 crore)
- Gross profit margin: 28% (previous year: 32%)
- Inventory as at 31 March 2024: ₹22 crore (previous year: ₹17 crore)
- Warranty provision: ₹1.05 crore

Management's incentive structure includes achieving revenue growth above 50% and maintaining online sales volumes. If achieved, senior management receives a performance bonus of up to 20% of annual basic salary.

During preliminary discussions, the auditor, PR & Associates, noted the following points:

- (1) Limited documentation available for manual overrides of automated dispatch holds.
- (2) Access logs to ERP during August–September migration period indicated changes made to inventory modules by IT personnel but not documented in change-management records.
- (3) The Company relies on periodic warehouse cycle counts instead of full stock counts during the year.
- (4) Some distributors have complained of delayed replacements under warranty, indicating possible understatement of warranty provision.
- (5) Management estimates materiality at ₹1.5 crore (~1% of revenue), whereas auditors believe users focus on profit before tax due to management bonuses.

The auditor intends to perform a detailed risk assessment in line with SA 315, especially regarding the automated environment, and assess whether materiality needs revision in accordance with SA 320. Further, given the risks identified, the auditor considers designing responses as per SA 330 and evaluating Internal Financial Controls (IFC) over financial reporting, particularly controls around revenue recognition, inventory management, and estimation of provisions.

Based on the above facts, answer the following:

2. As PR & Associates evaluates risks of material misstatement for revenue generated through automated online sales, which of the following indicates a *significant* risk requiring specific audit attention under SA 315?
 - (a) Several online orders were processed automatically during the ERP migration period, and system overrides bypassed mandatory dispatch validations without keeping supporting documentation.
 - (b) The Company expanded its online customer base, increasing the number of transactions, but the pricing remained stable and uniform across product lines.

- (c) Management increased the sales targets for distributors, resulting in slightly higher receivables, though ageing still remains within policy limits.
- (d) The Company revamped its website homepage to improve customer interface, and the IT team confirmed testing was done before launch.
3. While determining materiality for planning purposes, the auditor notes that management suggested 1% of revenue as materiality. Which of the following BEST supports the auditor revising materiality downward in line with SA 320?
- (a) Revenue increased significantly from the previous year, indicating that applying 1% on higher revenue will automatically ensure that all material misstatements are identified.
- (b) Warranty provision for a newly launched product is supported by internal testing; therefore, risks are minimal, and materiality can remain at management's suggested level.
- (c) Management's bonus is linked to revenue growth and profitability, and misstatements below the suggested level may still influence users' economic decisions due to incentive-driven pressure.
- (d) Because inventory is ₹ 22 crore, the auditor should base materiality only on inventory value and not consider profit or revenue benchmarks at all.
4. According to SA 330, after identifying risks of material misstatement, which of the following is MOST appropriate as auditor's response?
- (a) Performing only substantive procedures for all areas regardless of assessed risks, as reliance on controls is optional and may delay audit completion.
- (b) Designing and performing further audit procedures that are responsive to assessed risks, including both tests of controls and substantive procedures based on nature and extent of identified risks.
- (c) Ignoring control deficiencies if they relate to automated environment because technology-based systems are assumed reliable by default.
- (d) Preparing management representation letters early in the audit and relying primarily on them to reduce substantive testing efforts.
5. Which statement BEST describes the auditor's responsibility regarding Internal Financial Controls (IFC) over financial reporting?
- (a) The auditor is only required to examine sophisticated operational controls such as production scheduling and raw material usage efficiency, as these directly contribute to profits.
- (b) The auditor can avoid evaluating controls if the entity uses advanced ERP systems because such systems inherently prevent misstatements.
- (c) The auditor focuses solely on management's documented policies and does not need to observe actual control operation during the year.
- (d) The auditor evaluates design and operating effectiveness of controls relevant to reliable financial reporting and uses results to determine nature, timing and extent of further audit procedures.

CA Inter – Auditing and Ethics

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Detailed Schedule of MCQ Test Series – Nov. 2025

Date	Day	Topic	MCQ Style	Marks
6 Nov.	Wed.	Ch. 1 - Nature, Objective and Scope of Audit	1 Case Study with 4 MCQ + 1 General MCQ	10
7 Nov.	Thu.	Ch. 11 - Ethics and Terms of Audit Engagements		10
8 Nov.	Fri.	Ch. 2 - Audit Strategy, Planning & Programme		10
10 Nov.	Mon.	Ch. 3 - Risk Assessment and Internal Control		10
12 Nov.	Wed	Ch. 4 - Audit Evidence		10
14 Nov.	Fri.	Ch. 6 - Audit Documentation		10
17 Nov.	Mon.	Ch. 5 - Audit of Items of Financial Statements		10
19 Nov.	Wed	Ch. 7 - Completion and Review		10
24 Nov.	Mon.	Ch. 8 - Reporting		10
26 Nov.	Wed	Ch. 9 - Audit of Different Types of Entities		10
28 Nov.	Fri.	Ch. 10 - Audit of Banks		10

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2	Ch. 2 - Audit strategy, Planning and Programme	29 Nov. 2025
	Ch. 3 - Risk Assessment and Internal Control	
3	Ch. 4 - Audit evidence	03 Dec. 2025
	Ch. 6 - Audit Documentation	
4	Ch. 5 - Audit of Items of Financial Statements	06 Dec. 2025
5	Ch. 7 - Completion and Review	10 Dec. 2025
	Ch. 8 - Audit Report	
6	Ch. 9 - Sp. features of Audit of Different Entities	13 Dec. 2025
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