

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

Jin Kushal & Associates is a firm of Chartered Accountants practicing in Delhi. The firm consists of two partners namely, CA Jin and CA Kushal. The Statutory audit team is generally headed by CA Jin and his team consists of three articled assistants and one qualified Chartered Accountant, CA Reshu. With respect to the audit work of 4 clients for which the audit team intends to start the audit work, CA Jin discussed with the team members about the development of audit programmes for individual clients. One of the articled assistants, Mr. Sumit, was of the view that one single audit programme can be developed for all the 4 clients operating in different industries.

With respect to one of the clients namely, Saraswati Ltd., a labour-intensive company, CA Jin asked CA Reshu to compare the amount of wages paid by the company in the current year and last year. Also, she was asked to verify the relationship between the number of employees and wages paid in both the years by the company.

The audit firm started the audit of another client, namely, Sarthak Ltd. having maximum transactions in foreign currency. CA Jin asked one of the team members, Mr. Rahul, to verify whether the calculations related to conversion of the foreign currency into local currency is proper or not.

While verifying the share issue transactions of one client, namely, Laxman Ltd., CA Reshu found that the company has issued sweat equity shares during the year under audit. She asked one of the articled assistants, Mr. Saurabh, to further verify whether the relevant provisions of the Companies Act 2013, have been complied by the company in this regard. Also, with respect to Sarthak Ltd., there was reduction of share capital during the year. Mr. Saurabh was asked by

the engagement partner to verify the compliance of relevant provisions of the Companies Act, 2013 in this regard also. Mr. Saurabh was of the view that there is requirement of passing of Special Resolution by the respective company for both.

While starting the audit work of another client, Rintex Ltd., the audit team noticed that the company has its internal audit team. Mr. Sumit was of the view that the statutory audit team can use and rely on the work of the Internal Auditors of the company and as such there is no requirement for the statutory audit team to perform audit procedures again as the internal audit team must have verified the financial transactions of the company in detail. Further, while verifying the expenses ledger, Mr. Sumit noticed that the company has implemented a system whereby the entries related to expenses incurred during the year can be entered into the accounting system by authorised personnels only. However, with respect to travelling expenses which constituted about 30% of the total expenses, the entries were made by employees who were not authorised to make such entries.

Based on the above facts, answer the following: -

1. Is the view of Mr. Sumit with respect to the development of audit programme correct?
 - (a) Yes, the view of Mr. Sumit is correct as developing one audit programme for all the clients will avoid duplication of efforts of audit team.
 - (b) No, the view of Mr. Sumit is not correct as all the four clients operate in different industries and evolving one audit programme for all businesses is not practicable.
 - (c) Yes, the view of Mr. Sumit is correct as development of audit programme is not affected by the nature of client business.
 - (d) No, the view of Mr. Sumit is not correct as development of audit programme is not the responsibility of the audit team. The individual clients will develop their respective audit programmes.
2. Identify the audit procedures Ms Reshu was asked by CA Jin to perform with respect to Saraswati Ltd.
 - (a) Substantive Analytical Procedures.
 - (b) Test of details.
 - (c) Test of transactions.
 - (d) Test of Controls.
3. Whether understanding of Mr. Saurabh regarding the passing of Special Resolution is correct?

- (a) The understanding of Mr. Saurabh is partly correct as ordinary resolution is required in case of issue of sweat equity shares by the company though special resolution is required to be passed by the company in case of reduction of share capital.
 - (b) The understanding of Mr. Saurabh is partly correct as special resolution is required in case of issue of sweat equity shares by the company though ordinary resolution is required to be passed by the company in case of reduction of share capital.
 - (c) The understanding of Mr. Saurabh is correct as special resolution is required in case of issue of sweat equity shares by the company and reduction of share capital.
 - (d) The understanding of Mr. Saurabh is not correct as ordinary resolution is required in case of issue of sweat equity shares by the company as well as in case of reduction of share capital.
4. Is the view of Mr. Sumit correct with respect to using and relying on the work of the Internal Audit team of Rintex Ltd.?
- (a) Yes, the view of Mr. Sumit is correct.
 - (b) No, the view of Mr. Sumit is not correct as the statutory audit team cannot use the work of the internal audit team of the client company.
 - (c) No, the view of Mr. Sumit is not correct as the statutory auditor has the sole responsibility for the audit opinion expressed.
 - (d) The view of Mr. Sumit is partly correct as the statutory audit team can use and rely on the work of the internal audit team if the same is agreed while signing the engagement letter.
5. Identify the type of risk noticed by Mr. Sumit with respect to entries related to travelling expenses entered into the accounting system of Rintex Ltd.
- (a) Inherent Risk.
 - (b) Detection Risk.
 - (c) Control Risk.
 - (d) Audit Risk.

Case Scenario 2

MA & Associates, a Chartered Accountant firm is appointed as an auditor of XYZ Pvt. Ltd. Amit, partner of the firm, has recently bought stock in XYZ Pvt. Ltd. He believes that the company's goodwill will increase after the audit report is finalised, which could lead to a rise in stock price. As he reviews the company's financial statements, Amit decides to give unmodified opinion to help his investment.

During the audit of trade receivables, Amit selects a sample using a technique that ensures larger balances have a higher chance of being selected. However, this approach results in the exclusion of many smaller balances, potentially overlooking some crucial misstatements.

Meera, another Partner of Firm, is reviewing calculation of software development costs method adopted by XYZ Pvt. Ltd. Meera helped in creating this method earlier. She worries that her previous involvement in this method might affect her ability to review it.

Meanwhile, Raj, the CEO of XYZ Pvt. Ltd., has requested them to modify certain disclosures in the financial statements in a way that could mislead stakeholders. He argues that a more favourable presentation will help the company secure additional investments. Meera feels that complying with this request would compromise ethical standards and worries about potential conflicts with the client.

Based on the above facts, answer the following: -

6. Amit has bought stock in XYZ Pvt. Ltd., and his investment could benefit from issuance of unmodified opinion in his audit report. This indicate existence of:
 - (a) Self-interest Threat.
 - (b) Self-review Threat.
 - (c) Advocacy Threat.
 - (d) Familiarity threat.

7. In the given case, Amit is selecting a sample to verify the trade receivables balances where larger balances have a higher chance of being included, causing smaller balances to be overlooked. This method is known as:
 - (a) Random Sampling.
 - (b) Systematic Sampling.
 - (c) Block Sampling.
 - (d) Monetary Unit Sampling.

8. Meera is reviewing a method for calculating software development costs that she helped in creating while working at XYZ Pvt. Ltd. This may involve:
- (a) Advocacy Threat.
 - (b) Self-interest Threat.
 - (c) Familiarity Threat.
 - (d) Self-review Threat.
9. Raj, the CEO, is requesting the Meera and Amit to modify the financial statement disclosures in a misleading manner. Which fundamental principle of professional ethics would be violated if they agree to do so?
- (a) Integrity.
 - (b) Objectivity.
 - (c) Confidentiality.
 - (d) Professional Competence and Due Care.

Case Scenario 3

A government department was allocated a specific budget for infrastructure development projects during the current financial year. During the audit process, the auditor reviewed the department's expenditure and management of funds and found several discrepancies that raised significant concerns regarding the management and utilisation of the allocated funds. The key findings from the audit were as follows:

- Several payments were processed without obtaining the necessary approval from the competent authority.
- The department implemented a large-scale project. However, the audit found no record of assessment being conducted to determine whether the project achieved the expected benefits.
- Another serious concern identified during the audit was the utilisation of funds from an account that had no budgetary provision was made.

The auditor now needs to determine which type of audit would be most effective in addressing each of these concerns.

Based on the above facts, answer the following: -

10. Which type of audit is most likely to identify payments processed without proper approval from the competent authority?
 - (a) Audit against Rules & Orders.
 - (b) Audit of Sanctions.
 - (c) Audit against Provision of Funds.
 - (d) Propriety Audit.
11. Identify the type of audit to evaluate whether the expected benefits of a large-scale infrastructure project were achieved or not.
 - (a) Propriety Audit.
 - (b) Audit against Rules & Orders.
 - (c) Audit of Sanctions.
 - (d) Performance Audit.
12. Which type of audit addresses the issue of funds being used from an account without a budgetary provision?
 - (a) Audit against Provision of Funds.
 - (b) Audit of Sanctions.
 - (c) Performance Audit.
 - (d) Audit against Rules & Orders.

MCQs

13. PQR Ltd., a manufacturing company, has been facing operational challenges. Recently, they struggled to find essential raw materials due to supply chain disruptions. This shortage has significantly impacted production, leading to delays in fulfilling customer orders. The company's financial health has also deteriorated, with declining cash flows leading to inability to pay creditors on time. Additionally, key financial ratios have worsened, and the company has stopped paying dividends to shareholders due to liquidity concerns.

Given this situation, which of the following is not a financial event or condition that may cast significant doubt on the entity's ability to continue as a going concern?

- (a) Adverse key financial ratios.
 - (b) Inability to pay creditors on time.
 - (c) Shortages of important supplies.
 - (d) Arrears or discontinuance of dividends.
14. AMN Ltd. has capitalised a software as an intangible asset in its financial statements. To verify whether the software is actively in use, the auditor reviews the sale of goods and services that rely on this software during the audit period. Which assertion regarding intangible assets is the auditor verifying?
- (a) Completeness.
 - (b) Valuation.
 - (c) Disclosure.
 - (d) Existence.
15. ABC Ltd. appointed CA Jai to conduct the statutory audit. During the audit, the auditor identified some errors in the financial records and he got it corrected. The audited statements were then submitted to tax authorities for compliance purposes. The audit procedures also helped the company improve its record-keeping processes. However, the management assumed that since the financial statements were audited, they could be used to predict future profits with certainty. In view of above, which of the following is not a likely benefit of auditing?
- (a) Since auditing is connected to future events, audited information can be easily relied upon by users.
 - (b) Errors or frauds may be discovered during audit.
 - (c) Government authorities can make use of audited accounts for different purposes.
 - (d) It can help in bringing out deficiencies in maintenance of financial records.

PART II - Descriptive Questions

Question No. 1 is compulsory.

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

1. (a) CA T is the statutory auditor of QRS Ltd. While performing testing of additions during the year, he wanted to verify that:
- (i) All PPE (property, plant and equipment) are in the name of the entity he is auditing.
 - (ii) For all additions to land and building in particular, the auditor desires to have concrete about the ownership.
 - (iii) CA T also wants to know whether the entity has valid legal ownership rights over the PPE, where it is kept as security for any borrowings.

Advise the auditor CA T on the audit procedure to be undertaken by him to establish the Rights and Obligations of the entity over the PPE. **(5 Marks)**

- (b) Sigma Ltd. has approached CJK & Associates to appoint them as their auditor for a period of 5 years in accordance with provisions of the Companies Act, 2013. The prospective client company is new to audit firm. SQC 1 requires that a firm before accepting engagement should inquire vital information about the client which helps firm to decide about integrity of client. Apart from integrity, obtaining such vital information about client is helpful to audit firm in deciding about which other matters? Which matters would be considered by audit firm with regard to integrity of client? **(5 Marks)**

- (c) CA Yash is conducting audit of a company for year 2023-24. The company is engaged in export of ethnic rugs to buyers in Europe. The audit is nearing completion in month of July 2024. However, it becomes known to the auditor that one of overseas buyers has made a legal claim against the company on 1st June 2024 for injury caused to a customer of one European buyer due to sub-standard dyes used in rugs of one lot of order shipped in August, 2023. The management of company has decided to agree to an out of court settlement of ₹ 5 crore to protect its reputation. The financial statements of the company are silent on this issue. Discuss, how, CA Yash should proceed to deal with above issue.

(4 Marks)

2. (a) Significant risks often relate to significant non-routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty.
- In context of significant risk, explain the factors to be considered by the auditor in exercising judgment as to which risks are significant risks. **(5 Marks)**
- (b) No inspection under Section 79 of Multi-State Co-operative Societies Act, 2002 shall be made unless a notice has been given to the multi-state co-operative society. Explain clearly when and how such inspection can be made. Also state the powers available with the Central Registrar in this regard along with provisions relating to communication of the inspection report under the said section.
- (5 Marks)**
- (c) As the auditor of CRT Ltd., a construction company, for the year 2023-24, you are preparing an audit programme to systematically guide the audit procedures. A well-structured audit programme not only ensures efficient execution but also serves as documentary evidence in case of any allegations of negligence against the auditor. In this context, briefly explain advantages of audit programme that will support the auditor during the audit of CRT Ltd. **(4 Marks)**
3. (a) 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. 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. Analyse and Explain. **(5 Marks)**
- (b) A deficiency or combination of deficiencies in internal control that, in the auditor's professional judgment, is of sufficient importance to merit the attention of those charged with governance. Give examples of indicators of significant deficiencies in internal control. **(5 Marks)**
- (c) During an audit of MNT Ltd., CA Shubh, the auditor discovers an issue with stock valuation. To ensure the accuracy and reliability of his observations, CA Shubh needs to document the audit procedures, evidence collected, and his observations thoroughly.

In this situation, how does audit documentation help CA Shubh support his findings in audit in accordance with Standards on Auditing? **(4 Marks)**

4. (a) 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. Explain.

(5 Marks)

- (b) Jay & Associates, a Chartered Accountant firm is appointed as an auditor of XYZ Ltd., a manufacturing company with multiple branches across the region. CA Jay, Partner in firm, is conducting the audit of financial statements of XYZ Ltd. for the financial year 2023-24. As the lead auditor assigned to this engagement, Jay is responsible for planning the audit in accordance with SA 300. Briefly explain why it is necessary to plan the audit of XYZ Ltd.'s financial statements? **(5 Marks)**

- (c) While conducting the audit of Pummy Limited, the statutory auditors collected written representations from the Management. The audit was finalised in addition to other audit procedures but, without making any inquiries, as the statutory auditors were short of time. In the light of this information, elaborate "inquiry" as one of the methods of collecting Audit Evidence. **(4 Marks)**

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. Explain the broad considerations about which the auditor is primarily concerned with obtaining evidence in carrying out audit of advances. **(5 Marks)**

- (b) WEQ Ltd. has issued shares for cash at a premium. In accordance with section 52 of the Companies Act, 2013, the company is required to transfer the premium received from the issuance of shares to the securities premium account. What are the specific applications allowed for the funds in the securities premium account, as per the provisions of the Companies Act, 2013? **(5 Marks)**

- (c) An audit is a reasonable assurance engagement, whereas a review is a limited assurance engagement. Both types of assurance engagements provide assurance to users, but they differ in the degree of assurance offered.

In light of this, explain the difference between reasonable assurance engagements and limited assurance engagements, with examples. **(4 Marks)**

6. (a) CA T, the statutory auditor of a company, is in the process of designing external confirmation requests to be sent to trade receivables outstanding as of March 31, 2024. As properly designed confirmation requests are essential to ensure the reliability and effectiveness of the audit evidence obtained. Further, well-structured requests help in reducing the risk of misstatements, non-responses, or misunderstandings by the recipients.

In this context, explain why designing a proper confirmation request is necessary and discuss the key factors an auditor should consider when designing confirmation requests. **(5 Marks)**

- (b) 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.

Explain the same in view of above. **(5 Marks)**

- (c) SKN Ltd. a biopharma company and global manufacturers of select critical care medical products has been sanctioned working capital limits of ₹ 5.99 crores from a nationalized bank on the basis of security of current assets. During the year under audit, the statutory auditor of SKN Ltd. considers that inventory is material to the financial statements and performs audit procedures over the company's final inventory records to determine whether they accurately reflect actual inventory count and without any major discrepancies for each class of inventory. What are the reporting requirements regarding physical verification of inventory under CARO 2020 in this case? **(4 Marks)**

OR

SRT Pvt. Ltd., based in Mumbai, is engaged in export of brassware goods. The company has huge export receivables as on 31st March 2024. It is also analysed from Export Sales account of the company that large number of small shipments were almost despatched daily during the month of March 2024. The auditor is ensuring that all goods despatched prior to the year-end have been invoiced. Which assertion concerning trade receivables is being verified by auditor? List out few audit procedures you would adopt as an auditor to verify this assertion.

(4 Marks)