

MTP 2 (Ch. 3 – Audit Planning, Strategy and Execution & Ch. 4 – Materiality, Risk Assessment and IC)

Marks: 40

Time: 1 Hr. 15 Minutes

Instructions: Part A comprises of MCQ.

Part B Comprises of descriptive questions.

Part – A (Multiple Choice Questions)

Case Scenario - 1

Midas MicroFinance & Digital Lending Ltd. (“MMDL”) is a prominent digital lending platform that provides AI-based micro-credit to small merchants across India. For the year ended 31 March 2027, the company reported a total digital loan book of ₹ 1,250 crore, representing a growth of nearly 33% over the previous year. Of this amount, ₹ 138 crore constituted loans overdue for more than 90 days, which was a significant increase compared to ₹ 92 crore in the previous year. Historically, the company's default rate over the past five financial years averaged around 9.5%. However, management revised its default probability assumption for the current year to 6.2%, citing “improvement in customer repayment behaviour” as well as “stronger AI-driven customer analytics”, though no formal supporting documentation or detailed evidence was provided to substantiate this claim.

During the year, MMDL implemented a major technological upgrade through the introduction of a new machine learning (ML) model for Expected Credit Loss (ECL) computation. This model was recalibrated on 15 December 2026 after mid-year system migration. Immediately following the recalibration, the ECL estimated by management reduced sharply by ₹ 36 crore and resulted in a closing ECL provision of ₹ 78 crore for the year. A review of model documentation by the statutory auditor revealed incomplete version-control logs, insufficient evidence of testing of revised parameters, and lack of documentation supporting the rationale behind the mid-year changes. Furthermore, management used a data science consulting firm to validate the model, paying them a fee of ₹ 40 lakh. The consultant had based conclusions on only four months of data and had not reconciled assumptions with the long-term historical default trend or macroeconomic indicators.

During his risk assessment, CA Zubin noted increasing estimation uncertainty, inadequate internal control documentation, and evidence of possible management bias. His preliminary recalculation of ECL, based on a conservative re-analysis of default probabilities and actual recovery trends, indicated a provision of approximately ₹ 112 crore. This contrasted starkly with the ₹ 78 crore provision recorded by management. To address the complexity of AI-based modelling and blockchain-backed customer data migration, he engaged an independent auditor's expert specialising in credit-risk analytics. The expert observed that recovery rates during January–March 2027 were overstated owing to incomplete upload of customer repayment data and concluded that the provision shortfall likely ranged between ₹ 28 crore and ₹ 42 crore. These findings aligned with the auditor's preliminary recalculations and indicated potential material misstatement in loan impairment.

Considering the significant increase in overdue loans, lack of adequate documentation for model changes, doubts about management's assumptions, questionable internal audit competence, and expert findings, CA Zubin revised the overall audit strategy. He reduced materiality for the loan impairment area, expanded sample sizes, planned additional substantive and recalculation procedures, and communicated these changes to those charged with governance.

He also concluded that reliance on the work of internal auditors was not appropriate and that additional engagement with his own expert was required in accordance with the auditing standards. Before forming his final opinion, he evaluated whether sufficient appropriate audit evidence had been obtained and whether disclosures about model recalibration and underlying assumptions were adequate in the financial statements.

Based on the above facts, answer the following:

- Q.1** On observing that the ECL reduced by ₹ 36 crore immediately after model recalibration and that documentation was incomplete, how should the auditor respond under SA 300? **2**
- (a) Update the overall audit strategy by revising materiality levels, expanding substantive procedures and reconsidering the timing of detailed testing due to unexpected events.
 - (b) Maintain the original audit plan because mid-year recalibration is part of normal business processes in digital lending.
 - (c) Rely on management's expert to validate the adequacy of documentation and proceed with planned audit procedure.
 - (d) Conclude that reliance on analytical procedures alone is sufficient since default rates have historically been stable.
- Q.2** Management reduced default probability from 9.5% to 6.2% without evidence and used incomplete model data. Auditor's and expert's calculations indicate ECL should be around ₹ 112 crore. What is the correct approach under SA 540? **2**
- (a) Treat this as a high-risk estimate, evaluate management's assumptions for reasonableness, and assess indicators of possible management bias.
 - (b) Accept management's assumptions because they engaged a professional data science expert.
 - (c) Average the auditor's and management's estimates to arrive at a balanced provision figure.
 - (d) Conclude that the estimate is immaterial compared to total loan book of ₹ 1,250 crore.
- Q.3** The auditor's expert concludes that ECL is understated by ₹ 28 - ₹ 42 crore. What is the auditor required to do under SA 620? **2**
- (a) Accept the expert's conclusion automatically since the expert is more knowledgeable in the field.
 - (b) Evaluate the adequacy of the expert's work, corroborate findings with additional evidence and consider implications for audit opinion.
 - (c) Ask management's expert to validate the auditor's expert's work and rely on whichever report is more favourable.
 - (d) Remove ECL from audit scope as experts have conflicting views and focus only on disclosures.

Case Scenario - 2

Zenovia Life Sciences Ltd. (ZLSL) is a listed pharmaceutical manufacturing company with three plants located across India. As part of a strategic restructuring, the company has recently migrated from a partially automated ERP module to a fully integrated ERP system covering procurement, inventory management, production scheduling, quality control, batch tracking, sales, and financial reporting. The new ERP went live mid-year, after a four-month pilot run. Management claims the system has “cut processing errors by half,” though no formal post-implementation review has been conducted.

The internal audit department, which earlier consisted of two senior officers, expanded to a team of five, including two external consultants. Management now conducts quarterly meetings of the Audit Committee, but minutes reveal these meetings focus heavily on financial performance and less on internal control evaluations. Further, the Internal Auditor’s quarterly compliance report highlights persistent delays in generation of GRNs (Goods Receipt Notes) and mismatches between GRNs and supplier invoices, particularly at the Hyderabad plant.

The procurement process underwent redesign as part of the ERP implementation. Purchase requisition approvals are now routed through automated workflow, though it has been noted during walkthroughs that the system allows manual override of approval limits for emergency purchases. Plant Supervisors have been given “temporary elevated rights” to authorize purchases up to ₹ 25 lakhs - a limit significantly higher than the delegation matrix outlined in the company’s SOP for purchase operations.

In the previous year, ZLSL received observations from Statutory Auditors under SA 265 regarding two significant deficiencies: (i) lack of segregation of duties between inventory custodians and store ledger personnel; and (ii) untimely reconciliations between physical inventory and system records. Management had committed to implement corrective controls but internal audit follow-up reports indicate partial closure only. Further, surprise physical verification conducted by internal auditors in the current year revealed differences in batch-wise expiry reporting due to outdated manual records maintained parallel to the ERP system. www.altclasses.in

As the Statutory Auditor, you are examining the company’s controls over financial reporting, operational processes and compliance. You are required to identify residual risks, weaknesses and deficiencies in the internal control environment and design your audit response accordingly.

Based on the above facts, answer the following:

- Q.4** During your review, you note that the Audit Committee conducts quarterly meetings, but deliberations primarily focus on financial performance indicators instead of control effectiveness. Which COSO component is most directly impacted by this weakness? **2**
- (a) Control Environment – Because governance tone is weak and top management is not emphasising internal control responsibilities effectively.
 - (b) Information & Communication – Since the ERP reports are not being communicated regularly to the Audit Committee.
 - (c) Monitoring Activities – Because periodic reviews of control implementation and follow-up on deficiencies are inadequate.
 - (d) Control Activities – As transaction-level control procedures are being bypassed due to lack of supervisory review.

- Q.5** During testing of procurement controls, you observe that Plant Supervisors have been given temporary elevated rights to approve purchases far beyond the delegation limits specified in the SOP. What should be the most appropriate internal control response when performing SOP-based assessment? **2**
- (a) Recommend immediate removal of elevated rights and require re-design of access control matrix, ensuring only defined levels hold authorization powers as per SOP.
 - (b) Rely on later review by CFO as the supervisory review compensates the risk of override.
 - (c) Suggest documenting emergency purchase approvals manually without altering ERP access settings.
 - (d) Continue testing as designed since elevated rights are temporary and not material to risk.
- Q.6** In the context of SA 265, which of the following situations most appropriately represents a significant deficiency requiring communication to Those Charged with Governance? **2**
- (a) Consistent failure to perform periodic physical inventory verification, despite prior-year auditor recommendations, resulting in unresolved mismatches.
 - (b) One-off delay in posting of GRNs due to system downtime, corrected within the next working day.
 - (c) Isolated error in supplier invoice data entry, detected and rectified during monthly reconciliation.
 - (d) Temporary staff shortage leading to delayed review of exception reports, resolved within a fortnight.

Part B (Descriptive Questions)

Attempt Any two Questions from the rest.

- Q.1** (a) STU & Associates have been the statutory auditors of the listed company "First and Last Ltd.," operating in the petrochemical industry, for the past three years. CA. K, the engagement partner, had designed certain substantive procedures on some selected assertions in response to the assessed risk of material misstatements for the year under audit. These particular assertions were not examined by him in previous years due to materiality or risk considerations. **5**
- Mr. X leads the internal audit department of the company and reports to the company's audit committee. During the course of audit, a senior member of the engagement team decides to engage Mr. X for providing direct assistance in performing the above substantive procedures. Comment with respect to the relevant Standards on Auditing.
- Also, indicate the activities to be performed by the statutory auditor prior to using internal auditor for providing direct assistance.

- (b) New life Hospital is a multi-speciality hospital which has been facing a lot of pilferage and troubles regarding their inventory maintenance and control. On investigation into the matter, it was found that the person in charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. According to you, which basic system control has been violated? Also list down the other general conditions pertaining to such system which needs to be maintained and checked by the management. 5
- (c) During the course of audit of Fortune Ltd., CA Prasad is concerned with the quality and effectiveness of internal control. Towards achieving his objective, he wants to assess and evaluate the control environment. Guide CA Prasad with well-defined set of the Standard Operating Procedures in the assessment and evaluation of control. 4
- Q.2** (a) While assessing the impact of uncorrected misstatements in the audit of Manhattan Constructions Private Limited, Mr. Sushil encountered a significant issue related to the calculation of materiality on Sales. The initial materiality calculation was based on estimated figures provided by the management. Notably, during the estimation of full-year sales, the management extrapolated from the actual amount of 11 months to derive the 12 months of sales. However, given the nature of Manhattan Constructions as a company in the construction sector, where monthly sales exhibit substantial variations, a unique challenge emerged. 5
- The actual sales for the last month deviated significantly from the estimated sales due to an unforeseen increase in stamp duty rates imposed by the government in that region. As a result, the last month's actual sales represented only 25% of the estimated sales. Now, Mr. Sushil is confronted with a dilemma regarding the appropriate approach to evaluate uncorrected misstatements using the previously calculated materiality. Kindly Guide Mr. Sushil in the light of relevant Standards on Auditing.
- (b) CA A has been appointed as an auditor of Datacom Ltd. to conduct statutory audit. The company has various derivative contracts - options, forward contracts, interest rate swaps etc. which were required to be fairly valued for which company got the fair valuation done through an external third party. CA A involved a registered valuer Mr. S as an auditor's expert to do the valuation of derivatives in order to obtain sufficient appropriate audit evidence. CA A and Mr. S are new to each other and they were working for the first time. Mr. S performed his work and submitted the report. CA A, while evaluating the adequacy of the work of Mr. S, observed that expert's work involved use of significant assumptions and methods. Consequently, he wants to test the relevance and reasonableness of those assumptions and methods in the applicable circumstances. Guide CA A in this regard as per relevant Standard on Auditing. 5

- (c) Y & Co., Chartered Accountants have come across in the course of audit of a company that certain machinery had been imported for production of new product. Although the auditors have applied the concept of materiality for the financial statements as a whole, they now want to re-evaluate the materiality concept for this transaction involving foreign exchange. Give your views in this regard. 4

- Q.3 (a) BETA Ltd is engaged in the Construction business since year 2001. The auditor understands that a thorough construction estimate is vital to the viability of any construction business and requested the information related to financing and operating estimated costs from the management to review the outcome of accounting estimates included in the prior period financial statements and their subsequent re-estimation for the purpose of current period. 5

The management refused to provide the information to the auditor as it believed that the judgments and estimates made in the prior periods were based on the information available at that time, and the review of the prior period information should not be done by the auditor in the current financial year. With reference to the relevant SA, comment on whether the contention of management is correct or not.

- (b) CA Q is the engagement partner for the statutory audit of LAL Ltd. While conducting the audit he has identified some deficiencies in the internal controls. On further verification of the internal controls of the company, he has some indications that significant transactions in which management is financially interested are not being appropriately scrutinised by those charged with the governance and also in few cases he observed the susceptibility to loss of an asset. He determines, on the basis of the audit work performed, that identified deficiencies constitute significant deficiencies. How and to whom CA Q shall communicate identified significant deficiencies in the internal control? Which matters shall be included by CA Q in such communication? 5

- (c) CA Subhadra, an engagement partner in SRT & Associates, is conducting the statutory audit of MBI Ltd., an unlisted manufacturing company with 96 production and sales units spread across the country. These units are audited by different branch auditors. In respect of one major unit audited by a branch auditor, there were significant inventory valuation errors and misstatements in cost allocations, which were not reported by the branch auditor. The branch auditor submitted a NIL report without suggesting any modifications. 4

During overall review of financial statements of Company by statutory auditor, the above said errors did not come into light. The statutory auditor had also called soft copies of internal inspection reports etc. of above branch as part of overall review procedures. However, these reports did not point towards any concern or irregularities in the inventory or costing practices. Would the statutory auditor of the Company be liable for above lapses? What precautions have to be taken by him while expressing opinion considering possibilities of such situations?

Instructions for Self-Evaluation

Suggested Answers and Marking Scheme will be available at Knowledge Portal/ LMS of

<https://altclasses.in/paper-3-advanced-auditing-mock-test-papers/>

Link for Resources (Revision Videos, MTPs, Amendments, Charts, etc.) and Inquiries			
1	Youtube Channel	https://www.youtube.com/@altclassesca9193	 www.altclasses.in
2	Telegram Channel	https://t.me/altclasses	
3	Whatsapp Group for Doubts	https://chat.whatsapp.com/LSDM362gjy2ErmRgTi7ceA	
4	LMS Link	https://altclasses.in/knowledge-forum-ca-final/	
5	E-mail Id	altclasses11@gmail.com	 ALT CLASSES A venture of Pankaj Garg
6	Contact Number	9319805511, 7206941195	
7	Website Link	https://altclasses.in/	



Final Audit - Chapter-wise Mock Tests (For Nov. 2026 Exams)

Test No.	Chapter No. and Name	Date
WT - 1	Ch. 1 - Quality Control	14.08.2026
	Ch. 2 - General Auditing Principles & Responsibilities	
WT - 2	Ch. 3 - Audit Planning, Strategy & Execution	22.08.2026
	Ch. 4 - Materiality, Risk Assessment & Internal Control	
WT - 3	Ch. 5 - Audit Evidence	29.08.2026
	Ch. 6 - Completion & Review	
WT - 4	Ch. 7 - Reporting	05.09.2026
	Ch. 8 - Specialised Areas	
WT - 5	Ch. 9 - Related Services	12.09.2026
	Ch. 10 - Review of Financial Info.	
	Ch. 11 - PFI & Other Assurance Services	
WT - 6	Ch. 12 - Digital Auditing and Assurance	19.09.2026
	Ch. 13 - Group Audits	
WT - 7	Ch. 14 - Audit of Banks & NBFC	26.09.2026
	Ch. 15 - Audit of PSU	
WT - 8	Ch. 16 - Internal Audit	03.10.2026
	Ch. 17 - DD, Investigation & Forensic Accounting	
WT - 9	Ch. 18 - SDG & ESG Assurance	10.10.2026
	Ch. 19 - Professional Ethics & Liabilities of Auditor	
WT - 10	Full Syllabus Test	17.10.2026