

Intermediate Course: Group – II**(Mock Test Paper : 1)****DATE: 06.08.2024****MAXIMUM MARKS: 100****TIMING: 3¼ Hours****PAPER 5 : AUDITING AND ETHICS****DIVISION – A (MULTIPLE CHOICE QUESTIONS)****Case Scenario 1 carries 10 Marks****Case Scenario 2 carries 08 Marks****Case Scenario 3 carries 06 Marks****General MCQs (3 MCQs x 2 Marks Each = 06 Marks)****Total 30 Marks****Q. 1 to Q. 5:****CASE SCENARIO 1:**

- M/s TPR & Associates have been appointed as the auditors of Octopus Ltd. for the Financial Year 2021-22.
- During the course of audit, the auditor notices that there is significant change in the number of debtors of the company. The auditor decided to check the debtors account in detail.
- Further the company has made various provisions like the provisions for taxation, provision for bad & doubtful debts.
- Also, during the current Financial Year, the auditor attended the physical verification of the inventory being carried out by the management.
- The auditor notices that there is no substantial change in the bifurcation of amount of items representing the liability side of the balance sheet of Octopus Ltd. Still the auditor understands that he needs to check the liability side in detail.
- Further the company has also recognised various incomes like interest income and dividend income which auditor understands need to be checked in detail.
- The auditor is of the understanding that certain matters need to be reported under Companies Auditors Report Order (CARO).

Based on the above facts, answer the following:-

1. _____ is a possible obligation that arises from the past events and whose existence will be confirmed only by the occurrence/ non occurrence of one or more uncertain future events not wholly within the control of the entity:-
 - (a) Provision
 - (b) Reserve
 - (c) Contingent Liability
 - (d) Liability
2. Which of the following is not correct with respect to the inventory held by Octopus Limited:-
 - (a) All inventory units held by the company should have been recorded and recognized in the financial statements.
 - (b) Any inventory held by a third party on behalf of the company should not be included as part of the inventory balance.
 - (c) Inventory should be recognized at cost or net realizable value whichever is lower.
 - (d) Inventory balance as at the year end does not include any element of next year.

3. If the management of Octopus Ltd. refuses to allow the auditor, to send the confirmation request to the debtors, the auditor should:-
- Withdraw from the engagement.
 - Not listen at all to any requests of the management.
 - Consider the management's request for refusal and assess its validity and decide the nature, timing, extent of his audit procedures accordingly.
 - Agree to management request and proceed with audit of other items of the financial statements.
4. Which of the following statements is not true so far as the liabilities of a company are concerned:-
- Liabilities are the financial obligations of a company including owner's funds.
 - Liabilities include borrowing, trade payable and other current liabilities and provisions.
 - Verification of liabilities is as important as that of assets.
 - All of the above.
5. Statement 1: Confirmations as well as undelivered letters should be given/ returned to the auditor and not to the client
Statement 2: When no reply is received, the auditor should perform alternate procedures regarding the balances.
- Only statement 1 is correct
 - Only statement 2 is correct
 - Both 1 & 2 are correct
 - Both 1 & 2 are incorrect

MCQ [5 MCQ of 2 Marks Each : Total 10 Marks]

Q. 6 to Q. 9:

CASE SCENARIO 2:

Sun Private Limited is a newly formed private limited company, engaged in the manufacturing of solar panels. Company has appointed M/s M&S Associates, a Partnership Firm of Mr Meticulous and Mr Sincere - as their First Auditors. M/s M&S Associates accepted the assignment and Mr Meticulous being the engagement Partner, started their Audit.

During the course of Audit, Mr Meticulous asked the Management for name of the companies operating in similar business so that they can compare the Company's Figures. During this procedure, Mr Meticulous found that the Gross Margin of the Company is lower than the Industry Standard / Fellow Companies. He prepared an Interim Report dealing with this matter and asked the Management about the reasons for this deviation. Management asked him to give all the working along with the Working Papers as they believed it is the Company's Property. Mr Meticulous advised them that he can provide working but cannot give them the working papers as they are the property of the Firm.

Management agreed to that and asked Mr Meticulous to go into detail and tell him the reasons for lower Gross Margin to which he agreed. During the detailed audit, Mr Meticulous came to know about the fact that the company dispatched its solar panels to its Distributors on Delivery Challans and once the goods were accepted, Sales bills were raised. Checking each Challan against Sales Invoices, Mr Meticulous found that there were many challans for which no Invoices were raised and thus Sales was grossly understated and there was no mechanism where unbilled Challans were recorded or tracked. Company employed a person to reconcile all the Challans and prepared a list where Bills are yet to be sent to the Customers. In addition, Company was also asked to seek Confirmation of Balances from all its Customers. The Management assured Mr Meticulous that Inventories are physically verified and hence there will be no impact on them.

6. Mr Meticulous asked about other Companies, he was intending to perform which audit procedure?
 - (a) Analytical Procedures
 - (b) Substantive Procedures
 - (c) Random Sampling
 - (d) Statistical Sampling

7. What was the initial procedure carried on by Mr Meticulous?
 - (a) Trend Analysis
 - (b) Ratio Analysis
 - (c) Statistical Modelling
 - (d) Random Sampling

8. Who has the right to retain the audit working papers of the Company in current case?
 - (a) Audit Committee
 - (b) Board of Directors
 - (c) Auditor
 - (d) Chairman of the Audit Committee

9. When Mr Meticulous decided to go in detail checking of Sales, which Audit Procedure he applied to obtain the evidence?
 - (a) Test of Transactions
 - (b) Test of Balances
 - (c) Both (a) and (b)
 - (d) Analytical Procedures

MCQ [4 MCQ of 2 Marks Each : Total 8 Marks]

Q. 10 to Q. 12:

CASE SCENARIO 3:

- M/s ANS & Associates have been appointed as the auditors of Star Ltd. for the Financial Year 2021-22.
- During the year under audit, Star Ltd has issued share capital at a premium of Rs. 5 per share. The auditors understand that certain provisions as per the Companies Act 2013 related to the issue of shares at premium are applicable to the company.
- Also, Star Ltd. has issued Sweat Equity shares to its employees during the year. The audit staff had the following understanding with respect to the sweat equity shares:

“Sweat Equity Shares” mean equity shares issued by the company to employees or directors at a

- i. discount or
- ii. for consideration other than cash

for providing know-how or making available right in the nature of intellectual property rights or value additions, by whatever name called.”

The engagement partner has advised its audit staff to check in particular whether the company has complied with the relevant provisions related to the issue of sweat equity shares as per the Companies Act 2013.

- Further, the auditor understands that the Company Star Ltd. needs to file various forms with different authorities when there is a change in the share capital of the company during the year.
- Also special consideration is given under audit to the treatment of reserves as Revenue vs Capital by the company during the financial year.

Based on the above facts, answer the following:-

10. As there is a change in the share capital of Star Ltd. during the year, which of the following combination related to the forms to be submitted is not correct:-
- (a) Form SH 7: To be filed with Ministry of Corporate Affairs
 - (b) Form CRA 2: To be filed with the Ministry of Corporate Affairs
 - (c) Form PAS: To be filed with the Ministry of Corporate Affairs.
 - (d) Form FCGPR: To be filed with the Reserve Bank of India in case of Foreign Direct Investment by a Non Resident Shareholder.
11. The Securities Premium Account can be used by the Star Ltd. for various purposes, except one:-
- (a) In writing off the preliminary expenses of the company
 - (b) Towards the issue of the unissued shares of the company to the members of the company as fully paid bonus shares
 - (c) For purchase of its own shares and other securities under section 68.
 - (d) To be used as working capital.
12. With regard to the issue of Sweat Equity shares following conditions have to be complied. Identify the incorrect one:-
- (a) The issue is authorized by ordinary resolution passed by the company.
 - (b) The resolution should specify the number of shares, the current market price.
 - (c) The rights, limitations, restrictions and provisions as applicable to equity shares shall be applicable to the sweat equity shares issued under this section and the holders of such shares shall rank pari passu with other equity shareholders.
 - (d) Where the equity shares of the company are listed on recognized stock exchange, the shares are issued in accordance with requirements by SEBI.
- MCQ [3 MCQ of 2 Marks Each : Total 6 Marks]**
13. Where no reply is received during the performance of direct confirmation procedures as part of audit of accounts receivable balances, the auditor should perform:
- (a) No additional testing
 - (b) Additional testing including subsequent collections testing and agreeing the detail of the respective balance to the customer's remittance advice.
 - (c) Additional testing including preparing a detailed analysis of the balance, ensuring it consists of identifiable transactions and confirming that these revenue transactions actually occurred.
 - (d) Both (b) and (c)
- (2 Marks)**
14. In WH Limited every business activity was being carried out manually. The top management of WH Limited decided to change the business environment of WH Limited by using computer systems and computer systems related technology to carry out all the major business activities of WH Limited. This business environment of WH Limited, where all the major business activities are done using computer systems and computers related technology is an example of:
- (a) Operational Environment.
 - (b) Computational Environment.
 - (c) Control Environment.
 - (d) Automated Environment
- (2 Marks)**

15. Which of the following is Incorrect:
- (a) An auditor conducting an audit in accordance with SAs is responsible for obtaining absolute assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error.
 - (b) As described in SA 200, owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements will not be detected, even though the audit is properly planned and performed in accordance with the SAs.
 - (c) The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error.
 - (d) The risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud

(2 Marks)

DIVISION B-DESCRIPTIVE QUESTIONS

QUESTION NO. 1 IS COMPULSORY.

ATTEMPT ANY FOUR QUESTIONS THE REMAINING FIVE QUESTIONS

Question 1:

- (a) Preliminary identification of material classes of transaction, account balance & disclosure requires auditor's professional judgement are significant in directing engagement team's effort's in establishing overall audit strategy. List significant matters to which energies are devoted.

(4 Marks)

- (b) A Chartered accountant is conducting audit of a client for last two years. Before proceeding to start audit for next year, he notices that there is substantial change in management. Besides, client has ventured into areas of business activity which were not present at time of accepting initial audit engagement. Discuss responsibility of auditor in this regard in context of SA 210.

(4 Marks)

- (c) Mr. Shah has been appointed as auditor of MCC Jaipur, while finalizing the audit of Head Office, he is concerned about branch Account Audit. In the light of appropriate standard, guide Mr. Shah.

(3 Marks)

- (d) Before drafting a final Audit Report, it is responsibility of auditor to communicate with those changed with governance. Explain the objective behind such communication.

(3 Marks)

Question 2:

- (a) Pawan, auditor of Parvesh & Co., casted significant doubt on entity's ability to continue as going concern while performing Risk Assessment procedure. What further audit procedures he should perform in light of appropriate SA.

(4 Marks)

- (b) What are the factors that are to be considered while designing a confirmation request?

(4 Marks)

- (c) Explain the meaning of Government Audit and also discuss its objectives. **(3 Marks)**
- (d) A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures. Explain. **(3 Marks)**

Question 3:

- (a) Sitaram Textile Ltd is an established player in the textile manufacturing sector. It has developed strong internal controls in almost every area. It has appointed you as an Internal Audit team head. Internal audit has a very strong relation with internal control of the company. Internal Audit analyses the effectiveness with which the internal control of the company is operating and also makes suggestions for improvement in that internal control. Explain stating clearly activities relating to Internal Control. **(4 Marks)**
- (b) The chief utility of audit lies in reliable financial statements on the basis of which the state of affairs may be easy to understand. Apart from this obvious utility, there are other advantages of audit. Some or all of these are of considerable value even to those enterprises and organisations where audit is not compulsory. Explain. **(4 Marks)**
- (c) Explain the factors that should be considered for deciding upon the extent of checking on a sampling plan. **(3 Marks)**
- (d) How will you vouch and/or verify Endowment Policies. **(3 Marks)**

Question 4:

- (a) For the purposes of the SAs, the term "analytical procedures" means evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Explain giving examples of both. **(4 Marks)**
- (b) In performing an audit of financial statements, the auditor should have or obtain knowledge of the business. Explain in the light of SA 315 "Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment". **(4 Marks)**
- (c) Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Explain stating clearly objectives of the auditor regarding written representation. **(3 Marks)**

- (d) 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 clearly stating those matters also.

(3 Marks)

Question 5:

- (a) Companies prepare their financial statements in accordance with the framework of generally accepted accounting principles (Indian GAAP), also commonly referred to as accounting standards (AS). In preparing financial statements, Company's management makes implicit or explicit claims (i.e. assertions) regarding assets, liabilities, equity, income, expenses and disclosures in accordance with the applicable accounting standards. Explain with example stating the relevant assertions involved in this regard. Also explain financial statement audit.

(4 Marks)

- (b) State the background of "Local Bodies". Draft an audit programme for conducting audit of accounts of a Local Body.

(4 Marks)

- (c) Should branch auditor of a company comply with the request of the principal auditor of the company to give photocopy of the working papers pertaining to the branch audit? Explain.

(3 Marks)

- (d) MNP Ltd has reduced its Share Capital to a greater extent in the year for which you are conducting the audit. State how you will proceed for verifying the reduction of Capital.

(3 Marks)

Question 6:

- (a) Mention any ten special points to be examined by you in the audit of Income and Expenditure of a charitable institution running a hospital.

(4 Marks)

- (b) There are different provisioning requirements as regards to categories of NPA such as Sub-standards assets, Doubtful assets and loss assets. Explain in detail.

(4 Marks)

- (c) The firm should **establish policies and procedures** designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant, adequate, operating effectively and complied with in practice. Such policies and procedures should include an ongoing consideration and evaluation of the firm's system of quality control, including a periodic inspection of a selection of completed engagements. Explain in the above context the purpose of monitoring compliance with quality control policies and procedures.

(3 Marks)

- (d)** M/s GK & Co., a firm of Chartered Accountants, is auditor of DBR Ltd. for many years. DBR Ltd. has diversified their business into newer areas during the last year. The senior member of the audit team handed over the standard audit programme of earlier years to the audit assistants and instructed them to follow the same. The assistants are conducting the audit accordingly. Whether the attitude of the audit assistants is justified or they are required to keep an open mind? Guide them.
(3 Marks)

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