

Intermediate Course: Group – II
DATE: 10.09.2024

MAXIMUM MARKS: 100

(Mock Test Paper – Series : 1)
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

Ans. 1 to Ans. 5:

CASE SCENARIO

1. Ans. b
2. Ans. c
3. Ans. a
4. Ans. b
5. Ans. c

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

Ans. 6 to Ans. 9:

CASE SCENARIO

6. Ans. b
7. Ans. c
8. Ans. c
9. Ans. a

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

Ans. 10 to Ans. 12:

CASE SCENARIO

10. Ans. d
11. Ans. a
12. Ans. c

MCQ [3 MCQ of 2 Marks Each : Total 6 Marks]

13. Ans. d
 14. Ans. d
 15. Ans. a
- {2 M Each}

DIVISION B-DESCRIPTIVE QUESTIONS**QUESTION NO. 1 IS COMPULSORY.**

ATTEMPT ANY FOUR QUESTIONS THE REMAINING FIVE QUESTIONS

Answer 1:

- (a) Audit Procedure Regarding Events Occurring Between The Date Of The Financial Statements And The Date Of The Auditor's Report The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified.

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The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required above so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto. The auditor shall take into account the auditor's risk assessment which shall include the following:

- (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- (b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- (c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- (d) Reading the entity's latest subsequent interim financial statements, if any.

{1 M Each}

Answer:

(b) Other examples of situations where external confirmations may be used include the following:

- Inventories held by third parties at bonded warehouses for processing or on consignment
- Property title deeds held by lawyers or financiers for safe custody or as security
- Investments held for safekeeping by third parties, or purchases from stockbrokers but not delivered at the balance sheet date
- Amounts due to lenders, including relevant terms of repayment and restrictive covenants.
- Accounts payable balances and terms
- Long outstanding share application money.

{1 M Each for any 4 Points}

Answer:

(c) Audit Sampling: As per SA 530 on "Audit Sampling", the meaning of the term Audit Sampling is – the application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The requirements relating to sample design, sample size and selection of items for testing are explained below-

- Sample design - When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn.
- Sample Size - The auditor shall determine a sample size sufficient to reduce sampling risk to an acceptably low level.
- Selection of Items for Testing - The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection.

{1 M Each}

Answer:

(d) Verification of Profit & Loss Arising on sale of Plots by real estate dealer: The land holding in the case of real estate dealer will be a current asset and not a fixed asset. The same should, therefore, be valued at cost or market value whichever is less. The

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amount of profit or loss arising on sale of plots of land by such a dealer should be verified as follows:

- (i) Each property account should be examined from the beginning of the development with special reference to the nature of charges so as to find out that only the appropriate cost and charges have been debited to the account and the total cost of the property has been set off against the price realised for it.
- (ii) This basis of distribution of the common charges between different plots of land developed during the period, and basis for allocation of cost to individual properties comprised in a particular piece of land should be scrutinised.
- (iii) If land price lists are available, these should be compared with actual selling prices obtained. And it should be verified that contracts entered into in respect of sale have been duly sanctioned by appropriate authorities.
- (iv) Where part of the sale price is intended to reimburse taxes or expenses, suitable provisions should be maintained for the purpose.
- (v) The prices obtained for various plots of land sold should be checked with the plan map of the entire tract and any discrepancy or unreasonable price variations should be inquired into. The sale price of different plots of land should be verified on a reference to certified copies of sale deeds executed.
- (vi) Out of the sale proceeds, provision should be made for the expenditure incurred on improvement of land, which so far has been accounted for.

{1 M Each
for any 3
Points}

Answer 2:

(a) As per SA 220 "Quality Control for an Audit of Financial Statements", the engagement partner shall take responsibility for the overall quality on each audit engagement to which that partner is assigned. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise:

- (a) The importance to audit quality of:
 - (i) Performing work that complies with professional standards and regulatory and legal requirements;
 - (ii) Complying with the firm's quality control policies and procedures as applicable;
 - (iii) Issuing auditor's reports that are appropriate in the circumstances; and
 - (iv) The engagement team's ability to raise concerns without fear of reprisals; and
- (b) The fact that quality is essential in performing audit engagements

{1 M
Each}

Answer:

- (b)** (i) Year-end inventory verification: Existence Assertion.
- (ii) Depreciation has been properly charged on all assets: Valuation Assertion.
- (iii) Title deed of lands disclosed in the Balance Sheet are held in the name of the Company: Rights & Obligations Assertion.
- (iv) All liabilities are properly recorded in the financial statements: Completeness.

{1 M
Each}

Answer:

(c) When risks in IT systems are not mitigated the audit impact could be as follows:

- (i) First, auditors may not be able to rely on the data obtained from systems where such risks exist. This means, all forms of data, information or reports that they obtain from systems for the purpose of audit has to be thoroughly tested and corroborated for completeness and accuracy.

{1 M
Each}

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- (ii) Second, auditors will not be able to rely on automated controls, calculations, accounting procedures that are built into the applications. Additional audit work may be required in this case.
- (iii) Third, due to the regulatory requirement of auditors to report on internal financial controls of a company, the audit report also may have to be modified in some instances.

Answer:

- (d)**
- (a) In establishing the overall audit strategy, auditor shall ascertain the reporting objectives of the engagement to plan the timing of the audit and the nature of the communications required. The cases by which auditor can ascertain the reporting objectives of the engagement are:
 - (b) The entity's timetable for reporting, such as at interim and final stages.
 - (c) The organization of meetings with management and those charged with governance to discuss the nature, timing and extent of the audit work.
 - (d) The discussion with management and those charged with governance regarding the expected type and timing of reports to be issued and other communications, both written and oral, including the auditor's report, management letters and communications to those charged with governance.
 - (e) The discussion with management regarding the expected communications on the status of audit work throughout the engagement.

{1 M Each
for any 3
Points}

Answer 3:

(a) Audit reporting Regarding Corresponding Figures:

When corresponding figures are presented, the auditor's opinion shall not refer to the corresponding figures except in the following circumstances:

1. If the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:
 - (a) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
 - (b) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.
2. If the auditor obtains audit evidence that a material misstatement exists in the prior period financial statements on which an unmodified opinion has been previously issued, the auditor shall verify whether the misstatement has been dealt with as required under the applicable financial reporting framework and, if that is not the case, the auditor shall express a qualified opinion or an adverse opinion in the auditor's report on the current period financial statements, modified.
3. Prior Period Financial Statements Not Audited- If the prior period financial statements were not audited, the auditor shall state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. Such a statement does not, however, relieve the auditor of the requirement to obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

{2 M}

{1 M}

{1 M}

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Answer:

(b) The auditor has to ensure whether PPE has been valued appropriately and as per generally accepted accounting policies and practices.

The value of fixed assets/ PPE depreciates due to efflux of time, use and obsolescence. The diminution of the value represents an item of cost to the entity for earning revenue during a given period. Unless this cost in the form of depreciation is charged to the accounts, the profit or loss would not be correctly ascertained, and the values of PPE would be shown at higher amounts.

- The auditor should:
 - o Verify that the entity has charged depreciation on all items of PPE unless any item of PPE is non-depreciable like freehold land;
 - o Assess that the depreciation method used reflects the pattern in which the asset's future economic benefits are expected to be consumed by the entity. It could be Straight line method, diminishing value method, unit of production method, as applicable.
 - o The auditor should also verify whether the management has done an impairment assessment to determine whether an item of property, plant and equipment is impaired as per the requirements of AS 28 - Impairment of Assets.

{1^{1/2} M}

To verify whether the entity has valid legal ownership rights over the PPE claimed to be held by the entity and recorded in the financial statements

- In addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, the auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity.
- For all additions to land and building in particular, the auditor should check the conveyance deed/ sale deed to verify whether the entity is the legal and valid owner or not.
- The auditor should insist and verify the original title deeds for all immoveable properties held as at the balance sheet date.
- In case the entity has given such immoveable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immoveable property as security.
- In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.

{1/2 M
Each}

Answer:

(c) During the audit, the auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the following records or documents that may provide information about related party relationships and transactions, for example:

1. Entity income tax returns.
2. Information supplied by the entity to regulatory authorities.
3. Shareholder registers to identify the entity's principal shareholders.
4. Statements of conflicts of interest from management and those charged with governance.
5. Records of the entity's investments and those of its pension plans.
6. Contracts and agreements with key management or those charged with governance.
7. Significant contracts and agreements not in the entity's ordinary course of business.

{1/2 M
Each for
any 6
Points}

8. Specific invoices and correspondence from the entity’s professional advisors.
9. Life insurance policies acquired by the entity.
10. Significant contracts re-negotiated by the entity during the period.
11. Internal auditors’ reports.
12. Documents associated with the entity’s filings with a securities regulator e.g, prospectuses)

Answer:

(d) When information to be used as audit evidence has been prepared using the work of a management’s expert, the auditor shall, to the extent necessary, having regard to the significance of that expert’s work for the auditor’s purposes:

1. Evaluate the competence, capabilities and objectivity of that expert;
2. Obtain an understanding of the work of that expert; and
3. Evaluate the appropriateness of that expert’s work as audit evidence for the relevant assertion.
4. CA Amar should consider the above before using the work of the management’s expert.

{1 M Each
for any 3
Points}

Answer 4:

(a) Misstatement refers to a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework.

{1/2 M}

In the given situation, there is a difference in amount to be recorded as well as in disclosure of a financial statement item from what is required in accordance with applicable financial reporting framework. The company should have recorded gross amount of dividend and interest amounting to ₹ 2.00 lakhs and ₹ 3.00 lakhs respectively in its financial statements in accordance with AS 13. Therefore, amount recorded under head “Other income” should have been for ₹ 10 lakhs (2 lakhs+3 lakhs+5 lakhs).

{1/2 M}

Further, in accordance with disclosure requirements of Schedule III of the Companies Act, 2013, other income shall be classified in the above situation as: -

- (a) Interest Income of ₹ 3 lakhs
 - (b) Dividend Income of ₹ 2 lakhs
 - (c) Net gain on sale of investments of ₹ 5 lakhs
- Few examples of misstatements are:
- Charging of an item of capital expenditure to revenue or vice-versa.
 - Difference in disclosure of a financial statement item vis-à-vis its requirement in applicable financial reporting framework.
 - Selection or application of inappropriate accounting policies.
 - Difference in accounting estimate of a financial statement item vis-à-vis its appropriateness in applicable financial reporting framework.
 - Intentional booking of fake expenses in statement of profit and loss.
 - Overstating of receivables in the financial statements by not writing off irrecoverable debts.
 - Overstating or understating inventories.

{1 M Each
for any 3
Points}

Answer:

(b) The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions. Judging the significance of a matter requires an objective analysis of the facts and circumstances. Examples of significant matters include:

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- Matters that give rise to significant risks.
- Results of audit procedures indicating (a) that the financial statements could be materially misstated, or (b) a need to revise the auditor's previous assessment of the risks of material misstatement and the auditor's responses to those risks.
- Circumstances that cause the auditor significant difficulty in applying necessary audit procedures.
- Findings that could result in a modification to the audit opinion or the inclusion of an Emphasis of Matter paragraph in the auditor's report.

{1 M
Each}

Answer:

(c) Controls Relevant to the Audit: Factors relevant to the auditor's judgment about whether a control, individually or in combination with others, is relevant to the audit may include such matters as the following:

- (i) Materiality.
- (ii) The significance of the related risk.
- (iii) The size of the entity.
- (iv) The nature of the entity's business, including its organisation and ownership characteristics.
- (v) The diversity and complexity of the entity's operations.
- (vi) Applicable legal and regulatory requirements.
- (vii) The circumstances and the applicable component of internal control.
- (viii) The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
- (ix) Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

{1/2 M
Each for
any 6
Points}

Answer:

(d) In the context of recurring audits, as per SA-300, "Planning an Audit of Financial Statements", Planning is not a discrete phase of an audit, but rather a continual and iterative process that often begins shortly after (or in connection with) the completion of the previous audit and continues until the completion of the current audit engagement. Planning, however, includes consideration of the timing of certain activities and audit procedures that need to be completed prior to the performance of further audit procedures. For example, planning includes the need to consider, prior to the auditor's identification and assessment of the risks of material misstatement, such matters as:

1. The analytical procedures to be applied as risk assessment procedures.
2. Obtaining a general understanding of the legal and regulatory framework applicable to the entity and how the entity is complying with that framework.
3. The determination of materiality.
4. The involvement of experts.
5. The performance of other risk assessment procedures.

{1 M Each
for any 3
Points}

Answer 5:

(a) The Chartered Accountant has a responsibility to remain independent by taking into account the context in which they practice, the threats to independence and the safeguards available to eliminate the threats.

The following are the guiding principles in this regard: -

1. For the public to have confidence in the quality of audit, it is essential that auditors should always be and appears to be independent of the entities that they are auditing.

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2. In the case of audit, the key fundamental principles are integrity, objectivity and professional skepticism, which necessarily require the auditor to be independent.
3. Before taking on any work, an auditor must conscientiously consider whether it involves threats to his independence.
4. When such threats exist, the auditor should either desist from the task or put in place safeguards that eliminate them.
5. If the auditor is unable to fully implement credible and adequate safeguards, then he must not accept the work.

{1 M Each
for any 4
Points}

Answer:

- (b)** The external control of municipal expenditure is exercised by the state governments through the appointment of auditors to examine municipal accounts. However, the municipal corporations of Delhi, Mumbai and a few others have powers to appoint their own auditors for regular external audit.

The important objectives of audit are:

- (a) reporting on the fairness of the content and presentation of financial statements;
- (b) reporting upon the strengths and weaknesses of systems of financial control;
- (c) reporting on the adherence to legal and/or administrative requirements;
- (d) reporting upon whether value is being fully received on money spent; and
- (e) detection and prevention of error, fraud and misuse of resources.

{1 M Each
for any 4
Points}

Answer:

- (c)** When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700 (Revised) to include only the following:

- (a) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing and to issue an auditor's report;
- (b) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; and
- (c) The statement about auditor independence and other ethical responsibilities required by SA 700 (Revised).

{1 M
Each}

Answer:

- (d) Use of the Going Concern Basis of Accounting is Appropriate but a Material Uncertainty Exists**

The identification of a material uncertainty is a matter that is important to users' understanding of the financial statements. The use of a separate section with a heading that includes reference to the fact that a material uncertainty related to going concern exists alerts users to this circumstance.

- (a) Adequate Disclosure of a Material Uncertainty is Made in the Financial Statements**

If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern."

{1 M}

- (b) Adequate Disclosure of a Material Uncertainty is Not Made in the Financial Statements**

{1 M}

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall:

- (a) Express a **qualified opinion or adverse opinion**, as appropriate, in accordance with SA 705 (Revised); and
- (b) In the Basis for Qualified (Adverse) Opinion section of the auditor’s report, state that a material uncertainty exists that may cast significant doubt on the entity’s ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

{1 M}

Answer 6:

(a) As per the guidelines, Agricultural Advances are of two types:

- (1) Agricultural Advances for “long duration” crops; and
- (2) Agricultural Advances for “short duration” crops.

The “long duration” crops would be crops with crop season longer than one year and crops, which are not “long duration” crops would be treated as “short duration” crops.

{1 M}

The crop season for each crop, which means the period up to harvesting of the crops raised, would be as determined by the State Level Bankers’ Committee in each State.

{1 M}

The following NPA norms would apply to agricultural advances (including Crop Term Loans):

- A loan granted for short duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for two crop seasons; and
- A loan granted for long duration crops will be treated as NPA, if the instalment of principal or interest thereon remains overdue for one crop season.

{1 M}

{1 M}

Answer:

(b) **Qualification of Auditors** -Section 72 of the Multi-State Co-operative Societies Act, 2002 states that a person who is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 can only be appointed as auditor of Multi-State co-operative society.

However, the following persons are not eligible for appointment as auditors of a Multi-State co- operative society-

- (i) A body corporate.
- (ii) An officer or employee of the Multi-State co-operative society.
- (iii) A person who is a member or who is in the employment, of an officer or employee of the Multi- State co-operative society.
- (iv) A person who is indebted to the Multi-State co-operative society or who has given any guarantee or provided any security in connection with the indebtedness of any third person to the Multi-State co-operative society for an amount exceeding one thousand rupees.

{1/2 M Each}

If an auditor becomes subject, after his appointment, to any, of the disqualifications specified above, he shall be deemed to have vacated his office as such.

Appointment of Auditors - {Section 70 of the Multi-State Co-operative Societies Act, 2002 provides that the first auditor or auditors of a Multi-State co-operative society shall be appointed by the board within one month of the date of registration of such society and the auditor or auditors so appointed shall hold office until the conclusion of the first annual general meeting. If the board fails to exercise its powers under this sub-section, the Multi-State co-operative society in the general meeting may appoint the first auditor or auditors.}{1 M}

The subsequent auditor or auditors are appointed by Multi-State co-operative society, at each annual general meeting. The auditor or auditors so appointed shall hold office from the conclusion of that meeting until the conclusion of the next annual general meeting. {1 M}

Answer:

(c) The objectives and scope of internal audit functions typically include assurance and consulting activities designed to evaluate and improve the effectiveness of the entity's governance processes, risk management and internal control such as the activities Relating to Internal Control:

- (i) Evaluation of internal control: The internal audit function may be assigned specific responsibility for reviewing controls, evaluating their operation and recommending improvements thereto. In doing so, the internal audit function provides assurance on the control. For example, the internal audit function might plan and perform tests or other procedures to provide assurance to management and those charged with governance regarding the design, implementation and operating effectiveness of internal control, including those controls that are relevant to the audit.
- (ii) Examination of financial and operating information: The internal audit function may be assigned to review the means used to identify, recognize, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
- (iii) Review of operating activities: The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including nonfinancial activities of an entity.
- (vi) Review of compliance with laws and regulations: The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

{1 M Each
for any 3
Points}

Internal audit has a very strong relation with internal control of a company. Internal Audit analyzes the effectiveness with which the internal control of a company is operating and also makes suggestions for improvement in that internal control.

Answer:

(d) The following are the disclosure requirements as per CARO 2020, with respect to the moneys raised by the company by way of initial public offer or further public offer and where the company has made any preferential allotment or private placement of shares.

- (a) whether moneys raised by way of initial public offer or further public offer (including debt instruments) during the year were applied for the purposes for which those are raised, if not, the details together with delays or default and subsequent rectification, if any, as may be applicable, be reported;
- (b) whether the company has made any preferential allotment or private placement of shares or convertible debentures (fully, partially or optionally convertible) during the year and if so, whether the requirements of section 42 and section 62 of the Companies Act, 2013 have been complied with and the funds raised have been used for the purposes for which the funds were raised, if not, provide details in respect of amount involved and nature of noncompliance;

{1^{1/2} M}

{1^{1/2} M}

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