

Intermediate Course: Group – II**(Mock Test Paper – Series : 2)****DATE: 25.10.2024****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**

A partnership firm of Chartered Accountants, YZ and Associates were appointed as auditor of company UV Private Limited. The financial year for which YZ and Associates were to audit books of accounts of UV Private Limited began on 1 April, 2021 and ended on 31 March, 2022.

YZ and Associates consisted of four partners namely Mr. Y, Mr. Z, Mr. G and Mr. H.

While auditing books of accounts of UV Private Limited for the period beginning on 1 April, 2021 and ending on 31 March, 2022, one of the partners of YZ and Associates namely Mr. H took up the expenses part for the purpose of audit.

The management of UV Private Limited had adopted various accounting policies and principles related to expenses which Mr. H as auditor of UV Private Limited was unable to understand. Some of the issues which Mr. H was unable to understand are mentioned as follows:

- (1) Machinery Insurance expense paid for one year ending on 31.05.2022 has been included in the Insurance Expense for the financial year 2021-22.
- (2) Personal Rent Expense of the son of one of the directors, Mr. T of UV Private Limited has been shown as Rent Expense of business of UV Private Limited.
- (3) Repair and Maintenance Expenses for the months of February 2022 and March 2022 were still outstanding and were not shown in Balance Sheet of UV Private Limited.
- (4) Repair and Maintenance Expenses for the financial year 1 April, 2022 to 31 March, 2022 were very high as compared to financial year 1 April, 2020 to 31 March, 2021. The auditor Mr. H asked the appropriate authority about the reasons for such huge differences in amounts of two financial years.
- (5) While verifying the insurance expenses, the insurance policies were not shown to auditor Mr. H.

The above mentioned five points were some of the issues which Mr. H was unable to understand.

Answer the following questions:

1. As per the point number (1) mentioned in the above case, the Power and Fuel Expenses paid for the months of April 2022 and May, 2022 must be shown in the balance sheet of UV Private Limited as on 31st March, 2022 as:
 - (a) Outstanding Insurance Expense
 - (b) Prepaid Insurance Expense
 - (c) Insurance Expense
 - (d) Insurance Expense Payable
2. As per point number (2) mentioned above in the case, the Personal Rent Expense of the son of one of the directors Mr. T was added to Rent Expense of business of UV Private Limited. The amount of personal rent expense of the son of the director Mr. T must be:
 - (a) Subtracted from Rent Expense of business of UV Private Limited

- (b) Remain Added to Rent Expense of business of UV Private Limited
 - (c) Again Added to Rent Expense of business of UV Private Limited
 - (d) Subtracted twice from Rent Expense of business of UV Private Limited
3. As per point number (3) mentioned above in the case, the Repair and Maintenance Expenses outstanding for the months of February 2022 and March 2022 must be shown in the balance sheet of UV Private Limited as on 31 March, 2022 as:
- (a) Prepaid Repair and Maintenance Expenses
 - (b) Repair and Maintenance Expenses
 - (c) Repair and Maintenance Expenses paid in advance
 - (d) Repair and Maintenance Expenses Payable
4. As per point number (4) mentioned in the case above, the auditor Mr. H asked the appropriate authority for reasons of huge differences in the amount of two financial years of repair and maintenance expenses. By appropriate authority Mr. H was referring to:
- (a) All employees of UV Private Limited
 - (b) Management of UV Private Limited
 - (c) Members of UV Private Limited
 - (d) Any one director of UV Private Limited
5. As per point number (5) mentioned in the case above, in verifying insurance expenses the insurance policies would provide auditor Mr. H with:
- (a) Invalid Supporting
 - (b) No Supporting
 - (c) Lack of proper Supporting
 - (d) Sufficient and Appropriate Audit Evidence

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

**Q. 6 to Q. 9:
Case Scenario**

Moon Group of companies is a retail chain involved in the selling of daily consumer needs directly to the customer. They are in the process of appointing an audit firm for the audit of their accounts for the financial year 2021-22. Moon Group is a South Indian based consumer store having a total of 16 outlets across 4 cities in South India.

Sumant & Co. is appointed as the principal auditor for the entire group. Companies Act 2013 prescribes in detail the terms of this audit engagement. Further, there are many branch auditors appointed for the outlets in the other cities. The company also has an internal audit function conducted on quarterly basis by Ram & Co. Following are the observations during the course of the statutory audit:

- (a) One of the discounts offered by the store is in the form of payback cards where reward points are accumulated and the customer can redeem the same on subsequent purchase. The management and internal auditors are of the opinion that the points redeemed are to be treated as trade discount. The external auditors are doubtful on the matter.
- (b) One of the outlet in Chennai region is in the verge of getting closed and is only left with low value stock to be cleared before closure. During the year, the sales were only around Rs. 1,40,000/- and the auditor considers this component immaterial. All other outlets are performing well with good revenue share.
- (c) The gratuity valuation of the employees of the retail chain is done by an external valuer. The auditor, considering the quantum involved appoints an external auditor's expert for the verification of the actuarial calculation of gratuity.

From the above facts, answer the following questions by choosing the correct answer:

6. With respect to the treatment of discount on redemption of points in payback card, what should be the action of the external auditor?
- (a) The auditor can place reliance and go by the opinion of the branch auditor and internal auditor as they have only done a thorough and detailed audit of the accounts
 - (b) The auditor can place reliance on the management's accounting policy as prima facie they are only responsible for preparation of financial statements.
 - (c) The external auditor has sole responsibility for the audit opinion expressed and hence he should perform procedures to satisfy himself on the correct treatment and issue opinion accordingly.
 - (d) The auditor can advise management on correct treatment but cannot qualify his opinion as branch auditor's opinion has higher authority than external auditor's opinion.
7. What is the main objective of the external auditor, when he uses the work of the internal audit function of Ram & Co.?
- (a) To determine as to which areas, what extent the work can be used and whether that work is adequate for the purposes of the audit.
 - (b) To appropriately direct, supervise and review the work of the internal audit function
 - (c) Review the internal audit report and audit the areas not covered by the internal audit function
 - (d) Enquire from management on the special points that arose during internal audit and follow up on the course of action on those points.
8. The external auditor finds that the branch auditor of the outlet in the Chennai region, which is in the verge of closing down, is audited by an auditor who is not a member of the Institute of Chartered accountants of India. What should the external auditor do?
- (a) Since the professional competence of the auditor is in question, the external auditor should himself visit the premise and audit the accounts.
 - (b) Since the financial statement of the component is immaterial, the provisions of SA 600 do not apply.
 - (c) The auditor can rely on the financial statements of that component by obtaining written representation from management that the branch auditor is otherwise well qualified.
 - (d) Since the professional competence of the auditor is in question, the external auditor should co-ordinate with the branch auditor and call for the books of accounts and other explanations.
9. Which of these is not a factor affecting the external auditor's evaluation of the objectivity of the internal audit function?
- (a) Whether the organizational status of the internal audit function supports the ability of the function to be free from bias, conflict of interest or undue influence of others to override professional judgment.
 - (b) Whether the internal audit function is free of any conflicting responsibilities.
 - (c) Whether the internal auditors have adequate technical training and proficiency in auditing.
 - (d) Whether those charged with governance oversee employment decisions related to internal audit function.

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

Q. 10 to Q. 12:**Case Scenario**

Mr Laxman is appointed as statutory auditor of Best Limited for the Financial Year ended 31st March, 2022.

During the course of audit, it was found that few doubtful transactions had been committed by finance manager who retired in March, 2022.

The fraud was going on since last 4-5 years and the total amount misappropriated is approximately Rs. 75 lacs.

Balance sheet of Best Ltd. reflected a cash balance of Rs. 7 crores. The company has taken a loan of Rs. 2 crores from the bank despite of the huge cash balance with the company.

Also, Companies Act bestows some duties on auditors to report matters to Central Government in case of fraud.

On the basis of above facts answer below questions in relation to Mr Laxman's role and duties while conducting statutory audit of Best Limited.

10. Mr Laxman suspects that cash payments were inflated. Out of the below which could be probable reason for such inflated cash payments.
- (a) Not accounting for cash sales completely
 - (b) Making payments against purchase vouchers
 - (c) Making payments against inflated vouchers
 - (d) Teeming and Lading
11. As per Section 143 (12) of Companies Act, 2013 & Rule 13 of CAAR, 2014; Mr Laxman shall
- (a) report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as prescribed.
 - (b) report the matter to the audit committee constituted under section 177 within such time and in such manner as prescribed.
 - (c) report the matter to the audit committee constituted under section 177 and also to the Board within such time and in such manner as prescribed.
 - (d) report the matter to the Board within such time and in such manner as prescribed.
12. As an auditor what conclusion can Mr Laxman draw looking at the huge cash reserve of the company and corresponding bank loan?
- (a) Report this matter to the Central Government u/s 143(12) as there is a possibility of fraud
 - (b) Obtain sufficient and appropriate audit evidence of existence of fraud
 - (c) Report the matter under CARO, 2020
 - (d) There is nothing to report as it's a normal financial decision

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

13. ABC's investee company- XYZ declares final dividend for financial year 2020-21 in the meeting of board of directors held on April 10, 2021. In which financial year should ABC account for the dividend income:
- (a) Proportionately i.e. considering 10 days of financial year 2021-22 and 355 days of financial year 2020-21
 - (b) Financial year 2020- 21
 - (c) Financial year 2021- 22
 - (d) Equally between financial year 2020-21 and financial year 2021-22

(2 Marks)

MITTAL COMMERCE CLASSES

14. Public enterprises are required to maintain commercial accounts and are generally classified under three categories. Which of the following is not a category relating to above:
- departmental enterprises engaged in commercial and trading operations, which are subject to the same laws, financial and other regulations as other government departments and agencies;
 - statutory bodies, corporations, created by specific statutes mostly financed by government in the form of loans, grants, etc.; and
 - government companies set up under the Companies Act, 2013.
 - Charitable Trusts.

(2 Marks)

15. Which of the following is incorrect-
For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall :
- Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
 - Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
 - Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and
 - Not consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

(2 Marks)

DIVISION B-DESCRIPTIVE QUESTIONS

QUESTION NO. 1 IS COMPULSORY.

ATTEMPT ANY FOUR QUESTIONS THE REMAINING FIVE QUESTIONS

Question 1:

- (a) The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor to understand significant matters arising during the audit. Explain the above statement and also give examples of significant matters.

(4 Marks)

- (b) When performing risk assessment procedures as required by SA 315, the auditor shall consider whether events or conditions exist that may cast significant doubt on the entity's ability to continue as a going concern. In so doing, the auditor has determined that management of XYZ Ltd has already performed a preliminary assessment of the entity's ability to continue as a going concern. Explain how would auditor of XYZ Ltd proceed in the above case.

Also explain how would the auditor proceed if such an assessment has not yet been performed by the management.

(3 Marks)

- (c) Compute the Drawing Power for Cash Credit A/c of S Limited for the month of March 2022 with following information:

	(Amount in Rs.)
Stock	50,000

Debtors (Including Debtor of Rs. 5,000 for an invoice dated 17.11.2021)	45,000
Sundry creditors	15,000
Sanctioned Limit	45,000

Margin on stock is 20% and on debtors is 50%.

Note: Debtors older than 3 months are ineligible for calculation of DP.

(4 Marks)

- (d) CA PK Nair is offered appointment as auditor of a company engaged in providing tourism services. While making due diligence of the proposed client, he comes to know that there have been raids on premises of the company and residences of its directors by National Investigation Agency (NIA) on suspicion of links with terror outfits. It has been followed up with searches by Enforcement Directorate hunting for illicit money trail. There is a strong suspicion of tourism services provided by company being façade of terror funds. Should proposed offer be accepted by him and also provide the factors that auditor should consider to determine integrity of management?

(3 Marks)

Question 2:

- (a) Droma Shoes Private Limited was established in year 2022-23 for manufacturing of footwear. As funds were needed to carry on its business activities - including for purchase of different raw materials, incurring of regular expenses like power and fuel and payment of wages etc., it had got sanctioned a credit facility amounting to ₹ 2 crores repayable on demand from a bank against primary security of its current assets and collateral security of residential house of one of its directors. Duly signed guarantee documents by directors in favour of bank also form part of bank's loan documentation. Account statement of above facility downloaded from bank's website shows debit balance of ₹ 1.85 crores as on 31st March, 2023. The operations in above credit facility are satisfactory. In this regard: -
- Identify nomenclature of such credit facility given by banks. How would above amount of ₹ 1.85 crores be reflected and classified in financial statements of company as on 31.3.23?
 - Also state specific disclosure requirements of Schedule III of Companies Act, 2013 in relation to above.

(4 Marks)

- (b) Narrate the audit procedures to be performed by an auditor in order to ascertain that the Raw materials and consumables are valued appropriately and as per generally accepted accounting policies and practices.

(4 Marks)

- (c) CA Q, the auditor of XYZ Ltd, while conducting audit observes that the company has made various provisions in the books of account. What are the audit procedures that CA Q will follow to verify the existence, completeness, and valuation of the provisions made?

(3 Marks)

- (d) Audit testing done through Statistical sampling is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances. Explain and also state advantages of Statistical sampling.

(3 Marks)

Question 3:

- (a) Standards on Auditing (SAs) apply in "audit of historical financial information" whereas Standards on Review Engagements (SREs) apply in "review of historical financial information." Explain in detail giving examples. **(4 Marks)**
- (b) The auditor of FAST CARS Ltd obtains an understanding of the control environment. As part of obtaining this understanding, the auditor evaluates whether management has created and maintained a culture of honesty and ethical behaviour and the strengths in the control environment elements collectively provide an appropriate foundation for the other components of internal control. Advise what is included in control environment. Also explain the elements of control environment. **(4 Marks)**
- (c) Written representation about management's responsibilities involves confirmation of fulfillment of management's responsibilities in the preparation of the financial statements providing the relevant information and also informing about completeness of transactions. Explain. **(3 Marks)**
- (d) The nature of related party relationships and transactions may, in some circumstances, give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. Explain with the help of at least three examples. **(3 Marks)**

Question 4:

- (a) XYZ & associates are appointed as the statutory auditors of Fisco Ltd. for the FY 2021 -22. While constructing the audit programme, the engagement partner, CA X, should keep in mind various points. List such points. **(4 Marks)**
- (b) ABC Ltd. has many divisions and branches across the country. They have an internal control system which is well established maintained by the management on a regular basis. Explain the meaning of internal control as per SA-315 and also state the benefits of understanding the internal controls of a company. **(4 Marks)**
- (c) ABC Ltd. wants to buy some equipment on lease and hence is required to sign lease agreement with the supplier of the equipment. What are the important points to be considered in the lease agreement? **(3 Marks)**
- (d) Having obtained an understanding of the IT systems and the automated environment of a company, the auditor should understand the risks that arise from the use of IT systems. Explain those risks. **(3 Marks)**

Question 5:

- (a) The auditor of a limited company has given a clean report on the financial statement on the basis of xerox copies of the books of accounts, vouchers and other records which were taken away by the Income Tax Department in search under section 132 of the I.T. Act, 1961. Comment. **(4 Marks)**

- (b) You have been appointed as an auditor of ABC Hotel, a three-star hotel, for Financial Year 2022-23. As an auditor, what are the special points that need to be considered in verifying the Inventories in the nature of food and beverages?
(4 Marks)
- (c) UVW Ltd. a biopharma company and global manufacturers of select critical care medical products has been sanctioned working capital limits of Rs.5.99 crores from a nationalized bank on the basis of security of current assets. During the year under audit, the statutory auditor of UVW 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 under CARO 2020 in this case?
(3 Marks)
- (d) M/s TP & Co., a firm of Chartered Accountants, is auditor of KSR Ltd. for many years. KSR 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)

Question 6:

- (a) The description of management's responsibilities in the auditor's report includes reference to management's responsibilities as it helps to explain to users the premise on which an audit is conducted. Explain
(4 Marks)
- (b) X, a Chartered Accountant was engaged by PQR & Co. Ltd. for auditing their accounts. He sent his letter of engagement to the Board of Directors, which was accepted by the Company. In the course of audit of the company, the auditor was unable to obtain appropriate sufficient audit evidence regarding receivables. The client requested for a change in the terms of engagement.
(4 Marks)
- (c) What are the various assertions an auditor is concerned with while obtaining audit evidence from substantive procedure?
(3 Marks)
- (d) Explain the Element of Assurance Engagement?
(3 Marks)

OR

- (d) It has been suggested that actual operation of the internal control should be tested by the application of procedural tests and examination in depth. Explain with the help of example in respect of the procedure for sales.
(3 Marks)

— ** —