

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

M/s Vishwacharya and Associates, a CA firm based in Orissa, is appointed as an auditor of CBF Bank for the financial year 2023-24. During the course of audit, it came to notice that CBF Bank has sanctioned an overdraft facility of ₹ 75 lakh to Times Ltd. However, as per the stock statement furnished for the last quarter, the drawing power was calculated to be ₹ 50 lakh. It was observed that few advances were guaranteed by the:

- (i) Central Government as part of 'Make in India' initiative. However, the guarantee was not invoked, and the advances were overdue by 75 days. These advances were classified as standard assets and were regarded as NPA for income recognition purpose.
- (ii) State Government as part of power generation initiative. However, the guarantee was not invoked, and the advances were overdue by 80 days. These advances were also classified as standard assets and were regarded as NPA for income recognition purpose.

Additionally, XYZ Ltd., is a borrower availing cash credit facility of ₹ 110 Lakh against security of paid stocks and debtors up to 90 days. Margin stipulated was 25% of stock as and 40% for debtors. Bank has calculated drawing power based on following information provided by XYZ Ltd.

Particulars	Amount (₹)
Value of Stocks (as on 31.12.2023)	130 Lakh
Value of Debtors (as on 31.12.2023)	75 Lakh
Value of stocks (Fully damaged and included in (i) above)	7 Lakh
Value of Debtors (exceeding 90 days included in (ii) above)	10 Lakh
Value of creditors for goods	60 Lakh

Also, the outstanding balance in one of the Loan accounts was ₹ 25 Lakh and the realisable value of the security as assessed by the bank / approved valuers was ₹ 2.25 Lakh. Bank identified the same as erosion in the value of security. It was classified as doubtful category and provision was made for the doubtful assets. A

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discussion also took place among the team members regarding issuance of the audit reports after completion of the bank audit and annexure to the same such as Long Form Audit Report, Report on compliance with SLR Requirements, Report on Treasury Operations – as per RBI guidelines, Report on compliance as per Ghosh committee recommendations and Report on adverse credit - lending ratio in the rural areas, etc.

Based on the above facts, answer the following: -

1. With respect to the overdraft facility sanctioned to Times Ltd., the account would be termed as out of order if:
 - (i) The outstanding balance remains continuously in excess of ₹ 75 Lakh.
 - (ii) The outstanding balance remains continuously in excess of ₹ 50 Lakh.
 - (iii) The outstanding balance in the account is less than ₹ 75 Lakh but there are no credits or payments deposited into the account continuously for 90 days as on balance sheet date
 - (iv) The outstanding balance is less than ₹ 50 Lakh.

Choose the correct option from below:

- (a) (i), (ii) and (iii)
 - (b) (i), (iii) and (iv)
 - (c) (ii),(iii) and (iv)
 - (d) (iii) and (iv)
2. Which of the treatment by the bank on the provisioning and income recognition is correct in case of bank guarantee given by the Central Government and State Government?
 - (a) Both (i) and (ii) are correct
 - (b) Only (ii) is correct
 - (c) Only (i) is correct
 - (d) Both (i) and (ii) are incorrect.
3. In the given case drawing power of the borrower XYZ Limited should be:
 - (a) ₹ 86.25 Lakh
 - (b) ₹ 76.35 Lakh
 - (c) ₹ 96.25 Lakh
 - (d) ₹ 85.45 Lakh
4. The Bank has identified an erosion in the value of security and made provision for doubtful assets. Whether the treatment by bank for the doubtful asset is correct?
 - (a) Yes. The security should be classified under doubtful category. It may be either written off or fully provided by the bank.

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- (b) No. The existence of such security should be ignored, and the asset should straight away be classified as loss asset. It may be either written off or fully provided by the bank.
 - (c) Yes. The security should be classified under doubtful category and provisioning should be made as applicable for doubtful assets.
 - (d) No. The existence of the security should be ignored, and the asset should straight away be classified as loss asset. Provisioning should be made for doubtful assets.
5. The Statutory Central Auditors of a bank must furnish, in addition to the main audit report, various other audit reports. From the options, choose the audit reports that M/s Vishwacharya and Associates shall furnish.
- (i) Long Form Audit Report
 - (ii) Report on compliance with SLR Requirements
 - (iii) Report on Treasury Operations – as per RBI guidelines
 - (iv) Report on compliance as per Ghosh committee recommendations
 - (v) Report on adverse credit - lending ratio in the rural areas.

Choose the correct answer:

- (a) (i), (ii), (iii), (iv) and (v)
- (b) Only (i), (ii), (iii) and (iv)
- (c) Only (i), (ii) and (iii)
- (d) Only (i), (ii) and (v)

Case Scenario 2

Priority Limited is a large company engaged in manufacturing of terry towels making steady profits on a year-to-year basis. PMR & Associates, statutory auditors of the company since last two years, are in process of establishing audit strategy for conducting statutory audit under Companies Act, 2013 for year 2023-24.

The company has 5 branches which are audited by independent auditors appointed under Companies Act, 2013. It also has a wholly owned subsidiary company which is audited by another audit firm under name of JKL & Associates. The engagement team has noticed that company has maintained several bank accounts and there is substantial movement in fixed deposits during the year leading to risk of misstatement in cash and cash equivalents. The engagement team has planned procedures regarding the same.

- (i) At planning stage, engagement partner is also trying to set materiality for financial statements as a whole. The following information extracted from financial statements is given as under: -

Particulars	(Amount in ₹ crores)
Revenue	100
Total Assets	40

Profit before Tax	8
Total Liabilities (excluding Equity)	30

- (ii) While designing a sample for verifying revenues of company as part of tests of details, engagement partner has determined “tolerable misstatement” for ₹ 5.00 Lakh in order to address the risk that aggregate of individual immaterial misstatements may cause the financial statements to be materially misstated and provide a margin for possible undetected misstatements. One of the newly joined engagement team members has little conceptual understanding of “tolerable misstatement” determined by engagement partner. He also has no idea of the effect of change in tolerable misstatement on sample size.
- (iii) During course of audit, while performing tests of details, engagement team has come across certain misstatements in selected sample pertaining to verification of revenues. The team has projected misstatements to population of revenues. The team wants to comply with the Standards on Auditing strictly.

Based on the above facts, answer the following: -

6. The auditors of company are in process of establishing audit strategy. Which of the following is not a relevant factor in establishing overall audit strategy in the given case scenario?
- (a) Consideration of 5 branches which are audited by independent auditors
 - (b) Consideration of wholly owned subsidiary company audited by another audit firm
 - (c) Expected time of holding AGM in accordance with provisions of Companies Act, 2013
 - (d) Nature, timing and extent of planned procedures for cash and cash equivalents
7. For Priority limited, which benchmark would the engagement partner most likely to use for setting materiality for the financial statements as a whole?
- (a) A percentage of Revenue
 - (b) A percentage of Total assets
 - (c) A percentage of Profit before tax
 - (d) A percentage of Total liabilities (excluding equity)
8. In the given case scenario, assume that the engagement partner has decided to increase tolerable misstatement to ₹ 10.00 Lakh while designing sample described. Select the correct statement.
- (a) It would lead to decrease in sample size.
 - (b) It would lead to an increase in sample size.
 - (c) It would have no effect on sample size.
 - (d) It is not possible to draw inference on sample size due to increase in tolerable misstatement.

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9. While performing procedures on designed sample, the engagement team identified certain misstatements in selected sample and projected these to the entire population of revenues. According to the requirements of the Standards on Auditing, which statement is correct in this regard?
- (a) Anomalous misstatement is auditor's best estimate of misstatement in population.
 - (b) The projected misstatement plus anomalous misstatement, if any, is best estimate of misstatement in population.
 - (c) When projected misstatement exceeds tolerable misstatement, sample provides a reasonable basis for conclusion about tested population.
 - (d) When projected misstatement plus anomalous statement, if any, exceeds tolerable misstatement, sample provides a reasonable basis for conclusion about tested population.

Case Scenario 3

Bandhu Charitable Trust is considering appointment of MNO & Associates, Chartered Accountants, as independent auditors of its financial statements. The Trust is engaged in providing affordable healthcare services. It is in interest of both auditor and client to issue an engagement letter so that the possibility of misunderstanding is reduced to a great extent. It is, therefore, important that each party should be clear about nature of engagement. It should exactly specify the scope of work. Such an "engagement letter" is exchanged between Trust management and auditors.

While performing audit procedures, it is noticed by auditors that bills of two vehicles are not in name of Trust but in name of trustees. However, payment of these vehicles was made from bank account of Trust. The said vehicles are used for activities of Trust.

It is also noticed that a sum of ₹ 50.00 Lakh is reflected in Trust's financial statements in name of Gamma Instrument and Equipment in schedule of creditors. The said amount is outstanding since two years. The auditors sent confirmation request to the said supplier and seek management's co-operation in this regard. However, management of the Trust informs the auditor regarding certain dispute going on with the supplier of equipment due to some quality issues. It is further informed that dispute is near settlement and it would not be proper to send confirmation request as it can affect negotiation process.

Based on the above facts, answer the following: -

10. As regards exchange of engagement letter between Trust management and auditors is concerned, which of following statements is likely to be true?
- (a) Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It includes reference to the expected form and content of report to be issued by them and a statement that there may be circumstances in which such report may differ from its expected form and content.
 - (b) Engagement letter is sent by Bandhu Charitable Trust to MNO & Associates. It includes reference to the expected form and content of

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report to be issued by auditors. However, it does not include a statement that such report may differ from its expected form and content.

- (c) Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It includes reference to expected form and content of report to be issued by them. However, it does not include a statement that such a report may differ from its expected form and content.
 - (d) Engagement letter is sent by MNO & Associates to Bandhu Charitable Trust. It does not include reference to the expected form and content of report to be issued by them.
11. Considering the issues related to vehicles as described in the case study, identify the most appropriate statement.
- (a) Auditors have identified misstatement concerning “Existence” assertion made by Trust management.
 - (b) Auditors have identified misstatement concerning “Rights and Obligations” assertion made by Trust management.
 - (c) Auditors have identified misstatement concerning “Accuracy” assertion made by Trust management.
 - (d) Auditors have identified misstatement concerning “Completeness” assertion made by Trust management.
12. What course of action should the auditor take regarding the amount payable to the equipment supplier when management has communicated that sending a confirmation request could negatively impact the negotiation process?
- (a) The auditor should issue adverse opinion in auditor’s report.
 - (b) The auditor should seek audit evidence as to the validity and reasonableness of the reasons for refusal and perform alternative audit procedures.
 - (c) The auditor should withdraw from engagement as Trust management’s refusal is a limitation on scope of independent audit.
 - (d) The auditor should disclaim opinion in auditor’s report.

MCQs

13. CA Prince, after developing the audit strategy for Vedika Limited, develops an audit plan but finds a need to revise the materiality levels set earlier and therefore, a deviation from the already set audit strategy is felt necessary. In this case, he should
- (a) Drop the audit and withdraw from the engagement.
 - (b) Devise a new audit plan and then, change the strategy as per the Revised Plan.
 - (c) First Modify the audit strategy and thereafter, prepare the audit plan according to the modified strategy.
 - (d) Continue with the Audit Plan without considering the Audit Strategy.

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14. Jasmine was of the view that audited financial statements are not a guarantee against probable wrong doings in the financial matters of companies. What kind of assurance does audit of financial statements provide?
- (a) It provides reasonable assurance meaning a low level of assurance.
 - (b) It provides reasonable assurance meaning a high level of assurance.
 - (c) It provides reasonable assurance meaning an absolute level of assurance.
 - (d) It provides reasonable assurance meaning a moderate level of assurance.
15. CA Raman instructed his article Raju to verify whether employee benefit expense of Prep Limited has been fairly allocated between the operating expense incurred in production activities and general expense. Which of the following assertions is being addressed by this instruction?
- (a) Completeness
 - (b) Presentation and Disclosure
 - (c) Measurement
 - (d) Occurrence

PART II - Descriptive Questions

Question No. 1 is compulsory.

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

1. (a) Subodh has recently joined an audit firm as an articled clerk. He was in process of assembling audit working papers in audit file of Cop Limited, as per the instructions of his senior. While assembling, he noticed following working paper in audit file: -

Timing of Audit Activities

Activity	Expected Timing
Audit Planning	July 1, 2023 - July 5, 2023
Review by EQCR	July 6, 2023 - July 7, 2023
Audit Field Work	July 10, 2023 - August 20, 2023
Review by Manager	August 21, 2023
Review by Engagement Partner	August 22, 2023 - August 25, 2023
Review by EQCR	August 26, 2023 - August 27, 2023
Response on Audit Memo	August 28, 2023
Review by Partners – internally post response on audit memo	August 29, 2023
Review by EQCR	August 30, 2023

Finalization of Audit Report and Financial Statements	September 01, 2023 - September 02, 2023
Issuance of Audit Report and Financial Statements	September 03, 2023

The above working paper lists certain factors which are considered by the auditor while establishing audit strategy. Explain how these considerations highlighted in above working paper could have helped the auditor? **(5 Marks)**

- (b) CA Tina, while inspecting financial statements of a company, notices that gross profit ratio of company has increased from 14% in year 2022-23 to 24% in year 2023-24. Considering the above, she has assessed the risk of material misstatement to be high with respect to assertions relating to revenue and various direct expenses. CA Tina wants to know few possible reasons which could have led to abnormal jump in gross profit ratio.

During the discussion among engagement team members, her junior Ms. Tisha, expressed her view that detection risk in this engagement should be kept at high level.

- (i) List out a few possible reasons which could have led to abnormal jump in gross profit ratio.

- (ii) Do you agree with viewpoint of Tisha? Provide reasons for your answer. **(5 Marks)**

- (c) Expert Industries Limited is engaged in petrochemical business. Due to nature of its business, the company has hired PQR Associates, a reputed firm of chartered engineers, to determine the quantity and valuation of inventories for preparation of financial statements. The auditor of Expert Industries Limited want to use the same as audit evidence. Before using the work of PQR Associates, management's expert, what aspects should be taken care by auditor? **(4 Marks)**

2. (a) Stay fit Private Limited is a start-up that has been in business for about two years. It runs an application which provides valuable information pertaining to nutrition and helps its clients to access customized healthy food. The company's revenues are expected to grow in the coming period. Although company has reflected net losses in its financial statements for the last two years, it has managed to meet its financial commitments. The financial statements for last two years were prepared on going concern basis of accounting. The management of company wants to follow the same basis of accounting for the current year. Is the view of management appropriate? How does the "going concern" affect the preparation of financial statements? **(5 Marks)**

- (b) PQR & Associates and MNO & Co., both firms of Chartered Accountants, have been appointed as joint auditors of Gama and Beta Limited. Before the commencement of the audit, the joint auditors should discuss and

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develop a joint audit plan. In developing the joint audit plan, the joint auditors should identify division of audit areas and common audit areas. Explain stating the other relevant considerations in this regard with reference to the Standards on Auditing. **(5 Marks)**

- (c) The management of Cool Drinks Limited suspects that some employees of the company may be involved in making fraudulent payments to dummy workers at its various plants in the country. Therefore, they are considering appointment of a firm of auditors to conduct audit involving detailed examination of accounts. However, one senior person among Board members, Mr. P, objects to use of word “audit” in proposed assignment. Comment. Also, discuss how audit is different from investigation. **(4 Marks)**
3. (a) Mr. Chetan is appointed as an auditor of Spot Limited, a small company. Mr. Chetan is aware that CARO 2020 is not applicable to small company. List out the classes of companies that are specifically exempt from the applicability of CARO 2020. **(5 Marks)**
- (b) Zed Limited is engaged in the manufacturing and export of shoes. The statutory auditor of the company wants to reasonably ensure that only the inventories recorded in the financial statements are exclusively owned by the company and do not include any inventories that belong to third parties but includes inventories owned by the company but lying with third party. Advise the auditor on the audit procedures to be performed to achieve this assurance. **(5 Marks)**
- (c) SQC 1 requires assumption of leadership responsibilities for quality within firm. Are such leadership responsibilities required for audit engagements only? Who assumes such leadership responsibilities within firm? How it is important for audit quality? **(4 Marks)**
4. (a) CA X is contemplating the use of negative confirmation requests as the sole substantive audit procedure to verify certain accounts payable balances reflected in financial statements of a company. Which conditions need to be met to use negative confirmation requests as stated above? Additionally, CA X is of the view that negative confirmations provide same level of persuasive audit evidence as in case of positive confirmations. Do you agree with his viewpoint? Provide reasons for your answer. **(5 Marks)**
- (b) CA H has been offered audit of financial statements of a society engaged in promoting social causes, such as setting up of drug de-addiction centres for misguided youth and rehabilitating such young people by helping them find avenues of gainful employment. However, CA H failed to send audit engagement letter to the society’s governing body and proceeded to conduct the audit. In the absence of this letter, the governing body is of the view that purpose of such an audit is to provide absolute assurance against probable errors and frauds in the financial statements. Does it constitute violation of fundamental principles governing professional ethics? State reasons for the same. **(5 Marks)**

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- (c) While verifying cash and cash equivalents of a company, CA D engagement partner, is very particular that Bank reconciliation statement (BRS) prepared by the management in respect of bank account maintained by the company is proper to rule out misstatements in cash and cash equivalents reflected in the financial statements of the company. The company does not use net banking and prefers to issue cheques to its creditors and receives substantial payments locally through account payee cheques. Which aspects need to be taken care of and verified by CA D in respect of BRS? **(4 Marks)**
5. (a) CA Sumit has been appointed as statutory auditor of Core Limited. List out some matters that he may consider in determining whether a deficiency or combination of deficiencies in internal control constitutes a “significant deficiency”. **(5 Marks)**
- (b) While conducting the audit of Zeena Limited, CA E is trying to obtain understanding of different components of internal controls of the company. Such an understanding is necessary and is required to be documented in accordance with Standards on Auditing. In this context, how he shall obtain understanding of the risk assessment process of the company and how is this understanding important for the auditor? **(5 Marks)**
- (c) Section 72(1) of the Multi-State Co-operative Societies Act, 2002 states that only a person who is a Chartered Accountant within the meaning of the Chartered Accountants Act, 1949 can be appointed as an auditor of a multi-state co-operative society. Who, according to Section 72(2), is disqualified from being appointed as auditors of a multi-state co-operative society? **(4 Marks)**
6. (a) National Bank has advanced cash credit facility of ₹ 25 Lakh to Sun Industries. Following is the extract of account of Sun Industries reflecting in CBS of Bank from December 1, 2023 to March 31, 2024: -

Date	Particulars	Dr.	Cr.	Balance (Dr.)
01/12/2023	To Transfer	45,000		24,75,000
31/12/2023	By Clearing		1,00,000	23,75,000
31/12/2023	To Interest	25,000		24,00,000
31/01/2024	To Interest	24,700		24,24,700
29/02/2024	To Interest	24,800		24,49,500
31/03/2024	To Inspection charges	1,000		24,50,500
31/03/2024	To Interest	24,900		24,75,400

Drawing power during the above period was consistent at ₹ 25 Lakh. The account was classified as “Standard asset” as on 31.12.2023 in books of Bank. The security charged with the bank remains intact throughout this period.

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Comment on “asset classification” of above account as on 31st March 2024 in books of Bank in accordance with RBI norms. **(5 Marks)**

- (b) While performing audit of financial statements of a listed company, statutory auditor needs to maintain an attitude of professional skepticism for related party information. State examples of the records or the documents that may provide information about related party relationships and transactions. **(5 Marks)**
- (c) Sanjana is of the view that there exist some disadvantages in the use of audit programmes but most of these can be removed by following some concrete steps. Do you agree with her perspective? Comment. **(4 Marks)**

OR

BOTS is a manufacturing entity having material Property, Plant and Equipment (PPE) items in its financial statements. The auditor of the entity wants to verify that PPE items have been valued appropriately as per generally accepted accounting policies and practices. Comment on significance of such verification. Suggest a few audit procedures in this regard. **(4 Marks)**