

Mock Test Paper - Series II: August, 2025

Date of Paper: 8th August, 2025

Time of Paper: 10 A.M. to 1 P.M.

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 [MCQ 1-4]

Patrika & Co., Chartered Accountants, has been appointed as the statutory auditor of AVR Retails Pvt. Ltd., a company engaged in business of electronics, for the financial year 2024–25. The firm is auditing financial statements of AVR Retails Pvt. Ltd. for the first time. During the audit, the auditor made the following observations:

- The company operates through multiple retail outlets with heavy volumes of cash and card sales.
- Store managers are allowed to approve cash discounts and product returns independently.
- Reconciliations between POS records and bank deposits are not done regularly.
- The IT system used by AVR does not log any changes to inventory records, making it difficult to track adjustments.
- The company has an internal auditor, but this auditor does not report directly to senior management.
- During internal audit, it was found that the automated system failed to charge 12% interest on overdue customer payments due to a technical glitch.
- During audit documentation, an audit assistant saved working files in unsecured folders and did not mention the reviewer's name in the file.
- After signing the audit report, a senior audit team member altered the inventory sampling sheet to reflect a different method, without recording the reason or the date of change.

Based on the above facts, answer the following:

1. Which of the following is a clear non-compliance committed by the audit assistant in accordance with relevant Standard on Auditing?
 - (a) Completing documentation within 60 days of the audit report.
 - (b) Using standard templates for work papers.
 - (c) Omitting reviewer's name and saving files in unsecured folders.
 - (d) Preparing working papers electronically.
2. Which of the following is the most appropriate response for the change in the inventory testing sheet?
 - (a) Permit the change as it will improve the audit quality.
 - (b) Permit the change as the outcome is not changed.
 - (c) Such changes should not be permitted unless reason and date are recorded.
 - (d) Delete both versions and prepare a fresh sheet.
3. The internal auditor discovered that the software failed to charge 12% interest on overdue payments due to a technical glitch. Does reporting this situation fall under the scope of internal audit?
 - (a) No, as it involves customer transactions.
 - (b) Yes, as it relates to internal control failures.
 - (c) No, this is part of financial statement audit.
 - (d) Only if management asks them to review it.
4. Whether statutory auditor can rely extensively on the internal auditor's work in the given situation where internal auditor does not report to higher management and risk of material misstatement seems high.
 - (a) No, the independence and objectivity are compromised.
 - (b) Yes, internal auditor always assists external audit.
 - (c) Yes, if external auditor documents reasons for reliance.
 - (d) Yes, if previous experience with internal auditor is good.

Case Scenario 2 [MCQ 5-8]

CA Adhya, a partner at TAK & Associates, Chartered Accountants, is conducting the statutory audit of NextGen Appliances Pvt. Ltd., a company engaged in the manufacturing and sale of consumer durables, for the year 2024-25.

During the audit, the following observations were made:

- The company conducted its year-end physical inventory count on 30th March 2025. Inventory at one of its warehouses valued at ₹ 95 lakhs was excluded from the count as the location was not visited by him due to flood in that area.
- A large debtor balance of ₹ 68 lakhs is outstanding for over 9 months. The customer has partially shut down operations and has not responded to balance confirmation requests.
- Revenue recognition is done at the point of despatch. However, CA Adhya noticed that certain despatches made on 30th March, 2025 were billed but the goods actually left the premises on 2nd April, 2025.
- The company capitalised an amount of ₹ 25 lakhs as part of machinery installation expenses which included ₹ 5 lakhs incurred on employee training and inauguration ceremony.
- A creditor balance of ₹ 20 lakhs remains not confirmed despite repeated external confirmation requests. The management contends that the amount is payable and valid.

Based on the above facts, answer the following:

5. What should CA Adhya do regarding the inventory at the warehouse that could not be physically verified due to flood?
 - (a) Since the inventory is below materiality threshold, ignore the same.
 - (b) Issue adverse opinion.
 - (c) Perform alternative audit procedures to obtain sufficient appropriate audit evidence.
 - (d) Accept management's written representation as sufficient audit evidence.
6. What should be CA Adhya's conclusion regarding revenue recognised for sales billed on 30th March but despatched on 2nd April?
 - (a) Recognise the revenue in March based on invoice date.
 - (b) Revenue should be deferred to April since ownership and control did not transfer before year-end.

- (c) Consider it as timing difference in invoice and despatch.
 - (d) No action is required as stock is not returned.
7. While verifying capitalised expenses of machinery installation, CA Adhya notices ₹ 5 lakhs towards training and inauguration. What should she do?
- (a) Recommend for reclassification of ₹ 5 lakhs as revenue expenditure.
 - (b) Accept capitalisation as the training and inauguration was part of installation.
 - (c) Ignore as it is below materiality threshold.
 - (d) Ask management for capitalisation certificate from CFO.
8. Which of the following is not a valid alternative audit procedure in case of non-response from a debtor or creditor?
- (a) Examination of subsequent cash receipts or payments.
 - (b) Review of sales or purchase orders.
 - (c) Verification of Board resolution for the amount.
 - (d) Examination of related invoices and delivery documents.

Case Scenario 3 [MCQ 9-12]

Maya & Associates, a Chartered Accountant firm is appointed as an auditor of ABC Pvt. Ltd. CA Maya, partner of the firm, has recently bought stock in ABC Pvt. Ltd. She believes that the company's goodwill will increase after the audit report is finalised, which could lead to a rise in stock price. As she reviews the company's financial statements, Maya decides to give unmodified opinion to help her investment.

Puneet, the CEO of ABC Pvt. Ltd., has requested them to modify certain disclosures in the financial statements in a way that could mislead stakeholders. He argues that a more favourable presentation will help the company secure additional investments. Ashi, another Partner of Firm, feels that complying with this request would compromise ethical standards and worries about potential conflicts with the client.

Maya & Associates has also been appointed as the statutory branch auditors of Delhi branch of CIC Bank. While carrying out the audit, the following key issues were identified:

Issue 1: PV Ltd.'s account has seen no recovery for the past 18 months. However, the bank has not applied NPA norms or income recognition norms to this account. The management justifies this by stating that the account is guaranteed by the Central Government and that NPA and income recognition norms are not applicable. Government has not invoked the guarantee.

Issue 2: CWP Traders has applied for a cash credit limit from CIC Bank for supporting working capital requirements on account of business expansion. In discussions with CWP Traders, CIC Bank has requested different forms of security, depending on the nature of the assets offered, which includes immovable property (warehouse), goods in stock, accounts receivable, and insurance policies. Borrower provided the security and was sanctioned cash credit limit of ₹ 4.50 Crores.

Based on the above facts, answer the following MCQs:

9. CA Maya has bought stock in ABC Pvt. Ltd., and her investment could benefit from issuance of unmodified opinion in her audit report. This indicates existence of:
 - (a) Self-interest Threat.
 - (b) Self-review Threat.
 - (c) Advocacy Threat.
 - (d) Familiarity threat.
10. Puneet, the CEO, is requesting the Ashi and Maya to modify the financial statement disclosures in a misleading manner. Which fundamental principle of professional ethics would be violated if they agree to do so?
 - (a) Integrity.
 - (b) Objectivity.
 - (c) Confidentiality.
 - (d) Professional Competence and Due Care.
11. Is the bank's decision not to apply NPA and income recognition norms to account of PV Ltd. valid under regulatory guidelines?
 - (a) The bank is correct to the extent of not applying the NPA norms for provisioning purposes. However, this exemption is not available in respect of income recognition norms.
 - (b) The bank is not correct for not applying the NPA norms for provisioning purposes. But this exemption is available in respect of income recognition norms.
 - (c) The bank is correct in not applying the NPA norms and income recognition norms as both are not applicable.
 - (d) The bank is not correct in not applying the NPA norms and income recognition norms as both are applicable.

12. CWP Traders offered its warehouse as security for the loan. CIC Bank created a charge on the warehouse. Which form of security has been created and whether bank is required to get stock audit done of cash credit account of CWP Traders?
- (a) Security created is Pledge and bank is required to get stock audit done of cash credit account of CWP Traders.
 - (b) Security created is Mortgage and bank is required to get stock audit done of cash credit account of CWP Traders.
 - (c) Security created is Pledge and bank is not mandatorily required to get stock audit done of cash credit account of CWP Traders.
 - (d) Security created is Mortgage and bank is not mandatorily required to get stock audit done of cash credit account of CWP Traders.

MCQs

13. During the audit of PQR Ltd., the audit team decides to develop a graphical presentation of various components of the company's internal control system. This provides a bird's eye view of the system, including the flow of transactions and their integration. It helps the auditors to understand and evaluate the internal controls more in the correct perspective. Which method of evaluating internal control is being used by the audit team?
- (a) Check list
 - (b) Narrative record
 - (c) Internal Control questionnaire
 - (d) Flow Chart
14. KRAT & Co. has been appointed as the statutory auditor of Astral Resorts Ltd. This is the first time the firm is having audit engagement in the hospitality sector. After obtaining a comprehensive understanding of the Resort and its environment, the engagement partner, CA Ankita, and other key members of the engagement team have undertaken the activity of development of an audit plan for the audit of the resort. As per SA 300, description of which of the following matters is not a part of developing an audit plan?
- (a) The nature, timing, and extent of planned risk assessment procedures.
 - (b) The nature, timing, and extent of planned further audit procedures at the assertion level.
 - (c) Other planned audit procedures required to ensure compliance with Standards on Auditing.
 - (d) The nature, timing, and extent of resources necessary to perform the engagement.

15. CA Raj is in the completion phase of the audit of Happy Private Limited, a manufacturing company, for the financial year 2024-25. On 26th May 2025, he becomes aware that a fire had occurred on 15th April 2025 at one of the company's premises. As a result of the fire, all inventories stored at that location, amounting to ₹ 2 crores, were destroyed. However, these inventories were insured with Insure Goods Limited for ₹ 75 lakhs, and the company has lodged a claim, which is yet to be settled. This issue remains uncorrected in the financial statements. Which of the following statements is most appropriate regarding the fire incident?
- (a) The auditor should ask management to disclose it in notes to accounts.
 - (b) The auditor should ask management to adjust financial statements for period under audit and book a loss of ₹ 75 lakhs in its Statement of Profit and Loss.
 - (c) The auditor should ask management to adjust financial statements for period under audit and book a loss of ₹ 2 crores in its Statement of Profit and Loss.
 - (d) The auditor has no responsibility regarding described fire incident.

PART II - Descriptive Questions (70 Marks)

Question No. 1 is compulsory.

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

1. (a) CA Sakshi, the statutory auditor of ZMC Ltd., a medium-sized trading company, was reviewing the company's internal control system as part of her audit procedures. She noticed following instances where errors and lapses occurred:
- An employee failed to take action on an important report due to lack of understanding of its content.
 - The finance team made duplicate payments.
 - Two employees colluded to override a system check related to customer credit limits.
 - The owner approved certain transactions bypassing standard operating procedures, raising concerns about management override.
 - Duties were not segregated properly due to limited staff strength.

CA Sakshi discussed these findings with the management and explained that such control failures, despite the existence of internal controls, are not rare. She also highlighted that internal control systems inherently have certain limitations.

Based on the above, what is CA Sakshi trying to communicate to the management? What are the inherent limitations of internal control systems that may have led to these issues? **(5 Marks)**

- (b) CA Veer is conducting the statutory audit of Lamex Industries Ltd., a company engaged in manufacturing and export of textile goods. The audit firm has been auditing the company for the last three years using the same detailed audit programme prepared during the initial year of engagement. During the audit, one of the article assistants followed the audit programme strictly but failed to detect significant issues arising from the company's recent shift to an automated inventory system and changes in their revenue recognition policy. When reviewing the audit documentation, CA Veer realised that the audit programme had not been updated to reflect the company's operational and control changes over time.

In view of above situation, explain why periodic review of the audit programme is essential. What could be the consequences of continuing with outdated audit programme? **(5 Marks)**

- (c) M/s Dheeraj & Associates, Chartered Accountants, have been appointed as statutory auditors of SPICE Limited for the year 2024-25. CA Dheeraj relied solely on the prior year's audited financial statements and did not apply any audit procedures regarding opening balances. He is of the view that since financial statements were audited by the predecessor auditor, therefore, he is not required to verify them. Whether point of view of CA Dheeraj is correct? **(4 Marks)**

2. (a) Identify and explain the assertions that the auditor will check by performing the following audit procedures:
- (i) Any inventory held by the entity on behalf of another entity has not been recognised as part of inventory of the entity.
 - (ii) Employee benefit expense has been incurred during the period in respect of the personnel employed by the entity.
 - (iii) Inventory has been recognised at the lower of cost and net realisable value in accordance with AS 2 - Inventories.
 - (iv) Sales shall include the despatch of goods made at the year-end as they belong to the relevant period.
 - (v) Any inventory held by a third party on behalf of the entity has been included as part of the inventory balance. **(5 Marks)**
- (b) Advances generally constitute the major part of the assets of the bank. There are large number of borrowers to whom variety of advances are granted. The audit of

advances requires the major attention from the auditors. In carrying out audit of advances, the auditor is primarily concerned with obtaining evidence about, among other points, the amounts included in balance sheet in respect of advances are outstanding at the date of the balance sheet. Explain. **(5 Marks)**

- (c) ABS & Co., Chartered Accountants, have been appointed as statutory auditors of Aerotech Systems Pvt. Ltd., a company that makes advanced equipment used in airplanes. Considering technical and complex nature of operations, the auditors recognise that involvement of experts in the audit is required. Does consideration for involvement of experts by auditors fall in the domain of planning audit? **(4 Marks)**
3.
 - (a) The auditor should maintain alertness for related party information while reviewing records and documents. He may inspect the records or documents that may provide information about related party relationships and transactions. List any ten documents or records that an auditor may inspect to identify related party relationships and transactions during an audit. **(5 Marks)**
 - (b) CA Ritu is conducting the statutory audit of KLM Ltd. During the audit, she encountered significant difficulties in obtaining certain information from the company's finance team. She also noted that one of the accounting practices, although acceptable under the applicable financial reporting framework, may not be the most appropriate considering the company's circumstances. With reference to SA 260, what significant findings from the audit should an auditor communicate to those charged with governance? **(5 Marks)**
 - (c) Fair Ltd. has been sanctioned a Cash Credit facility of ₹ 1.50 crores by Worthy Bank. Based on the monthly stock statements submitted for the last quarter, the drawing power is calculated at ₹ 1.45 crores. The outstanding balance in the cash credit account at the end of the quarter is ₹ 1.40 crores. Interest charged to the account is ₹ 6 Lakh and total credit into the account for the quarter is ₹ 4 Lakh. As an auditor, how would you examine and report the account if it is classified as 'out of order' by the bank? **(4 Marks)**
4.
 - (a) Delightful Limited is required to present comparative financial statements for the year 2023-24 and 2024-25. CA Mohit has been appointed as the statutory auditor for the year 2024-25. While reviewing the financial statements of year 2023-24, he notices that the last year's financial statements contain an adverse opinion for the financial statement as a whole due to a misstatement in the evaluation and disclosure of the debtors. Guide CA Mohit for his duty regarding the treatment and addressing the issue while drafting his audit report. What disclosures he is required to make in this regard? **(5 Marks)**

- (b) CA Sulsa is conducting the statutory audit of SATI Ltd. While reviewing the purchase records, she noticed a large purchase transaction supported by only one internal document. The management responded that this is usual practice and assures her of the document's authenticity. However, the amount involved is material and no external supporting evidence is provided. What should be CA Sulsa's approach in this situation as per the professional skepticism principle? Why is it important for an auditor to maintain professional skepticism throughout the audit? **(5 Marks)**
- (c) CA Mahavir is conducting a training session for newly joined audit trainees. He explains the concept of audit risk and its three components. He mentions that while two components of audit risk are beyond the auditor's control, one component can be influenced by the auditor. Identify the component of audit risk that can be controlled by the auditor. Give two examples of this component. Also explain how the auditor can manage this component to keep audit risk at a low level. **(4 Marks)**
5. (a) Shiksha Public School maintains a Fee Register and issues receipts to students for fee collection. During the audit, the auditor observed that some students were granted concessions, and some fee payments were pending. As an auditor, what procedures would you perform to verify the student fee collections in such an institution? **(5 Marks)**
- (b) RST Ltd., a company engaged in manufacturing eco-friendly packaging solutions, is planning to enter into a new geographical market and launch a new biodegradable product line. To attract investors and secure bank funding, the management has prepared prospective financial information based on expected sales and expansion costs. RST Ltd. appointed a firm of auditors to conduct an assurance engagement on this prospective financial information. During the engagement, the auditors reviewed the assumptions made by the management and issued a report.
- Explain the key differences between prospective financial information and historical financial information. How does this distinction impact the level of assurance provided in an assurance engagement on prospective financial information? **(5 Marks)**
- (c) CA Saurabh is conducting the statutory audit of UVW Ltd. for the year 2024-25. While verifying the purchases made by the company, he decided to perform analytical procedures for obtaining audit evidence regarding the overall reasonableness of purchase quantity and price of purchases. Briefly mention the

analytical procedures an auditor can perform to evaluate the overall reasonableness of raw material purchase quantity and price. **(4 Marks)**

6. (a) Money Ltd. is a listed company engaged in the business of manufacturing. During the financial year 2024–25, the company has given loans to its subsidiary and provided a corporate guarantee on behalf of a related party.

State the reporting responsibilities of the auditor under Clause (iii) of Paragraph 3 of CARO, 2020. **(5 Marks)**

- (b) TED Ltd. has taken an office building on rent for its operations. The auditor wants to verify the rent expense recorded in the books. Describe the audit procedures that should be performed by you as an auditor to verify the rent expense.

(5 Marks)

- (c) CA Sandeep has identified certain misstatements during course of audit of an entity. Except two misstatements, all were corrected by management. He wants to obtain written representation from management regarding effects of these uncorrected misstatements. Describe matter contained in such written representations.

Also discuss documentation requirements regarding misstatements identified during the course of audit in accordance with relevant SA. **(4 Marks)**

OR

CA Kavita is statutory auditor of Sigma Limited. While conducting audit for financial year 2024-25, it is noticed that there is risk of material misstatement regarding identified litigation or claims. In these circumstances, it has been considered appropriate by auditor to send a “letter of specific inquiry” to external legal counsel of the company. When is an auditor likely to send a letter of specific inquiry to an entity’s external legal counsel instead of a letter of general inquiry? Which matters are likely to be included in “letter of specific inquiry” sent by auditor to external legal counsel? **(4 Marks)**