

Mock Test Paper - Series II: August, 2025

Date of Paper: 6th August, 2025

Time of Paper: 2 PM to 5 PM

FINAL COURSE: GROUP – I

PAPER – 3: ADVANCED AUDITING, ASSURANCE AND PROFESSIONAL ETHICS

ANSWERS

Part I: MULTIPLE CHOICE QUESTION

1. (b)
2. (d)
3. (c)
4. (b)
5. (b)
6. (d)
7. (c)
8. (a)
9. (d)
10. (b)
11. (d)
12. (d)
13. (b)
14. (b)
15. (b)

Part II - DESCRIPTIVE QUESTION

1. (a) As per SA 510, "Initial Audit Engagements – Opening Balances", while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether -
 - (i) Opening balances contain misstatements that materially affect the current period's financial statements; and
 - (ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or

changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements.

Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures, say, the collection of opening accounts receivable, (like external confirmations) during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In addition, according to SA 505, "External confirmations" the auditor can use external confirmation procedures to obtain audit evidence.

Further, according to SA 580, "Written Representations", the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

In the given case, the management of Vij Pvt. Ltd. has restrained CA Pawan, its auditor, from obtaining appropriate audit evidence for balances of accounts receivable outstanding as it is from the preceding year. CA Pawan, on believing that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Thus, CA Pawan should have requested the management to provide written representation for their views and expressions and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme.

(b) In the given case, following factors are indicator of material uncertainty that may cast significant doubt on the company's ability to continue as a going concern:

- The ageing schedule of the company reflects that company is not able to pay its creditors on time. Outstanding creditors for a period of 1 year or more account for 80% of total creditors of the company.
- Most of key financial ratios are adverse.
- Bankers have refused further debits in cash credit accounts due to negative drawing power from March, 2025.
- Cash credit loans are repayable on demand.
- There is no other information available on how the company plans to run its business without bank finance.

Also, upon inquiry with the management, it was identified that management did not have any major future contracts to boost their revenue and financial position.

All the above factors indicate that a material uncertainty exists that may cast significant doubt on the company's ability to continue as a going concern and appropriate disclosure of this fact is also not made in financial statements.

Therefore, it is a situation where material uncertainty exists, which has cast significant doubt on company's ability to continue as going concern in accordance with SA 570, "Going Concern".

Considering above the fact that although a material uncertainty exists casting significant doubt on the ability of the company to continue as going concern, adequate disclosure of material uncertainty is not made in financial statements. Thus, CA Prashant shall give qualified or adverse opinion in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

(c) As per SA 620, "Using the work of an Auditor's Expert", the nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances, as may the respective roles and responsibilities of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore required that these matters are agreed between the auditor and the auditor's expert.

In certain situations, the need for a detailed agreement in writing is required like -

- The auditor's expert will have access to sensitive or confidential entity information.

- The matter to which the auditor's expert's work relates is highly complex.
- The auditor has not previously used work performed by that expert.
- The greater the extent of the auditor's expert's work, and its significance in the context of the audit.

In the given case, Mohan Ltd. is mandatorily required to comply with Ind AS as it had complex derivative contracts requiring fair valuation under Ind AS 109. The company obtained valuations from a third party, and statutory auditor CA Paras engaged Mr. Sohan as an auditor's expert to assess their appropriateness and accuracy of the valuation methodology and results. Though it was their first time that they were working together and developed good bonding, no formal written agreement was made with the expert.

Thus, as per SA 620 considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/engagement letter with the auditor's expert in respect of the work assigned to him.

2. (a) As per Ind AS 24, "Related Party Disclosures", a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with (i) a government that has control or joint control of, or significant influence over, the reporting entity; and (ii) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

If a reporting entity applies the above exemption, it shall disclose the following about the transactions and related outstanding balances referred to:

- (1) the name of the government and the nature of its relationship with the reporting entity (i.e. control, joint control or significant influence);
- (2) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:
 - (i) the nature and amount of each individually significant transaction; and
 - (ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

Further, as per SA 550, "Related Parties", in forming an opinion on the financial statements in accordance with SA 700, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

In the instant case, Electric Corporation Limited, a Government Company has procured spares for transmitters for ₹ 700 crore from abroad through a corporation namely PCDC India Limited which is also owned and controlled by Government of India. Even after applying the exemption of Ind AS 24, Electric Corporation Limited has to disclose the matters specified above (i.e.name of Government, nature of its relationship with reporting entity, the nature and amount of transaction etc.). Contention of Management of Corporation regarding no requirement of disclosure for transactions between State Controlled Enterprise is not tenable.

- (b) IT dependencies are created when IT is used to initiate, authorize, record, process, or report transactions or other financial data for inclusion in the financial statements.

System generated reports are the information generated by the IT systems. These reports are often used in an entity's execution of a manual control, including business performance reviews, or may be the source of entity information used by us when selecting items for the testing, performing substantive tests of details or performing a substantive analytical procedure. e.g. (Vendor master report, customer ageing report).

Interfaces are programmed logic that transfer the data from one IT system to another. For example, an interface may be programmed to transfer data from a payroll subledger to the general ledger.

In this manner, IT dependencies arise due to "system generated reports" and "interfaces".

Identifying and documenting the entity's IT dependencies in a consistent, clear manner helps to identify the entity's reliance upon IT, understand how IT is integrated into the entity's business model, identify potential risks arising from the use of IT, identify related IT General Controls and enables us to develop an effective and efficient audit approach.

- (c) Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct, if he discloses information acquired in the course of his professional engagement to any person other than his client so

engaging him, without the consent of his client or otherwise than as required by any law for the time being in force.

An accountant, in public practice, has access to a great deal of information of his client which is of a highly confidential character. It is important for the work of an accountant and for maintaining the dignity and status of the profession that he should treat such information as having been provided to him, only to facilitate the performance of his professional duties for which his services have been engaged. The Code of Ethics further clarifies that such a duty continues even after completion of the assignment.

In the given situation, TP & Associates complained to the Registrar of Companies (ROC) through letter highlighting the points of dispute including non-existence of fixed assets, bogus creditors, etc. after coming to know about the removal. TP & Associates made voluntary disclosure of the information acquired during the professional engagement without the consent of the client and without there being any requirement in law to disclose the same. Thus, the concerned responsible partner of TP & Associates, being a Chartered Accountant in practice, shall be held guilty of professional misconduct for voluntary disclosure made by him.

3. (a) In the given scenario, C&AG appointed Rajni & Associates, a chartered accountant firm, to conduct Performance Audit of LBC Ltd., a PSU of Government of India. The firm conducted audit with a view to check all the expenses of the unit are in conformity to the public interest and publicly accepted customs which is not Performance Audit.

A performance audit is an objective and systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability and facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit and Accounts Department (IAAD). In conducting performance audit, the subordinate offices are guided by manual and auditing standards prescribed by C&AG.

Therefore, the objectives of performance auditing are evaluation of economy, efficiency, and effectiveness of policy, programmes, organisation and management. It also promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance; and transparency by affording taxpayers, those targeted by government policies and

other stakeholders an insight into the management and outcomes of different government activities.

Performance auditing focuses on areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action.

Regulations on Audit and Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives and performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate and final outputs and outcomes in measurable and monitorable terms, standardise the unit cost of delivery and benchmark quality of outputs and outcomes.

Thus, rejection of audit report (submitted by audit firm) by C&AG is in order as audit with a view to mere check all the expenses of the unit are in conformity to the public interest and publicly accepted customs done by audit firm is not performance audit in all aspects.

- (b) As per SRE 2410, "Review of Interim Financial Information Performed by the Independent Auditor of the Entity", procedures performed by the auditor to update the understanding of the entity and its environment, including its internal control, ordinarily include the following:
- Reading the documentation, to the extent necessary, of the preceding year's audit and reviews of prior interim period(s) of the current year and corresponding interim period(s) of the prior year, to enable the auditor to identify matters that may affect the current-period interim financial information.
 - Considering any significant risks, including the risk of management override of controls, that were identified in the audit of the prior year's financial statements.
 - Reading the most recent annual and comparable prior period interim financial information.
 - Considering materiality with reference to the applicable financial reporting framework as it relates to interim financial information to assist in determining the nature and extent of the procedures to be performed and evaluating the effect of misstatements.

- Considering the nature of any corrected material misstatements and any identified uncorrected immaterial misstatements in the prior year's financial statements.
 - Considering significant financial accounting and reporting matters that may be of continuing significance such as material weaknesses in internal control.
 - Considering the results of any audit procedures performed with respect to the current year's financial statements.
 - Considering the results of any internal audit performed and the subsequent actions taken by the management.
 - Inquiring of management about the results of management's assessment of the risk that the interim financial information may be materially misstated as a result of fraud.
 - Inquiring of management about the effect of changes in the entity's business activities.
 - Inquiring of management about any significant changes in internal control and the potential effect of any such changes on the preparation of interim financial information.
 - Inquiring of management of the process by which the interim financial information has been prepared and the reliability of the underlying accounting records to which the interim financial information is agreed or reconciled.
- (c) This aspect is covered under 'Other Misconduct' which has been defined in Part IV of the First Schedule and Part III of the Second Schedule. These provisions empower the Council even if it does not arise out of his professional work. This is considered necessary because a Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.
- Further, when a Chartered Accountant uses the services of his Articled Assistant for purposes other than professional practice, it tantamount to 'Other Misconduct'.
- In the given case, CA Ajay has engaged his Articled Assistant for his election campaigning for the Central Council elections of ICAI. Hence, CA Ajay is guilty of 'Other Misconduct'.

4. (a) As per Chapter X of Council General Guidelines, 2008 a member of the Institute in practice or a partner of a firm in practice or a firm shall not accept appointment as auditor of a concern while indebted to the concern or given any guarantee or provided any security in connection with the indebtedness of any third person to the concern, for limits fixed in the statute and in other cases for amount exceeding ₹ 1,00,000/-.

Under section 141(3) of the Companies Act, 2013 along with Rule 10 of the Companies (Audit and Auditors) Rules, 2014, a person shall be disqualified to be appointed as auditor if he or his relative or his partner is indebted in excess of rupees five lakh to the company or its subsidiary or its holding company or its associate company or a subsidiary of such holding company.

However, the Research Committee of the ICAI has expressed the opinion that where in accordance with the terms of engagement of auditor by a client, the auditor recovers his fees on a progressive basis as and when a part of the work is done without waiting for the completion of the whole job, he cannot be said to be indebted to the company at any stage.

Conclusion: In the instant case, Mr. Dharam is appointed to conduct statutory audit of Great Ltd., a listed entity and it was decided in the terms of acceptance of audit, that the whole audit fee shall be payable in four installments of ₹ 1.5 lakh each and shall be paid after every limited review done on quarterly basis and conclusion of audit committee meeting every quarter. He has received the audit fees of ₹ 1.5 lakh in respect of two quarters, but for third and fourth quarter the payment of fees was received on March 21st, 2025, for the year ended 31.3.2025 which is on progressive basis. Therefore, Mr. Dharam will not be held guilty of misconduct.

- (b) (i) The activity described in the situation is Due diligence. Due diligence is a measure of prudence activity, or assiduity, as is properly to be expected from, and ordinarily exercised by, a reasonable and prudent person under the particular circumstance, not measured by any absolute standard but depending upon the relative facts of the case. It involves a careful study of financial and non-financial possibilities. It implies a general duty to take care in any transaction.

Due diligence is a process of investigation, performed by investors, into the details of a potential investment such as an examination of operations and management and the verification of material facts. It entails conducting inquiries for the purpose of timely, sufficient and accurate disclosure of all material statements/information or documents, which may influence the outcome of the transaction. Due diligence involves a careful study of the

financial as well as non-financial possibilities for successful implementation of restructuring plans.

Due diligence involves an analysis carried out before acquiring a controlling interest in a company to determine that the conditions of the business conform with what has been presented about the target business. Also, due diligence can apply to recommendation for an investment or advancing a loan/credit.

(ii) There would be no difference in answer if above activity was to be performed by a person who is not a Chartered Accountant. The activity would remain due diligence. Due diligence can be performed by any person. It is not necessary that due diligence can only be carried out by a Chartered Accountant. As due diligence involves exercise of prudence and general duty to take care in any transaction, it can be undertaken by any person.

(iii) The areas where due diligence may be undertaken are: -

- Corporate restructuring
- Venture capital financing
- Public offerings

(c) SA 600 states that the principal auditor would not be responsible in respect of the work entrusted to the other auditors, except in circumstances which should have aroused his suspicion about the reliability of the work performed by the other auditors. When the principal auditor has to base his opinion on the financial information of the entity as a whole relying upon the statements and reports of the other auditors, his report should state clearly the division of responsibility for the financial information of the entity by indicating the extent to which the financial information of components audited by the other auditors have been included in the financial information of the entity, e.g., the number of divisions/branches/subsidiaries or other components audited by other auditors.

In the given situation, nothing has come to light of statutory auditor which would arouse his suspicion about reliability of work performed by branch auditor. Therefore, he would not be responsible for work performed by branch auditor.

Further, it should be clearly stated in the report that 96 production and sales units of company have been audited by branch auditors.

5. (a) Sometimes, a customer is sanctioned a cash credit limit at one branch but is authorised to utilise such overall limit at several other branches also, for each of which a sub-limit is fixed.

In such a case, the determination of status of the account as NPA or otherwise should be determined at the limit-sanctioning branch with reference to the overall sanctioned limit/drawing power and not by each of the other branches where a sub-limit has been fixed.

The auditor of the limit-sanctioning branch should examine whether it receives particulars of all transactions in the account at sub-limit branches and whether status of the account has been determined considering the total position of operation of the account at all concerned branches. The standalone matter of no credit transactions for more than 90 days as on 31st March, 2025 at Amritsar branch is irrelevant.

Hence, keeping in view above, CA Krish should consider asset classification considering the total position of operation of the account at all concerned branches.

Regarding sub-limits at branches, the classification adopted by the limit-sanctioning branch should be followed. Hence, the Amritsar branch has to follow asset classification made by the limit-sanctioning branch.

- (b) As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall review the outcome of accounting estimates included in the prior period financial statements, or, where applicable, their subsequent re-estimation for the purpose of the current period. The nature and extent of the auditor's review takes account of the nature of the accounting estimates, and whether the information obtained from the review would be relevant to identifying and assessing risks of material misstatement of accounting estimates made in the current period financial statements.

The outcome of an accounting estimate will often differ from the accounting estimate recognised in the prior period financial statements. By performing risk assessment procedures to identify and understand the reasons for such differences, the auditor may obtain:

- Information regarding the effectiveness of management's prior period estimation process, from which the auditor can judge the likely effectiveness of management's current process.
- Audit evidence that is pertinent to the re-estimation, in the current period, of prior period accounting estimates.

- Audit evidence of matters, such as estimation uncertainty, that may be required to be disclosed in the financial statements.

The review of prior period accounting estimates may also assist the auditor, in the current period, in identifying circumstances or conditions that increase the susceptibility of accounting estimates to, or indicate the presence of, possible management bias. The auditor's professional skepticism assists in identifying such circumstances or conditions and in determining the nature, timing and extent of further audit procedures. However, the review is not intended to call into question the judgments made in the prior periods that were based on information available at that time.

In the given case, the contention of management is not correct in refusing the relevant information to the auditor.

- (c) **Principle 1 – Ethics, Transparency and Accountability:** The first principle emphasizes that the business decisions in an organisation should be open to disclosure and accessible to the relevant interested parties.

The essence of the core elements associated with the first principle are:

- (i) The entities' governing structure should develop policies, procedures, and practices for their offices, factories, and work areas, ensuring that ethics is not compromised.
- (ii) The information relating to the policies, procedures, and practices along with the performance should be made available to the stakeholders.
- (iii) In case of adverse effects, more care has to be taken for transparent disclosures.
- (iv) The entities in the value chain should be encouraged to adopt these principles by the governance structure.
- (v) The entities should proactively respond to the outside entities that violate the nine principles of the BRSRs. This includes their suppliers, distributors, sub-contractors, or regulatory officers that may engage with the business concern.

6. (a) In the given situation, CA Shreyansh is carrying out an audit of restated financial statements of MBC Limited for past 3 financial years i.e., 2024-25, 2023-24 and 2022-23 so he requested Management Representation Letter from the management of the Company for this assignment before issuance of the report. The management of the Company provided the Management Representation Letter only for the financial year 2024-25 as they were not in place during that period.

As per SA 580, "Written Representations", as written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated before the date of the written representations.

As per SA 560, "Subsequent Events", the auditor is concerned with events occurring up to the date of the auditor's report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the audit. Where this is the case, it may be necessary to request an updated written representation.

The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

Situations may arise where current management was not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole.

Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies. Therefore, as per the above requirement of SA 580, CA Shreyansh should take written representation letter from management of MBC Limited for the financial year 2023-24 and 2022-23 also.

In case the management of MBC Limited does not provide written representation as requested, the auditor shall discuss with the management, re-evaluate the integrity of management, and take appropriate actions including the impact on the audit report as per SA 705.

- (b)** As per Clause (11) of Part I of Schedule I to the Chartered Accountants Act, 1949, a member in practice is deemed to be guilty if he engages in any business or occupation other than the profession of chartered accountant unless permitted by the Council so to engage. Provided that nothing contained herein shall disentitle

a chartered accountant from being a director of a company (not being a managing director or a whole-time director) unless he or any of his partners is interested in such company as an auditor.

As per Regulation 190A, a chartered accountant in practice not to engage in any other business or occupation other than the profession of accountancy except with the permission granted in accordance with a resolution of the Council.

In the given case, CA Deepali is a practicing chartered accountant having office in Surat. CA Deepali is owner of creative.net. In order to generate additional revenue, CA Deepali sold this domain name for earning royalty of ₹ 3,50,000 to GRIP Limited. One of the directors of GRIP Limited contended that CA Deepali has violated the Code of Conduct. CA Deepali responded that there is no violation of Code of Conduct as selling of domain name is not related to any professional assignment which requires approval of the Institute. As per Regulation 190A, the activity of selling domain name for earning Royalty would amount to "other business/occupation" without approval is prohibited.

Hence, CA Deepali is guilty of professional misconduct under Clause 11 of Part I of Schedule I to the Chartered Accountants Act, 1949 for selling domain name for a royalty.

- (c) Yes, in the given situation general conditions pertaining to the internal check system are violated as follows:
- (i) Allowing Mr. Abhishek, the store manager, to maintain inventory records while also having custody of the inventory violates the principle that those with physical custody of assets should not have access to accounting records.
 - (ii) The lack of staff rotation for over seven years violates the principle that staff duties should be rotated periodically to prevent any single person from performing the same function for too long.
 - (iii) The head of procurement, Mr. Sumit, having complete control over the procurement process without oversight violates the principle that no single person should control any important aspect of the business operation.

OR

- (c) As per SA 610, "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance to perform procedures that involve making significant judgments in the audit.

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

Significant judgments include the following:

- Assessing the risks of material misstatement;
- Evaluating the sufficiency of tests performed;
- Evaluating the appropriateness of management's use of the going concern assumption;
- Evaluating significant accounting estimates; and
- Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

In view of the above, CA Ajeet cannot ask for direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.