

# M.K.G CA EDUCATION

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## TEST-3

### CA INTERMEDIATE

### AUDITING AND ETHICS

#### Topics Covered:

#### Full Syllabus

**QUESTION PAPER BOOKLET NO. 3042024**

**(14-04-2024 3:00 P.M. TO 6:00 P.M.)**

Roll No .....347256.....

Time allowed: 3 hours

Total No. of Printed Pages: 10

Maximum Marks: 100

#### GENERAL INSTRUCTIONS TO CANDIDATES

1. The Question Paper comprises two parts, Part I & Part II
2. Part I comprises Multiple choice Questions
3. Part II comprises questions which require descriptive type answers
4. TIME ALLOWED 180 MINUTES
5. MAXIMUM MARKS 100

## Part I

### MULTIPLE CHOICE QUESTIONS

#### Case Scenario

DS & Co., Chartered Accountants, are statutory auditors of SAR Industries Pvt Ltd, a company engaged in manufacturing business since 2018. The company is operating from rented premises and it does not have building of its own. It had upgraded its machinery last time in 2020. Except interest in this company, promoters, directors, key managerial persons and their relatives do not have interest or ownership in any other entity. Also, the company does not enter into any business dealings with promoters, directors, key managerial persons and their relatives. The directors and key managerial persons get only reasonable remuneration from the company. Though company has an internal control system in place, it has not appointed internal auditor. It is also not mandatorily required to make such an appointment under the provisions of the Companies Act, 2013.

DS & Co. have accepted audit of the above company for year 2022-23 for the first time. Promoters and directors of the company are known to engagement partner only socially for quite some time. However, it is for the first time that any type of professional work related to this company has been accepted by them.

While formulating audit plan for the company, CA D (engagement partner) has planned certain risk assessment procedures and further audit procedures consisting of tests of controls and substantive procedures in relation to different areas.

The following is extract of financial information of the company: -

(figures in rupees crores)

S. No.	Particulars	Year 2022-23	Year 2021-22
1.	Turnover	30.00	15.00
2.	Inventories	5.00	2.00
3.	Property, plant and equipment (Gross block)	1.25	1.25
4.	Property, plant and equipment (Net block)	1.00	1.25
5.	Gross profit	6.00	3.75
6.	Trade receivables	12.50	5.00

The PPE items consist of machinery only. While planning procedures in respect of Property, Plant and Equipment, auditor has included audit procedures like inspecting and reviewing company's plan for performing physical verification of PPE, assessing depreciation method used, verifying cost of PPE items acquired during the year with purchase bills and recalculation of depreciation charged in statement of profit and loss.

Further, while performing risk assessment procedures to identify risk of material misstatements in financial statements., engagement partner has come to notice that there is considerable variation in gross profit ratio as compared to last year. During performance of substantive procedures, he has also studied data of purchases and sales of the company during the year under audit and has also compared such data with preceding year and earlier years also.

**Based on above, answer the following questions: - (Q. No. 1 to 5)**

1. Keeping in view description provided in the case scenario, which of the following statements is likely to be most appropriate? **(2 Marks)**

(a) Engagement partner is known socially to promoters and directors of the company. The situation mandatorily involves advocacy threat casting a doubt on auditor's independence. Irrespective of this, detection risk in engagement is low.

(b) Engagement partner is known socially to promoters and directors of the company. The situation mandatorily involves familiarity threat casting a doubt on auditor's independence. Irrespective of this, detection risk in engagement is high.

(c) The situation reflected in the case scenario may not constitute threat to independence of auditor. Irrespective of this, detection risk in engagement is low.

(d) The situation reflected in the case scenario may not constitute threat to independence of auditor. Irrespective of this, detection risk in engagement is high.

2. CA D has included in audit plan certain procedures in respect of PPE items. Which of the following audit procedure included in audit plan is not likely to be relevant? **(2 Marks)**

(a) Inspecting and reviewing company's plan for physical verification of PPE

(b) Assessing depreciation method used

(c) Verifying cost of PPE items acquired during the year with purchase bills

(d) Recalculation of depreciation charged in statement of profit and loss

3. Which of the following statements is likely to be most suitable to explain the fact relating to variation in gross profit ratio as compared to last year? **(2 Marks)**

(a) Gross profit ratio has decreased in year 2022-23 as compared to year 2021-22. It may be due to the reason that sales prices may have been reduced by the company to procure more orders.

(b) Gross profit ratio has increased in year 2022-23 as compared to year 2021-22. It may be due to the reason that cost of materials purchased by company could have decreased.

(c) Gross profit ratio has decreased in year 2022-23 as compared to year 2021-22. It may be due to the reason that office staff salary engaged in administrative functions and office maintenance expenditure could have increased.

(d) Gross profit ratio has decreased in year 2022-23 as compared to year 2021-22. It may be due to the reason that company has not made an allowance for obsolescence in respect of inventories during the year.

4. CA D has also studied purchases and sales data of the company during the year and has also compared such data with preceding year and earlier years also. It is an example of \_\_\_\_\_? **(2 Marks)**

(a) Ratio analysis forming part of substantive analytical procedures

(b) Trend analysis forming part of substantive analytical procedures

(c) Reasonable test forming part of substantive analytical procedures

(d) Structural modelling forming part of substantive analytical procedures

5. Considering case scenario in totality, identify which of following combination of Standards is not proper for their likely relevance in performing and completing above engagement? **(2 Marks)**

(a) SQC 1, SA 220, SA 501, SA 505

(b) SA 550, SA 510, SA 220, SA 610

(c) SA 700, SA 510, SA 220, SA 500

(d) SQC 1, SA 700

### Case Scenario

CA M. Raja has accepted offer of appointment of auditor of an entity. As business carried on by the entity is new to him, he wants to gain an understanding about the entity and its environment including its internal control. In this regard, he has performed procedures to obtain audit evidence about design and implementation of relevant controls. He has performed various procedures like inquiry, inspection and observation in this regard.

He wants reasonable assurance that accounting system is adequate and that all accounting information which should be recorded has, in fact, been recorded.

Further, during the course of audit, he has noticed as under: -

- As required by the management, bank reconciliation is required to be performed monthly. However, the same is not carried out as stipulated due to time constraints faced by accountant.

- The entity has a system of procuring its raw material supplies on the basis of valid purchase orders issued by the entity. However, purchase orders are not numbered in a sequence properly.
- Wage sheets are not verified by a responsible official as required by management.
- Staff of the entity is responsible for bringing cash from centers in nearby areas to entity's premises from where it is deposited into entity's bank account. However, concerned officer has not renewed insurance for cash in transit.

**Based on above, answer the following questions: - (Q. No. 6 to 9)**

6. The auditor has performed procedures to obtain audit evidence about design and implementation of controls. Which of the following procedures is more reliable to obtain audit evidence relating to application of a control? **(2 Marks)**
- (a) Observing application of control
  - (b) Inspecting documentation pertaining to control
  - (c) Inquiry about application of control
  - (d) Studying design of control
7. Examination and evaluation of internal control is indispensable for CA M. Raja. It provides him necessary comfort relating to completeness of accounting information. However, review of internal controls of the entity will not enable him to know \_\_\_\_\_ **(2 Marks)**
- (a) whether errors or frauds are likely to be located in ordinary course of operations of business
  - (b) whether an effective internal audit department is operating
  - (c) whether his opinion needs modification
  - (d) whether any administrative control has bearing on his work
8. As regards weaknesses identified by the auditor in control system, which of the following represent(s) significant deficiencies in internal control? **(2 Marks)**
- (a) Not performing bank reconciliation timely and not verifying wage sheets by responsible official only
  - (b) Not performing bank reconciliation timely and lack of proper sequence in purchase orders only
  - (c) Not performing bank reconciliation timely, lack of proper sequence in purchase orders, not verifying wage sheets by responsible official and lack of insurance for cash in transit
  - (d) Lack of insurance for cash in transit only
9. Which of the following is most appropriate regarding auditor's responsibility in accordance with SA 265? **(2 Marks)**
- (a) To communicate significant deficiencies in internal control to management
  - (b) To communicate significant deficiencies in internal control along with explanation of their potential effects to management
  - (c) To communicate significant deficiencies in internal control along with explanation of their potential effects, to provide sufficient information to understand context of communication to management and express opinion on effectiveness of internal control
  - (d) To communicate significant deficiencies in internal control along with explanation of their potential effects and to provide sufficient information to understand context of communication to management

**Case Scenario**

Dhanush, a CA student undergoing articles, is part of an engagement team conducting audit of Test Enterprises Private Limited. The company is engaged in business of conducting aptitude and language tests every fortnight at centres spread all over major cities of country for Indian students desirous of applying to foreign universities. It also sells books containing model test papers for the benefit of students.

The company has substantial number of computers at each centre to enable seamless experience for students appearing for standardized aptitude and language tests. The company has acquired new identifiable software involving substantial expenditure for conducting tests during the year which is expected to drive company's

revenues in coming years. At the time of taking a test, a CD containing software is run in each system for enabling students to take tests. Cost of CD without software is nominal.

The revenue of the company during the year 2023-24 was ₹ 50 crores (₹45 crores from fees charged from students and ₹5 crores from sale of books). Besides, company has also received ₹ 10 lacs as interest on certain investments during the year. The company has a history of profitable operations.

During the course of audit, it is noticed by Dhanush that computers form significant chunk of PPE items in financial statements of company. The company has taken useful life of computers consisting of desktops for 3 years. However, depreciation charged on computers in financial statements of the company is higher than depreciation allowable under Income tax law. It results in lower accounting income as per books of accounts of company as compared with taxable income under Income tax law.

During the course of audit, he notices that cost of CDs along with software cost is treated as an intangible asset by company. It is also part of his responsibility to verify PPE register in accordance with audit programme. On perusing details in PPE register, he finds that some computers have moved from one centre to another centre to meet business requirements. Further, many computers were disposed or scrapped in earlier years. However, proper details in relation to movement and disposal/scrapping have not been entered in PPE register. When these items were physically verified by the management during the year, it has resulted in material discrepancies. The management has properly dealt with such discrepancies in books of accounts.

**Based on above, answer the following questions: (Q. No. 10 to 14)**

10. Considering description provided in case scenario regarding accounting income as per books of accounts and taxable income under Income tax law, choose appropriate responsibility of Dhanush: **(2 Marks)**
- To verify deferred tax liability likely created in financial statements in accordance with AS 22
  - To verify deferred tax asset likely created in financial statements in accordance with AS 22
  - To verify deferred tax asset likely created in financial statements in accordance with AS 29
  - To verify deferred tax liability likely created in financial statements in accordance with AS 29
11. Keeping in view description provided in case scenario, which of following statements is likely to be correct regarding accounting treatment of cost of CDs and software acquired by company to run tests? **(2 Marks)**
- The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated such costs as revenue expenditure.
  - The company's accounting treatment of treating cost of CDs with software costs as intangible assets is proper.
  - The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as intangible asset.
  - The company's accounting treatment of treating cost of CDs with software costs as intangible assets is not proper. It should have treated cost of CDs as PPE item and software cost as revenue expenditure.
12. As regards discrepancies noticed in computer systems on physical verification by management as described in case scenario, which of following statements is most appropriate? **(2 Marks)**
- The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it may result in modification of auditor's opinion.
  - The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it entails specific reporting requirement for auditor under Companies Act, 2013.
  - The management has properly dealt with such discrepancies. Therefore, Dhanush should not do anything further.
  - The management has properly dealt with such discrepancies. However, Dhanush should bring it to light of engagement partner as it is in nature of misstatement which needs to be communicated and documented by auditor.
13. Which of following statements meets requirements of law in respect of revenue from operations of the company? **(2 Marks)**
- Revenue from operations of ₹ 50 crores should be shown in Statement of Profit and loss.

(b) Revenue from operations of ₹ 50.10 crores should be shown in Statement of Profit and loss. However, revenue from sale of books, fees charged from students and interest on investments should be disclosed separately in notes.

(c) Revenue from operations of ₹ 50.10 crores should be shown in Statement of Profit and loss.

(d) Revenue from operations of ₹ 50 crores should be shown in Statement of Profit and loss. However, revenue from sale of books and fees charged from students should be disclosed separately in notes.

14. The company has taken useful life of desktops to be 3 years. Such a requirement is \_\_\_\_\_ **(2 Marks)**

(a) prescribed under Schedule III to Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule III.

(b) is not prescribed under Companies Act, 2013. It depends upon manufacturing specifications of desktops.

(c) prescribed under Schedule II to Companies Act, 2013. However, a company can choose useful life different from what is prescribed under Schedule II.

(d) is not prescribed under Companies Act, 2013. It needs to be arrived at mandatorily by a management expert.

15. “*We, the people*” is an NGO working for rights of citizens. Due to nature of its activities, its volunteers take part in agitations which acquire political overtones. It also gets money from trusts based in overseas countries.

The government has tightened regulatory mechanism for NGOs receiving foreign funding. The finance and accounts department in NGO is headed by an experienced person, a former volunteer and activist himself. However, he has no professional or legal educational background. CA N is appointed as auditor of above NGO for the first time.

Choose the most appropriate option regarding audit risk inferred by you from above. **(1 Mark)**

(a) Audit risk in the above situation is low.

(b) The situation does not provide quantitative data. Therefore, it is not possible to make a precise measurement of audit risk.

(c) Audit risk in the above situation is high.

(d) The situation does not provide information affecting all components of audit risk. Therefore, inference cannot be made properly.

16. CA J is in process of planning audit for a large company engaged in business of dealing and manufacturing of pharmaceutical products. Central Drugs Standard Control Organisation (CDSCO), National regulatory Authority under Ministry of Health & Family Welfare is responsible for approval of drugs, conduct of clinical trials and laying down Standards for drugs and control over quality of imported drugs. Auditor is also considering whether to make use of audit evidence obtained in previous audit of the same company. Besides, he is also considering volume of transactions to determine whether it is efficient to rely on internal controls. As part of planning activities, he is also considering extent of substantive audit procedures to be performed. Consider following factors stated from 1 to 5: **(1 Mark)**

1. Reporting requirements required by CDSCO, if any

2. Need for specialized knowledge of pharma industry

3. Expected use of audit evidence obtained in previous audit

4. Volume of transactions to consider reliance on internal control

5. Nature and extent of substantive audit procedures

Choose the most appropriate factor/combination of factors which could be relevant to CA J in establishing audit strategy: -

(a) 1, 3, 4 and 5

(b) 1 only

(c) 1, 2, 3 and 4

(d) 2 only

## SUBJECTIVE QUESTIONS

*Note: Question no. 1 is compulsory. Answer any Four questions from the rest.*

### Question 1

- (a) DOX Limited, a service provider company engaged in providing courier services pan-India as well as internationally, has appointed an internal auditor, Mr. G, in accordance with requirements of the Companies Act, 2013 during financial year 2023-24. The company's annual turnover during year 2022-23 and 2023-24 has been about ₹ 300 crores during each of above years. Business of the company has been profitable. Mr. G heads internal audit department of the company assessing governance activities, assisting in improving risk management activities and reviewing controls. Discuss reporting responsibility of statutory auditor of the company under the Companies Act, 2013 specifically in relation to internal audit and related matters for the year 2023-24. **(4 Marks)**
- (b) Up and High Private Limited has started its export business during the year 2023-24. The company was catering to domestic market only in past years. CA H, statutory auditor of the company, is of the view that the company has understated its revenue by ₹ 50.00 lacs in the year 2023-24 by not complying with requirements of AS 9 relating to revenue recognition.
- (i) Discuss responsibilities of statutory auditor to communicate with management in the above situation in accordance with SA 450. Also explain the usefulness of such communication.
- (ii) If management refuses to correct misstatement as communicated by the statutory auditor, how should he proceed? **(4 Marks)**
- (c) Prudent Enterprises Private Limited has incurred and fully spent for the first time Corporate Social Responsibility (CSR) expenditure amounting to ₹ 14.50 lacs in pursuance to provisions of section 135 of Companies Act, 2013. The expenditure was spent for women empowerment programmes through an implementing agency (not a related party). As per law provisions, it was required to spend ₹ 14.00 lacs during the year. Discuss how such information is required to be disclosed in accordance with requirements of Schedule III to the Companies Act, 2013 in financial statements of the company. **(3 Marks)**
- (d) CA Tripad (engagement partner) based at New Delhi is external auditor of Lap of Nature, a firm, since last three years. The firm is engaged in business of providing tourism services including holiday packages to its club members. It has also provided auditor including his team members free holiday for a week every year in one of its premium resorts in Ooty in the State of Tamil Nadu. The company has also booked free air travel for engagement team members during all these years. Discuss why Chartered Accountant is not acting ethically. How are familiarity threats created in above situation? **(3 Marks)**

### Question 2

- (a) Mention any four financial events or conditions that, individually or collectively, may cast significant doubt on the entity's ability to continue as going concern. **(4 Marks)**
- (b) Adequate planning benefits the audit of financial statements in several ways. Explain. **(4 Marks)**
- (c) The auditor carries out his work by obtaining audit evidence through performance of audit procedures. However, there are practical and legal limitations on ability of auditor to obtain audit evidence. Give one example each for such practical and legal limitations. **(3 Marks)**
- (d) Goods and Services Tax Network (GSTN) is a not for profit, limited by shares, company. Its 50% shareholding is with Union Government and 50% with different State Governments. The company provides IT infrastructure and services to various stakeholders including governments and tax payers. The company is in operation since past few years and subsequent auditor needs to be appointed during financial year 2023-24. Who appoints statutory auditor of such a company described above in accordance with provisions of Companies Act, 2013? Can any directions be issued to statutory auditors of above company? **(3 Marks)**

**Question 3**

- (a) Suniti, a CA student, is part of an engagement team conducting audit of a company TIM Private Limited. According to audit programme, she is responsible for verifying purchases and PPE items appearing in books of accounts from records/bills of company. Besides, she has also been entrusted responsibility to obtain written representation from management regarding carrying out of physical verification of inventories during the year. During course of her work, she finds that:
- One purchase bill amounting to ₹ 5.00 lacs pertaining to TIM Industries has been entered in books of TIM Private Limited.
  - The management has refused to provide a written representation relating to physical verification of inventories during the year. She has brought it to knowledge of engagement partner who has decided to use lack of such a representation as audit evidence.
- Discuss whether each of above constitutes audit evidence. State reasoning for your answer. **(4 Marks)**
- (b) CA B is statutory auditor of Boom Payments Bank for year 2023-24. During the year, banking regulator has imposed restrictions on Bank from accepting new deposits due to non-compliance in conducting KYC in large number of accounts and violation of rules aimed at preventing money laundering. There is material uncertainty regarding probable outcome of such restrictions on ability of Bank to continue as going concern. However, for year 2023-24, auditor has concluded that use of going concern basis of accounting is appropriate. The financial statements of Bank do not make adequate disclosure of material uncertainty due to above events in financial statements. What are implications for auditor's report for year 2023-24 in view of above? **(4 Marks)**
- (c) Auditor shall develop an audit plan that includes description of audit procedures. Specify requirements in this regard. **(3 Marks)**
- (d) What is meant by audit documentation? What are objectives of an independent auditor in accordance with SA 230? **(3 Marks)**

**Question 4**

- (a) You are part of engagement team conducting audit of an entity engaged in manufacturing business. State few audit procedures you would undertake to perform to verify that recorded sales in financial statements represent goods actually sold during the period and recorded sales are not overstated. **(4 Marks)**
- (b) While performing statutory audit of Contra Industries Private Limited, a company engaged in manufacturing and assembling of LED lights, CA Varun has decided to attend physical inventory count process of the company on 30th and 31st March, 2024. The inventories are lying at three different locations - two such locations A and B are in one city and third location C is in another city. Further, company also sends inventories to some service providers for quality control and testing as such facilities are not available with the company. CA Varun is well-versed with this type of industry and has prepared a list of following matters which could be relevant to him in planning attendance at physical inventory count process for discharging his responsibilities in accordance with SAs: -
- Nature of inventories i.e. LED light components, parts, circuits, panels, body, WIP and finished packed LED lights
  - Materiality of inventories at different locations A, B and C
  - Stage of completion of work-in-progress
  - Maintenance of perpetual inventory system by company
  - Materiality of inventories lying with service providers
  - Timing of physical inventory counting i.e. year end
- There are two important matters which do not find place in above list. Without considering these crucial matters, it would be difficult for the auditor to properly plan his attendance at inventory count process in accordance with relevant SA. Discuss such matters. **(4 Marks)**



- (c) The auditor should decide whether relevant information is properly disclosed in the financial statements. Explain with reference to scope of audit. **(3 Marks)**
- (d) SQC 1 dwells upon engagement quality control review (EQCR) as part of system of quality control in a firm. Why is such a review required? For which type of engagements EQCR is mandatory? What should be approach of firm for engagements for which EQCR is not mandatory? **(3 Marks)**

### Question 5

- (a) M Motors Ltd is a leading Indian automobile manufacturer with many offerings across commercial, passenger and electric vehicles. The Company is pioneering India's electric vehicle transition and enjoys considerable advantage in one of the fastest growing automotive markets. GR & Associates have been appointed as its statutory auditors for financial year 2022-23. J and K are newly appointed audit assistants in the firm and are part of engagement team constituted for purpose of audit of M Motors Ltd. However, they are confused about what such an audit tends to achieve. They perceive audit as a guarantee against possible errors or frauds in financial statements. Do you agree with perception of both the assistants? In this context, outline objectives of an independent audit conducted in accordance with Standards on Auditing. **(3 Marks)**
- (b) Preliminary engagement activities include certain activities to be performed by an auditor while planning an audit. Discuss such activities briefly. How performing such activities assists an auditor? **(4 Marks)**
- (c) Satranga Foods Private Limited is engaged in manufacturing of pickles. The auditors of the company have planned audit procedures in respect of recognition of revenues of the company. Despite that, there is a possibility that misstatements in revenue recognition are not identified by planned audit procedures. Identify and explain that particular risk in detail. **(4 Marks)**
- (d) CA Kanika audited books of accounts of Engineering Ltd. for the financial year 2022-2023. The auditor used an audit procedure according to which all the documents and records maintained by the company were checked in detail to obtain audit evidence. Explain the audit procedure used by the auditor. Comment on reliability of audit evidence obtained by performing such an audit procedure in some situations. **(3 Marks)**

### Question 6

- (a) Rajni, a CA student, has understood that SA 230 requires auditor to prepare audit documentation on a timely basis. While reading about SQC 1, she notices that time limit for completion of final audit file is ordinarily not more than 60 days after the date of auditor's report. She finds it to be puzzling. Unable to comprehend, she seeks your guidance. Guide her. **(4 Marks)**
- (b) Mention some examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph. **(4 Marks)**
- (c) Pilfering is one of the greatest problems in any hotel and the importance of internal control cannot be undermined. Explain. **(3 Marks)**
- (d) While conducting statutory audit of branch of a nationalized bank, it is noticed by CA Z that credit facilities granted to a borrower consisting solely of term loan have been classified as "Sub-standard Asset" during the year 2022-23 due to failure of borrower to pay EMIs on time. Such EMIs were outstanding for more than 90 days and account was, therefore, classified as "Sub-Standard Asset". CA Z has also agreed to above asset classification made by branch management. What are CA Z's responsibilities regarding verification of compliance with income recognition norms by branch in respect of above credit facilities? **(3 Marks)**

**SPACE FOR ROUGH WORK**