

# MKG

**Roll No .....589127.....**

**Total No. of Printed Pages: 7**

**Total No. of Questions – 16**

**Time allowed: 3 hours**

**Maximum Marks: 30**

## **GENERAL INSTRUCTIONS TO CANDIDATES**

1. The question paper comprises two parts, Part I and Part II.
2. Part I comprises Multiple Choice Questions (MCQs).
3. Part II comprises questions which require descriptive type answers.
4. Ensure that you receive the question paper relating to both the parts. If you have not received both, bring it to the notice of the invigilator.
5. Answers to MCQs in Part I are to be marked on the OMR answer sheet as given on the cover page of descriptive answer book only. Answers to questions in Part II are to be written in the same descriptive answer book. Answers to MCQs, if written inside the descriptive answer book or on Part-I Question paper will not be evaluated.
6. OMR answer sheet given on the cover page of descriptive answer book will be in English only for all candidates, including for Hindi medium candidates.
7. The bar coded sticker provided in the attendance register, is to be affixed only on the descriptive answer book.
8. You will be allowed to leave the examination hall only after the conclusion of the exam. If you have completed the paper before time, remain in your seat till the conclusion of the exam.
9. Duration of the examination is 3 hours. You will be required to submit (a) Part I of the question paper containing MCQs, and (b) the answer book in respect of descriptive answer book with OMR cover page to the invigilator before leaving the exam hall, after the conclusion of the exam.
10. The invigilator will give you acknowledgement on Page 2 of the admit card, upon receipt of the above-mentioned items.
11. Candidate found copying or receiving or giving any help or defying instructions of the invigilators will be expelled from the examination and will also be liable for further punitive action.

# M.K.G CA EDUCATION

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## TEST-3

### CA INTERMEDIATE AUDITING AND ETHICS

Topics Covered:

Full Syllabus

**QUESTION PAPER BOOKLET NO. 3122024**

**(18-12-2024 7:45 A.M. TO 11:00 A.M.)**

**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)**
- Observing application of control
  - Inspecting documentation pertaining to control
  - Inquiry about application of control
  - 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)**
- whether errors or frauds are likely to be located in ordinary course of operations of business
  - whether an effective internal audit department is operating
  - whether his opinion needs modification
  - 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)**
- Not performing bank reconciliation timely and not verifying wage sheets by responsible official only
  - Not performing bank reconciliation timely and lack of proper sequence in purchase orders only
  - 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
  - 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)**
- To communicate significant deficiencies in internal control to management
  - To communicate significant deficiencies in internal control along with explanation of their potential effects to management
  - 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
  - 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