

Mock Test Paper - Series I: November, 2025

Date of Paper: 26th November, 2025

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

INTERMEDIATE: GROUP – II

PAPER – 5: AUDITING AND ETHICS

SUGGESTED ANSWERS / HINTS

Part I - Multiple Choice Questions

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

Part II - Descriptive Answers

1. (a) (i) The auditor should design and perform tests of controls to obtain sufficient appropriate audit evidence about the operating effectiveness of relevant controls within the core banking system. This is because:
- The auditor intends to rely on the operating effectiveness of controls for assessing risks of material misstatement; and
 - Substantive procedures alone cannot provide sufficient audit evidence due to the high volume and automated nature of transactions.
- (ii) In designing and performing tests of controls, the auditor shall obtain more persuasive audit evidence, the greater the reliance the auditor places on the effectiveness of controls. This includes examining system logs, testing automated interest calculations, reviewing exception reports, and observing authorization controls in operation.
- A higher level of assurance may be sought about the operating effectiveness of controls when the approach adopted consists primarily of tests of controls, in particular, where it is not possible or practicable to obtain sufficient appropriate audit evidence only from substantive procedures.
- (b) (i) The main preliminary engagement activities are:
- Performing procedures regarding the continuance of the client relationship.
 - Evaluating compliance with ethical requirements, including independence.
 - Establishing an understanding of terms of engagement.
- (ii) Matters the firm should consider regarding the continuance of the client relationship are:
- Integrity of principal owners and key management of the company.
 - Competence of the engagement team to perform the audit engagement.
 - Implications of matters that have arisen during current and previous audit engagement may need to be considered.

- (c) (i) **Relevance** deals with the logical connection between the audit procedure and the assertion under consideration. In the given case, testing the recorded accounts payable may be relevant when verifying overstatement, but not when testing for understatement. For detecting understatement of payables, procedures such as examining subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports are more relevant. Thus, the direction and purpose of testing affect the relevance of audit evidence.
 - (ii) The auditor must consider both the **relevance and reliability** of audit evidence, as the quality of evidence depends on these factors. Relevance ensures that the evidence logically relates to the assertion being tested, while reliability depends on the source, nature, and circumstances under which the information is obtained. Only evidence that is both relevant and reliable can provide a sound basis for expressing an opinion on the truth and fairness of financial statements.
2. (a) Completeness Assertion for Inventory requires that only inventories held by entity have been recorded in the financial statements and do not include any inventories that belong to third parties but does include inventories owned by the entity and lying with a third party

Audit Procedures to Verify Completeness of Inventories

- (i) Perform analytical procedures (comparison tests with industry averages, budgets, prior years, trend analysis, etc.).
 - Compute inventory turnover ratio (COGS/ average inventory)
 - Perform vertical analysis (inventory/ total assets)
 - Compare budgetary expectations vis-à-vis actuals
- (ii) Examine non-financial information related to inventory, such as weights and other measurements.
- (iii) Perform purchase and sales cut-off tests. Trace shipping documents (bills of lading and receiving reports, warehouse records, and inventory records) to accounting records immediately before and after year-end.
- (iv) With respect to tagged inventory, perform tests for omitted transactions and tests for invalid transactions.
- (v) Verify the clerical and arithmetical accuracy of inventory listings.
- (vi) Reconcile physical inventory amounts with perpetual records.

- (vii) Reconcile physical counts with general ledger control totals.
 - (viii) Reconcile inventories which belong to client but are held with third parties like transporters, warehouses, port authorities etc.
 - (ix) Goods received on consignment basis have been properly segregated from other items of inventory.
- (b) Erosion means the gradual destruction or diminution of something not prudent to follow stages of asset classification. It should be straight-away classified as doubtful or loss asset as appropriate as follows:
- (i) Erosion in the value of security can be reckoned as significant when the realisable value of the security is less than 50% of the value assessed by the bank or accepted by RBI at the time of last inspection, as the case may be. Such NPAs may be straight-away classified under doubtful category and provisioning should be made as applicable to doubtful assets.
 - (ii) If the realisable value of the security, as assessed by the bank/ approved valuers/ RBI is less than 10% of the outstanding in the borrower accounts, the existence of security should be ignored and the asset should be straight-away classified as loss asset. It may be either written off or fully provided for by the bank.

Based on above, the two accounts can be classified as per RBI norms as under :

M/s Neem Tree Infrastructure Ltd.

- The realizable value of the security (₹ 0.8 crore) is less than 50% of the value assessed at the time of last inspection (₹ 6 crore).
- This represents significant erosion in the value of security.
- Hence, the account should be straight-away classified as a Doubtful Asset, and provisioning should be made as applicable to doubtful assets.

M/s Gayatri Textiles Pvt. Ltd.

- The realizable value of security (₹ 0.4 crore) is less than 10% of the outstanding balance (₹ 5 crore).
- This means the security is practically non-existent.
- Therefore, the account should be classified as a Loss Asset, which may be written off or fully provided for by the bank.

- (c) SA 300 on “Planning an Audit of Financial Statements”, states that auditor shall develop an audit plan that shall include description of-
- (i) The nature, timing and extent of planned risk assessment procedures
 - (ii) The nature, timing and extent of planned further audit procedures at assertion level
 - (iii) Other planned audit procedures that are required to be carried out so that the engagement complies with SAs.

The auditor plans what type of audit procedures are to be performed, their timing and how much work should be done taking into account sample size etc.

The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops.

For example, planning of the auditor's risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. In addition, the auditor may begin the execution of further audit procedures for some classes of transactions, account balances and disclosures before planning all remaining further audit procedures.

3. (a) As per SA 500 on “Audit Evidence”, the auditor shall design and perform audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient and appropriate audit evidence.

Audit evidence is necessary to support the auditor's opinion and report. It is cumulative in nature and is primarily obtained from audit procedures performed during the course of the audit.

It may, however, also include information obtained from other sources such as previous audits. In addition to other sources inside and outside the entity, the entity's accounting records are an important source of audit evidence.

Also, information that may be used as audit evidence may have been prepared using the work of a management's expert.

Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions.

In addition, **in some cases the absence of information** (for example, management's refusal to provide a requested representation) is used by the auditor, and therefore, **also constitutes audit evidence**.

Most of the auditor's work in forming the auditor's opinion consists of obtaining and evaluating audit evidence. The auditor uses various audit procedures to obtain audit evidence such as inspection, observation, confirmation, recalculation, reperformance and analytical procedures, often in some combination, in addition to inquiry.

Reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.

SA 330 requires the auditor to conclude whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base the auditor's opinion, is a matter of professional judgment.

SA 200 contains discussion of such matters as the nature of audit procedures, the timeliness of financial reporting, and the balance between benefit and cost, which are relevant factors when the auditor exercises professional judgment regarding whether sufficient appropriate audit evidence has been obtained.

(b) (i) Auditor's Objective

- As per SA 265, the auditor's objective is to communicate appropriately to those charged with governance and management the deficiencies in internal control identified during the audit.
- The auditor uses professional judgment to determine which deficiencies are of sufficient importance to merit the attention of management and those charged with governance.

(ii) Auditor's responsibilities regarding communicating deficiencies in internal control to those charged with governance and management are: Determine whether, on the basis of the audit work performed, one or more deficiencies in internal control have been identified.

If one or more deficiencies in internal control have been identified, determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies.

Communication in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis giving their description, explanation of potential effects and sufficient information to those charged with governance and management to understand context of communication.

- (c) Without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor- General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor- General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

The C&AG shall direct the manner in which the company's accounts shall be audited by the statutory auditors and give such auditors instructions in regard to any matter relating to the performance of his functions as such. The directions under section 143(6) broadly cover the system of book-keeping and accounts, internal control etc.

The C&AG has power to conduct a supplementary or test audit of the company's accounts by such person as he may authorise in this behalf and for the purposes of such audit require information or additional information to be furnished to any person or persons so authorised on such matters by such person or persons and in such form as the C&AG may by general or special order, direct.

The statutory auditors shall submit a copy of their audit report to C&AG who shall have a right to comment upon or supplement the audit report submitted by the statutory auditors in such manner as he may think fit. Section 134(3) of the Companies Act, 2013 imposes a duty on the board of directors of a company to give an explanation or comments on every reservation, or adverse remarks or disclaimer contained in the auditors' report and secretarial audit report of the Company Secretary in practice. In the absence of similar provisions requiring the company to give reply on the reservation made by the C&AG, the board of directors of such a company is not bound to give information or explanation in respect of such comments.

4. (a) (i) Use of Substantive Analytical Procedures:

Substantive analytical procedures refer to analytical procedures used as substantive procedures by auditor. The term "analytical procedures" means evaluations of financial information through analysis of plausible

relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount.

In the given case, the auditor estimates the total rental income by analysing non-financial information—such as number of apartments, rental rates, and vacancy rates—and compares it with the rental income recorded in the books. This approach reflects a logical relationship between rental income (financial data) and property details (non-financial data), and hence constitutes a substantive analytical procedure.

If a significant difference arises between the expected and actual rental income, the auditor is required to investigate the reason for the variation, which may involve errors, unrecorded transactions, or incorrect rates.

- (ii) Substantive analytical procedures are generally more applicable to large volumes of transactions that tend to be predictable over time.

In this case, since rental income tends to remain consistent and predictable, analytical procedures are particularly useful and efficient.

Analytical procedures involving, for example, the prediction of total rental income on a building divided into apartments, taking the rental rates, the number of apartments and vacancy rates into consideration, can provide persuasive evidence and may eliminate the need for further verification by means of tests of details.

- (b) As per SQC 1 – “Quality Control for firms that perform audits and reviews of historical financial Information, and other assurance and related services engagements”, the firm’s system of quality control should include policies and procedures addressing each of the following elements: -

- (A) Leadership responsibilities for quality within the firm
- (B) Ethical requirements
- (C) Acceptance and continuance of client relationships and specific engagements
- (D) Human resources
- (E) Engagement performance
- (F) Monitoring

Quality control policies and procedures should be documented and communicated to the firm's personnel. By communicating, the firm recognizes the importance of obtaining feedback on its quality control system from its personnel. Therefore, the firm encourages its personnel to communicate their views or concerns on quality control matters.

(c) **SA 700 (Revised), "Forming an Opinion and Reporting on Financial Statements", requires that the auditor's report shall include a section, directly following the Opinion section, with the heading "Basis for Opinion", that:**

- (i) States that the audit was conducted in accordance with Standards on Auditing;
- (ii) Refers to the section of the auditor's report that describes the auditor's responsibilities under the SAs;
- (iii) Includes a statement that the auditor is independent of the entity in accordance with the relevant ethical requirements relating to the audit and has fulfilled the auditor's other ethical responsibilities in accordance with these requirements.
- (iv) States whether the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's opinion.

Thus, the Basis for opinion section provides important context about the auditor's opinion.

5. (a) In Maharashtra, the co-operative societies are required to maintain books of account in terms of the instructions of the Registrar as following:

- (i) All sums of money received and expended by the society and the matters in respect of which receipts and expenditure take place.
- (ii) All sales and purchases of goods by the society.
- (iii) Assets and liabilities of the society.

In order to maintain proper financial accounting records so as to disclose full financial results of working of the society, the statutory or mandatory provisions provide a directive, but they are not conclusive. The society is at liberty to maintain such additional records according to its convenience and which it thinks more useful for clarity and detailed explanation. Ultimately the financial transactions and the results thereof must be presented very clearly and in the best possible manner.

Depending upon the nature and object of the society, different kinds of books and registers will be maintained, so as to disclose a proper and fair picture of financial transactions. In case of large scale co-operative organisation, different subsidiary books and registers shall be maintained and the daily summary totals will be transferred to main Cash Book. For example:

- (a) Daily cash sales summary register.
 - (b) A register of collection from debtors if credit sales are allowed by bye-laws of society.
 - (c) A register of recovery of loans from salaries and directly by receipts from members in case of credit society.
 - (d) Loan disbursement register in case of credit society.
 - (e) Any other columnar subsidiaries depending upon the nature and functions of society.
- (b) The auditor should evaluate each expenditure with reference to the recognition and measurement principles for Property, Plant and Equipment (PPE).

According to the recognition criteria, the cost of an item of PPE should be recognised as an asset only if:

- (i) It is probable that future economic benefits will flow to the enterprise; and
- (ii) The cost of the item can be measured reliably.

As per measurement principles, PPE should be measured at cost, which includes:

- Purchase price,
- Costs directly attributable to bringing the asset to the location and condition necessary for it to operate as intended by management, and
- The initial estimate of dismantling or restoration costs.

Therefore, the auditor should ensure that:

- Costs such as site preparation, installation, testing, and professional fees are capitalised, as they are directly attributable to making the asset ready for use.
- Costs like staff training and advertising are charged to revenue, since they do not bring the asset to its intended working condition and are not part of the cost of PPE.

The auditor's analysis and classification of these expenditures are essential to ensure that the financial statements present a true and fair view of the valuation of Property, Plant and Equipment.

- (c) It is the duty of professional accountants to see that Standards are followed in engagements undertaken by them. Ordinarily, these are to be followed by professional accountants. However, a situation may arise when a specific procedure as required in Standards would be ineffective in a particular engagement. In such a case, he is required to document how alternative procedures performed achieve the purpose of required procedure. Also, reason for departure has also to be documented unless it is clear. Further, his report should draw attention to such departures. It is also to be noted that a mere disclosure in the report does not absolve a professional accountant from complying with applicable Standards.

CA Rushil should have properly documented the alternative procedure and reason for departure, in addition to disclosing it in the report, to fully meet his professional duties.

6. (a) **As per the requirements of SA 705, "Modifications to the Opinion in the Independent Auditor's Report" -**

- If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers is likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.
- If management refuses to remove the limitation referred above, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.
- If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:
 - (I) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
 - (II) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:

- (i) Withdraw from the audit, where practicable and possible under applicable law or regulation; or
 - (ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.
 - If the auditor withdraws as contemplated by point (b)(i) above, before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.
- (b)** Auditor needs to consider the following attributes while verifying for depreciation and amortisation expenses:
- (i) The airframe and engines are significant parts of the aircraft. The auditor needs to verify whether each part has been depreciated separately, as applying a single rate to the total cost may not reflect the true consumption of each component.
 - (ii) Obtain the understanding of entity's accounting policy related to depreciation and amortisation.
 - (iii) Ensure the Company policy for charging depreciation and amortisation is as per the relevant provisions of the Companies Act, 2013/ applicable accounting standards.
 - (iv) The accounting policy has been applied consistently year on year. Any change in the accounting policy has been adequately disclosed.
 - (v) The change in the amortisation method for software must be checked for compliance.
 - (vi) Whether the depreciation has been calculated after making adjustment of residual value from the cost of the assets.
- (c)** As per SA 560 on "Subsequent Events", financial statements may be affected by certain events that occur after the date of the financial statements. Many financial reporting frameworks specifically refer to such events. Such financial reporting frameworks ordinarily identify two types of events:
- (a) Those that provide evidence of conditions that existed at the date of the financial statements and
 - (b) Those that provide evidence of conditions that arose after the date of the financial statements.

The auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the

financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The insolvency of the major debtor declared after 31st March 2025 provides evidence of conditions that existed at the date of the financial statements. This event affects the recoverability of the amount due as on 31st March 2025, therefore, it requires adjustment in the financial statements to reflect the correct realisable value.

On the other hand, the planned merger of the company provides evidence of conditions that arose after the date of the financial statements. Such an event does not require adjustment in the financial statements but should be disclosed if it is of such importance that non-disclosure would affect the ability of users to make proper evaluations or decisions.

Hence, the auditor should ensure that appropriate adjustments or disclosures are made in accordance with the nature of each subsequent event.

OR

(c) As per SA 230 – 'Audit Documentation', the form, content and extent of audit documentation depend on factors such as:

1. The size and complexity of the entity.
2. The nature of the audit procedures to be performed.
3. The identified risks of material misstatement.
4. The significance of the audit evidence obtained.
5. The nature and extent of exceptions identified.
6. The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
7. The audit methodology and tools used.