

Mock Test Paper - Series II: December, 2025

Date of Paper: 15th December, 2025

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

INTERMEDIATE GROUP – II

PAPER – 5: AUDITING AND ETHICS

Time Allowed – 3 Hours

Maximum Marks – 100

PART I - Case Scenario based MCQs (30 Marks)

Write the most appropriate answer to each of the following multiple-choice questions by choosing one of the four options given. All MCQs are compulsory and carry 2 Marks each.

Case Scenario 1 [MCQs 1-5]

Samta Tools Pvt. Ltd. manufactures precision cutting tools. You are auditing the company for FY 2024–25. The company employs about 450 workers.

The auditor performs trend analysis on salary expense for the past three years:

Particulars	2022-23	2023-24	2024-25
Number of Employees	430	440	450
Salary Expense (₹ crore)	18.0	19.2	27.5
Overtime Hours	8,000	7,500	8,200

Observations by Auditor

- (i) Salary expense increased by 43.2% in 2024–25 (from 19.2 to 27.5 crore).
- (ii) Number of employees increased by only 2.3% (from 440 to 450).
- (iii) Overtime hours increased only marginally (9%).
- (iv) HR records show no major revision in pay scales.
- (v) Increase is not supported by production records.

The auditor suspects:

- Possible payments to fictitious employees,
- Incorrect accounting classification (e.g., bonuses, labour subcontracting recorded as salaries), or

- Unauthorized salary revisions.

Trend analysis is applied to identify this unusual, unexplained fluctuation.

During payroll verification, the auditor identifies several salary payments that cannot be matched to any employee in the master employee list. HR confirms that these employee IDs do not belong to any current or former employee and may have been generated due to a payroll system error. This raises concerns about the occurrence of certain salary expenses, as some payments appear to be made to non-existent or fictitious employees. However, based on checks of attendance records, appointment files, and authorized HR approvals, the auditor verifies that all genuine employee benefit expenses relating to actual personnel have been recorded and no legitimate salary transactions have been omitted. The issue therefore relates to possible overstatement and not to completeness.

Based on above, answer the following MCQs (1-5):

1. The auditor compares salary expense for the current year with the previous two years and notes a 43% increase. This method is an example of:
 - (a) Reasonableness test
 - (b) Trend analysis
 - (c) Ratio analysis
 - (d) Substantive test of details
2. Despite only a small increase in employees, salary expense increased significantly. What should be the auditor's next step after identifying this unusual trend?
 - (a) Conclude that the increase is justified
 - (b) Ignore it as overtime hours also increased
 - (c) Perform further audit procedures to investigate the cause
 - (d) Reduce audit work as trend analysis provides sufficient evidence
3. Which of the following situations most strongly indicates a risk of fictitious employees based on the trend analysis results?
 - (a) Salary expense increased far more than employee count
 - (b) Overtime hours increased slightly
 - (c) Production increased by 5%
 - (d) A new HR manager joined during the year

4. Which situation BEST tests the Occurrence assertion for employee benefit expenses?
- (a) Ensuring all employee benefit expenses have been recorded
 - (b) Matching payroll expense with personnel records to confirm no unauthorized persons were paid
 - (c) Checking the arithmetic accuracy of payroll calculations
 - (d) Verifying that all employee benefits are presented under the correct heading
5. Which situation BEST reflects the Completeness assertion for employee benefit expenses?
- (a) Confirming that no unauthorized employees have received salary payments
 - (b) Ensuring that every recorded employee benefit expense relates to a genuine employee and represents a valid transaction
 - (c) Ensuring salary expense is correctly classified in the financial statements
 - (d) Ensuring that employee benefit expenses for all personnel have been fully accounted for

Case Scenario 2 [MCQs 6-9]

Madan Leasing Co. Ltd. is a non-banking leasing company that leases industrial machinery and consumer durables. During the current year, Madan Leasing entered into a lease agreement with Sulekha Engineering Pvt. Ltd. for a Textile machine valued at ₹ 10 Crore.

Facts gathered by the audit team from the lease files are:

- (i) The company's object clause in the memorandum authorises leasing of capital goods but is silent about undertaking financing activities.
- (ii) A credit appraisal file exists for Sulekha Engineering containing their past credit record, capitalisation details and proposed collateral.
- (iii) The lease agreement describes lessor, lessee, equipment and location. It states that the equipment must not be removed from the location except for repairs and contains timelines for payments and late charges. It does not expressly state who will bear the cost of returning the equipment on termination.
- (iv) The lease proposal form from Sulekha Engineering is present in the file.
- (v) The original invoice for the Textile machine is filed in the lease folder.
- (vi) There is no acceptance letter from the lessee on file confirming the equipment was received in order.

- (vii) A Board resolution authorising the execution of the lease on behalf of Sulekha Engineering is included.
- (viii) Copies of the insurance policy for the machine are not found in the lessor's records.

Based on above, answer the following MCQs (6-9):

6. Which audit procedure confirms whether Madan Leasing Co. is legally permitted to transact the lease of the Textile machine?
 - (a) Check the object clause of the leasing company to verify permitted activities.
 - (b) Examine the lease proposal form submitted by the lessee.
 - (c) Examine the lease agreement for description of equipment and location.
 - (d) Verify that copies of insurance policies have been obtained.
7. Which missing document in the lease file creates an audit issue about whether the lessee accepted delivery in good order?
 - (a) Invoice retained safely in the file.
 - (b) Board resolution authorising execution of lease.
 - (c) Acceptance letter obtained from the lessee.
 - (d) Lease proposal form submitted by the lessee.
8. Which procedure would the auditor perform to evaluate the lessee's ability to meet lease commitments?
 - (a) Ensure that the invoice is retained safely.
 - (b) See that copies of the insurance policies have been obtained.
 - (c) Check whether the agreement prohibits subletting.
 - (d) Verify whether there exists a procedure to ascertain credit analysis of lessee.
9. Given the facts, which control deficiency should the auditor report as missing in Madan Leasing Co.'s records?
 - (a) The invoice for the machine is not retained.
 - (b) The Board resolution authorising lease execution is absent.
 - (c) Copies of insurance policies for the leased asset are not obtained.
 - (d) The lease agreement does not describe equipment and location.

Case Scenario 3 [MCQs 10-12]

Trimurti & Co., Chartered Accountants, are appointed as the statutory auditors of Techno Industries Ltd., a medium-sized manufacturing company engaged in producing automobile parts. The audit team is led by CA Aakriti, assisted by one qualified assistant, Mr. Pradeep, and two articled trainees.

While planning the audit, the team notes that Techno Industries Ltd. recently implemented a new Inventory Management System (IMS). The management claims that the new system allows real-time tracking of raw materials, automated reorder levels, and barcode-based issuance of materials for production.

During the preliminary review, Mr. Pradeep notices that the value of raw materials has increased by 35% compared to last year, whereas production levels increased by only 12%. He suspects possible errors in valuation or inclusion of obsolete stock. Further, the IMS allows only store managers to update inventory records. However, during walkthrough, an articled trainee observes that two production supervisors also have access to change stock quantities, without any documented authorisation.

Analytical review reveals that payments to one of the major suppliers, Alpha Metals, have doubled compared to previous year, despite no proportional increase in material purchases. To understand the functioning of the new IMS, the audit team prepares a visual diagram showing flow of material requisitions, approvals, barcode scanning, and issuance of materials to the shop floor. This helps them identify gaps in segregation of duties and authorization.

10. The auditor noticed a 35% increase in raw material value with only a 12% rise in production. Which audit procedure is being used here?
 - (a) Test of Controls
 - (b) Substantive Analytical Procedure
 - (c) Inquiry
 - (d) Test of Details
11. Unauthorized access to the Inventory Management System by production supervisors indicates which type of risk?
 - (a) Control Risk
 - (b) Business Risk
 - (c) Detection Risk

- (d) Audit Risk
12. Preparing a visual diagram showing the movement of material requisitions and barcode-based issuance represents which method of internal control evaluation?
- (a) Narrative Record
 - (b) Internal Control Questionnaire
 - (c) Checklist
 - (d) Flow Chart
13. A newly qualified Chartered Accountant, CA Riya is handling an assignment where no specific ethical rule is prescribed for a particular unusual transaction. She decides to evaluate the situation based on her knowledge, skills and expertise to determine the most ethical course of action, even though there is no detailed rule guiding her.
- Which approach is Riya following?
- (a) Rules-based approach
 - (b) Principles-based approach
 - (c) Statutory compliance approach
 - (d) Disciplinary approach
14. An audit firm, RST & Co., conducted the statutory audit of Bluewing Traders Ltd. During the review of audit files by regulatory authority, it was alleged that the auditor failed to exercise due professional care while verifying certain high-value transactions. Also, Bluewing Traders faced financial losses and the management claimed that the auditor was negligent.
- However, during the proceedings, RST & Co. produced a detailed audit programme that had been prepared before commencing audit work. The programme documented the steps planned, the nature and extent of checking, the responsibilities assigned to assistants and the areas where professional judgement was exercised. It was also signed and approved by the engagement partner. The auditor argued that this properly constructed audit programme demonstrated that reasonable skill and care had been exercised throughout the audit.
- In the above situation, which of the following best explains why the detailed audit programme prepared by RST & Co. can help defend the auditor against allegations of negligence?

- (a) A properly drawn-up audit programme provides documentary proof that the auditor planned and executed audit procedures with reasonable skill and care thereby supporting his defence against charges of negligence.
 - (b) An audit programme allows the auditor to detect all types of fraud and errors which automatically proves that negligence cannot occur during the audit.
 - (c) The existence of an audit programme guarantees that no mistakes were made by the audit staff during the examination of financial records.
 - (d) An audit programme shifts the entire responsibility for negligence to the client because it shows that the auditor relied on management representations.
15. During the audit of JKL Industries, the auditor identified certain significant deficiencies in the company's internal control system. Senior management acknowledged these issues but suggested that an oral briefing would be sufficient. The auditor, however, was required to determine the appropriate method and timing of communication.

Which action is the auditor required to take?

- (a) Provide only an oral communication to management since they have acknowledged the deficiencies.
- (b) Communicate in writing the significant deficiencies in internal control to those charged with governance on timely basis.
- (c) Delay the communication until the audit is completed to avoid disturbing the management's ongoing activities while the audit is still in progress.
- (d) Communicate only if the deficiencies are expected to materially misstate the financial statements.

PART II - Descriptive Questions (70 Marks)

Question No. 1 is compulsory.

Attempt any four questions from the Rest.

- 1. (a) During audit of ABC Ltd., the audit team discussed the concept of audit risk. The engagement partner explained that audit risk is a function of the risks of material misstatement and detection risk. He further stated that the assessment of these risks depends on the audit procedures performed to obtain necessary information and evidence gathered throughout the audit. One of the junior auditors asked whether such risk assessment could be determined through precise measurement. The partner clarified that risk assessment is a matter of professional judgment, not an exact calculation and that such judgment comes from the auditor's training, knowledge, and experience which help in forming reasonable conclusions.

- (i) Discuss the concept of Audit risk. Explain what is included and what is not included in audit risk and state the basis on which the assessment of audit risk is made.
- (ii) The assessment of audit risks is considered a matter of professional judgment. Explain how an auditor's training and experience support this judgment. **(5 Marks)**

- (b) Bell Manufacturing Ltd. has undergone a restructuring during the current year resulting in changes in key personnel and ownership interests. The auditor observes that several new parties have become related to the entity due to these changes. During the audit, the auditor also notices a few transactions that appear unusual and possibly outside the normal course of business. Management states that all related party relationships and transactions have been properly identified and recorded.

Explain, with reference to SA 550, inquiries the auditor should make of management and the additional audit procedures to be performed in relation to related parties and related party transactions in this situation. **(5 Marks)**

- (c) R & Co., Chartered Accountants, have been appointed as auditors of XYZ Ltd., a company operating in multiple business segments, including manufacturing and financial services. The company is subject to industry-specific reporting requirements issued by the financial regulator. During audit planning, the engagement partner emphasises the importance of identifying the characteristics of the engagement defining its scope while establishing the audit strategy.

As an auditor, explain the characteristics of engagement defining its scope.

(4 Marks)

2. (a) Ridham Enterprises, a trading firm, has shown a substantial amount under "Trade Payables and Other Current Liabilities" in its financial statements for the year ended 31st March, 2025. The auditor observes that certain purchase invoices were recorded close to the year-end. The management asserts that all liabilities have been properly recorded.

As an auditor, explain the audit procedures you would perform to establish the existence of trade payables and other current liabilities at the end of the period and state why verification of liabilities is as important as verification of assets.

(5 Marks)

- (b) MNB Bank Ltd. is undergoing its statutory branch audit. During planning stage, engagement partner convened a meeting with audit team and a valuation expert contracted by the firm. The team discussed several matters, including the

likelihood of specific errors, instances of misstatements found in previous years and possible ways in which fraud could be perpetrated by bank personnel. The partner also emphasised the importance of professional skepticism and identifying any conditions indicating potential material misstatements.

Explain the purpose of such an engagement team discussion. List any three matters that are ordinarily included in the engagement team discussion. Also, state two advantages of holding such discussions. **(5 Marks)**

- (c) Kiran Anupam & Associates, Chartered Accountants, are conducting statutory audit of ABC Ltd. for the F.Y 2024-25. During the audit, the engagement team decided to modify certain audit procedures due to introduction of new product range by the company and consequently unexpected changes in the company's internal control system. The audit manager instructed the team to update the documentation accordingly and to record the reasons for the modifications made.

Explain key elements the auditor is required to document in relation to audit planning. State what is recorded and included in the documentation of the overall audit strategy and audit plan and their main purpose. Why is it important to document significant changes made to the audit strategy or audit plan? **(4 Marks)**

3. (a) The auditor of Global Manufacturing Ltd. is planning to use Inspection as an audit procedure to achieve various audit objectives relating to the company's financial statements.

Discuss Inspection as an audit procedure as per SA 500 "Audit Evidence". Identify the factors affecting the varying degrees of reliability of audit evidence obtained through inspection and provide an example of how inspection can be applied as a test of controls.

Also, the auditor wants to determine which assertion is reliably addressed when a tangible asset is inspected and which two assertions are not necessarily addressed. Explain. **(5 Marks)**

- (b) AB Ltd. is facing a temporary decline in sales due to adverse market conditions. However, the management has prepared future cash flow projections showing that the company will be able to continue its operations and discharge its liabilities in the normal course of business. The financial statements have been prepared on the assumption that the entity is a going concern. In such a situation, the auditor is also required to evaluate this assumption in line with the objectives of SA 570. Explain the concept of going concern and its significance in the preparation of financial statements, linking it with the objectives of SA 570 regarding the auditor's evaluation of the going concern assumption. **(5 Marks)**

- (c) The office of the Comptroller and Auditor General (C&AG) undertook an Audit of Receipts in the Department of Indirect Taxes. During the audit, it was observed that although all taxes collected were credited to the Government account, several procedural deficiencies existed. There were delays in detecting double refunds, weak internal checks on assessments and absence of a proper mechanism to review judicial decisions taken by tax authorities. The audit team also noted that the extent of audit was predetermined by the C&AG based on test checks and in-depth studies of specified areas, which were not open to negotiation by the department.

Explain the main checks carried out in the audit of government receipts.

(4 Marks)

4. (a) FGH Ltd. has appointed you as the auditor for the financial year 2024–25. The company had a different auditor in the previous year. While planning the audit, you note that the opening balances include significant inventory and receivable amounts. The Manager (Accounts) informs you that accounting policies are generally consistent but the prior year auditor's report contained a qualification relating to valuation of receivables.

As statutory auditor of the company, you need to obtain sufficient appropriate audit evidence regarding the opening balances.

Explain the matters that will influence the nature and extent of audit procedures you will consider for verifying the opening balances.

(5 Marks)

- (b) Wing Ltd. has appointed CA G as its statutory auditor for FY 2024–25. During preliminary discussions, CA G observes that the company prepares financial statements using the prescribed financial reporting framework, but management is unwilling to give a formal acknowledgment of its responsibilities for preparing the financial statements, maintaining necessary internal controls, and providing unrestricted access to records and personnel. Management also states that certain documents will be provided only on request and interviews of staff will require prior approval.

Based on SA 210, evaluate whether the preconditions for an audit are present and how CA G should proceed.

(5 Marks)

- (c) SA 705, "Modifications to the Opinion in the Independent Auditor's Report," deals with circumstances in which the auditor is required to modify the opinion on the

financial statements. Explain this statement and also state the objective of the auditor under SA 705 when forming a modified opinion. **(4 Marks)**

5. (a) During audit of Himani Electronics Ltd., the auditor identifies that several purchase bills bearing proper stamps and signatures of authorised person from the “Goods Receiving Section” have been processed and paid. However, during verification of store records, the auditor observes that goods related to some of these bills were never actually received.

On inquiry, it is discovered that the accountant responsible for processing purchase bills and the authorised person in the Goods Receiving Section had colluded, allowing false bills to appear genuine. Management argues that because proper internal controls existed, the auditor should have detected such misstatements and prevented their occurrence.

With reference to inherent limitations of audit, explain why the auditor cannot obtain absolute assurance that financial statements are free from material misstatement. Also explain how the above situation illustrates these inherent limitations. **(5 Marks)**

- (b) ABC Ltd. has several fixed deposits with different banks. During audit for the year 2024–25, the auditor notices that the interest income shown in the financial statements appears significantly higher than the previous year. The management provides a working of interest earned on all fixed deposits but does not provide any bank-wise confirmation of interest. Some fixed deposits are still outstanding at the year-end.

State the audit procedures, the auditor should perform to verify interest income on fixed deposits. **(5 Marks)**

- (c) Sunrise Degree College appointed you as the auditor for the FY 2024–25. During audit, you observed the following:

(i). The Students’ Fee Register showed several names for whom no fees were recorded for certain months. On inquiry, the accountant stated that “the class attendance register itself acts as evidence of students on roll,” and no independent check was performed to ensure that fee demands were correctly raised.

(ii) You noticed that receipt counterfoils were not being compared with Cash Book entries regularly. Further, while the college normally issued receipts through its regular system/pre-numbered receipt books, in some cases

handwritten manual receipts were issued. These manual receipts were outside the normal control process and, in several instances, were not traced or posted to the Fee Register, indicating a risk of unrecorded or misappropriated collections.

- (iii) Few students had paid fees for the next term in advance, but the entire amount was recorded as income for the current year.
- (iv) Admission fees collected at the beginning of the session were credited to the General Fund instead of the Capital Fund, without any resolution of the Managing Committee.
- (v) There were cases where concessions and free studentships were granted by the clerk without written approval from the Principal or any authorised person.

As the auditor of Sunrise Degree College, explain the audit procedures you would perform regarding fees from students. **(4 Marks)**

6. (a) SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" requires the auditor to include an Emphasis of Matter paragraph in the auditor's report when the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements, which is of such importance that it is fundamental to users' understanding of the financial statements.

Give examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph in the auditor's report. **(5 Marks)**

- (b) Sunrise Pharma Ltd. has incurred significant expenditure during the financial year 2024–25 on developing a new drug formula and also on purchasing certain software licences. The management has capitalised all such costs under intangible assets. During the audit, the auditor notices that the company has also written off one software package purchased two years ago, stating that it is no longer in use.

On further review, the auditor observes that no documentation has been provided to distinguish between research and development costs, and the company has capitalised certain items that may relate to the research phase. For the new software purchased, the auditor is not provided with any evidence of competitive quotations or approval from authorised personnel. For the discarded software, the entity has not shared any disposal note, approval for deletion, or calculation of gain/loss on disposal.

Describe the audit procedures the auditor should perform for additions and deletions of intangible assets during the period under audit. **(5 Marks)**

- (c) State the auditor's responsibilities in relation to facts that become known to the auditor after the date of the auditor's report but before the date the financial statements are issued. The question should be answered in terms of steps the auditor is required to take when such facts may have led to an amendment in the auditor's report. **(4 Marks)**

OR

CA Rohit is conducting the audit of Suman Exports Ltd. During the audit, he notices that certain sales invoices provided by the client contradict the dispatch records obtained from the warehouse. He also observes that the Managing Director gives evasive answers when asked about certain high-value cash expenses. Additionally, some documents submitted appear to have been altered, and certain transactions seem unusual compared to prior years.

In this context, explain how CA Rohit should apply the concept of professional skepticism. What specific matters should he remain alert to while performing the audit? **(4 Marks)**

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INTERMEDIATE: GROUP – II
PAPER – 5: AUDITING AND ETHICS
SUGGESTED ANSWERS / HINTS
Part I - Multiple Choice Questions

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

Part II - Descriptive Answers

1. (a) (i) Audit risk means the risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk.

Audit risk is a technical term related to the process of auditing; it does not refer to the auditor's business risks such as loss from litigation, adverse publicity, or other events arising in connection with the audit of financial statements.

For purposes of the SAs, audit risk does not include the risk that the auditor might express an opinion that the financial statements are materially misstated when they are not. This risk is ordinarily insignificant.

The assessment of risks is based on audit procedures to obtain information necessary for that purpose and evidence obtained throughout the audit.

- (ii) The assessment of risks is a matter of professional judgment, rather than a matter capable of precise measurement. The distinguishing feature of the professional judgment expected of an auditor is that it is exercised by an auditor whose training, knowledge and experience have assisted in developing the necessary competencies to achieve reasonable judgments.

(b) According to SA 550 on “Related Parties”, the auditor shall inquire of management regarding:

- (i) The identity of the entity’s related parties, including changes from the prior period.
- (ii) The nature of the relationships between the entity and these related parties; and
- (iii) Whether the entity entered into any transactions with these related parties during the period and, if so, the type and purpose of the transactions.

The auditor shall inquire of management and others within the entity, and perform other risk assessment procedures considered appropriate, to obtain an understanding of the controls, if any, that management has established to -

- (i) Identify, account for, and disclose related party relationships and transactions in accordance with the applicable financial reporting framework;
- (ii) Authorise and approve significant transactions and arrangements with related parties; and
- (iii) Authorise and approve significant transactions and arrangements outside the normal course of business.

(c) It is important for auditor to identify scope of the engagement. Only a well identified scope can lead to establishment of a sound audit strategy. There are many characteristics of engagement defining its scope. Some of characteristics are as under: -

- Applicable financial reporting framework applicable to the entity

- Nature of business segments to be audited including the need for specialized knowledge
- Industry specific reporting requirements required by industry regulators
- Expected use of audit evidence obtained in previous audits

2. (a) Audit procedures - To establish the existence of trade payables and other current liabilities as at the period- end

- (i) Check whether there are controls in place to ensure that any purchase/ expense invoice does not get recorded more than once and payable balances are automatically recorded in the general ledger at the time of recording of expense.
- (ii) Obtain accounts payable ageing report and trace its balances to the general ledger. If there are any differences, investigate reconciling items. Journal entries, specially for large amounts should be carefully examined.
- (iii) An important audit activity is to contact vendors directly/independently and ask them to confirm the amounts of accounts payable as at the end of the reporting period under audit. This should necessarily be done for all significant account payable balances as at the period end and for parties from whom material purchases have been made during the period under audit even if period-end balance of such parties is not significant.
- (iv) If there are any related party payables, review whether they were properly authorised and the value of such transactions were reasonable and at arm's length.
- (v) Review a trend line of purchases/ expenses and accounts payable, or a comparison of the two over time, to see if there are any unusual trends. Make inquiries about reasons for changes in trends from the management.

Verification of liabilities is as important as that of assets because omission, understatement, or overstatement of liabilities would result in the financial statements not showing a true and fair view of the entity's state of affairs.

- (b) Engagement Team Discussions:** All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement are known to be the "Engagement Team". The engagement team should hold discussions to gain better understanding of the bank and its environment, including internal control, and also to assess the potential for material misstatements of the financial statements. All these discussions should be appropriately documented for future reference. The discussion between the

members of the engagement team and the audit engagement partner should be done on the susceptibility of the bank's branch financial statements to material misstatements. These discussions are ordinarily done at the planning stage of an audit.

The engagement team discussion ordinarily includes a discussion of the following matters:

- (i) Errors that may be more likely to occur;
- (ii) Errors which have been identified in prior years;
- (iii) Method by which fraud might be perpetrated by bank personnel or others within particular account balances and/or disclosures;
- (iv) Audit responses to Engagement Risk, Pervasive Risks, and Specific Risks;
- (v) Need to maintain professional skepticism throughout the audit engagement;
- (vi) Need to alert for information or other conditions that indicates that a material misstatement may have occurred (e.g., the bank's application of accounting policies in the given facts and circumstances).

Advantages of such a discussion :-

- (i) Specific emphasis should be provided to the susceptibility of the bank's financial statements to material misstatement due to fraud, that enables the engagement team to consider an appropriate response to fraud risks, including those related to engagement risk, pervasive risks, and specific risks.
- (ii) It further enables the audit engagement partner to delegate the work to the experienced engagement team members and to determine the procedures to be followed when fraud is identified.
- (iii) Further, audit engagement partner may review the need to involve specialists to address the issues relating to fraud.

(c) The auditor shall document: -

- (i) the overall audit strategy
- (ii) the audit plan and
- (iii) any significant changes made during the audit engagement to the overall audit strategy or the audit plan, and the reasons for such changes.

The documentation of the overall audit strategy is a record of the key decisions considered necessary to properly plan the audit and to communicate significant matters to the engagement team.

The documentation of the audit plan is a record of the planned nature, timing and extent of risk assessment procedures and further audit procedures at the assertion level in response to the assessed risks. It also serves as a record of the proper planning of the audit procedures that can be reviewed and approved prior to their performance. The auditor may use standard audit programs and/or audit completion checklists, tailored as needed to reflect the particular engagement circumstances.

A record of the significant changes to the overall audit strategy and the audit plan and resulting changes to the planned nature, timing and extent of audit procedures, explains why the significant changes were made and the overall strategy and audit plan finally adopted for the audit. It also reflects the appropriate response to the significant changes occurring during the audit.

3. (a) Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.

Some documents represent direct audit evidence of the existence of an asset, for example, a document constituting a financial instrument such as a stock or bond. Inspection of such documents may not necessarily provide audit evidence about ownership or value. In addition, inspecting an executed contract may provide audit evidence relevant to the entity's application of accounting policies, such as revenue recognition.

An example of inspection used as a test of controls is inspection of records for evidence of authorisation.

Inspection of tangible assets may provide reliable audit evidence with respect to their existence, but not necessarily about the entity's rights and obligations or the valuation of the assets. Inspection of individual inventory items may accompany the observation of inventory counting.

- (b) Going concern is one of the fundamental accounting assumptions. The enterprise is normally viewed as a going concern, that is, as continuing in operation for the foreseeable future. It is assumed that the enterprise has neither the intention nor

the necessity of liquidation or of curtailing materially the scale of the operations. SA 570 requires the auditor to obtain sufficient appropriate audit evidence regarding and conclude on the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements

Under the going concern basis of accounting, the financial statements are prepared on the assumption that the entity is a going concern and will continue its operations for the foreseeable future. General purpose financial statements are prepared using the going concern basis of accounting, unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. Based on the audit evidence obtained, the auditor also has to conclude whether any material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern

The significance of Going Concern is due to its effect on preparation of financial statements. Ability or otherwise of an enterprise to be viewed as going concern affects its preparation of financial statements.

When the use of the going concern basis of accounting is appropriate, assets and liabilities are recorded on the basis that the entity will be able to realize its assets and discharge its liabilities in the normal course of business.

When an enterprise is not viewed as a going concern, the financial statements are prepared on liquidation basis. For example, inventories may need to be written down as these may be sold for a lower price. Assets may have to be recorded at the likely prices they will fetch.

The auditor must report appropriately as required by SA 570, depending on whether the going concern basis is appropriate, whether adequate disclosures are made, and whether a material uncertainty exists.

- (c) **Audit of Receipts:** The audit of receipts is neither all pervasive nor as old as audit of expenditure but has come to stay in some countries. Such an audit provides for checking;
- (i) whether all revenues or other debts due to government have been correctly assessed, realised and credited to government account by the designated authorities;
 - (ii) whether adequate regulations and procedures have been framed by the department/agency concerned to secure an effective check on assessment, collection and proper allocation of cases;
 - (iii) whether such regulations and procedures are actually being carried out;

- (iv) whether adequate checks are imposed to ensure the prompt detection and investigation of irregularities, double refunds, fraudulent or forged refund vouchers or other loss of revenue through fraud or willful omission or negligence to levy or collect taxes or to issue refunds; and
- (v) review of systems and procedures to see that the internal procedures adequately secure correct and regular accounting of demands collection and refunds and pursuant of dues up to final settlement and to suggest improvement. The basic principle of audit of receipts is that it is more important to look at the general than on the particular, though individual cases of assessment, demand, collection, refund, etc. are important within the area of test check. A review of the judicial decisions taken by tax authorities is done to judge the effectiveness of the assessment procedure.
- (vi) The extent and quantum of audit required to be done under each category of audit are determined by the C&AG. These are neither negotiable nor questioned. The prescribed extent and quantum of audit are structured in accordance with the design of test check, random sampling, general review, in-depth study of specified areas, etc. as may be warranted by the nature of transactions, its importance in the scheme of activities of a department and the totality of its transactions, the frequency of check and total plan of audit to be executed during a period.

4. (a) The nature and extent of audit procedures necessary to obtain sufficient appropriate audit evidence regarding opening balances depend on such matters as:

- The accounting policies followed by the entity.
- The nature of the account balances, classes of transactions and disclosures and the risks of material misstatement in the current period's financial statements.
- The significance of the opening balances relative to the current period's financial statements.
- Whether the prior period's financial statements were audited and, if so, whether the predecessor auditor's opinion was modified.

In the case of FGH Ltd., the presence of significant inventory and receivable opening balances along with the prior auditor's qualification on receivables increases the risk associated with opening balances. Therefore, these factors will require you, as the new statutory auditor, to design more extensive and carefully focused audit procedures in

accordance with SA 510 to obtain sufficient appropriate audit evidence before forming your opinion on the current year's financial statements.

(b) As per SA 210 "Agreeing the Terms of Audit Engagements", in order to establish whether the preconditions for an audit are present, the auditor of Wing Ltd, CA G shall:

- (1) Determine whether the financial reporting framework is acceptable; and
- (2) Obtain the agreement of management that it acknowledges and understands its responsibility:
 - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework;
 - (ii) For the internal control as management considers necessary; and
 - (iii) To provide the auditor with:
 - Access to all information such as records, documentation and other matters;
 - Additional information that the auditor may request from management for the purpose of the audit; and
 - Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Since the management of Wing Ltd. has not acknowledged its responsibilities and is restricting access to information and personnel, the preconditions for an audit are not present as per SA 210. Therefore, CA G should decline the engagement, unless the management agrees to fulfil all obligations required under SA 210 before the audit begins.

(c) Standard on Auditing (SA) 705 "Modifications to the Opinion in the Independent Auditor's Report" deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700 (Revised) "Forming an Opinion and Reporting on Financial Statements", the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary. This SA also deals with how the form and content of the auditor's report is affected when the auditor expresses a modified opinion.

The objective of the auditor is to express clearly an appropriately modified opinion on the financial statements that is necessary when:

- (i) The auditor concludes, based on the audit evidence obtained, that the financial statements as a whole are not free from material misstatement; or
- (ii) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

5. (a) The auditor cannot obtain absolute assurance that financial statements are free from material misstatement because the process of audit suffers from certain inbuilt or inherent limitations. Preparation of financial statements involves making many judgments by management. These judgments may involve subjective decisions or a degree of uncertainty. Therefore, the auditor may not be able to obtain absolute assurance that financial statements are free from material misstatements due to frauds or errors.

One of the premises for conducting an audit is that management acknowledges its responsibility for preparation of financial statements in accordance with the applicable financial reporting framework and for devising suitable internal controls. However, such controls may not have operated to produce reliable financial information due to their own limitations.

In Himani Electronics Ltd., management devised a control that all purchase bills should reflect stamp and signatures of an authorised person in the “Goods Receiving Section” stating the date and time of receipt of goods. This control was meant to ensure that only those purchase bills are processed for payment for which goods have actually been received.

However, the concerned accountant and authorised person in the “Goods Receiving Section” colluded, and false bills were stamped and processed. This is a case of overriding of internal controls due to collusion between two persons. Such probable collusion is itself a limitation of internal controls.

Because such collusion and control failures can occur, an audit provides only reasonable assurance. The existence of proper controls does not eliminate the inherent limitations of audit, nor does it guarantee detection of all frauds or errors. Hence, the auditor cannot obtain absolute assurance that financial statements are free from material misstatement.

(b) Audit procedure for verifying interest income on fixed deposits:

- (i) Obtain a listing of fixed deposits opened during the period under audit along with the applicable interest rate and the number of days for which the deposit was outstanding during the period.
- (ii) Verify the arithmetical accuracy of the interest calculation made by the entity by recomputing i.e. multiplying the deposit amount with the applicable rate and number of days during the period under audit.
- (iii) For deposits still outstanding as at the period- end, trace the same to the direct confirmations obtained from the respective bank/ financial institution.
- (iv) Obtain a confirmation of interest income from the bank and verify that the interest income as per bank reconciles with the calculation shared by the entity.
- (v) Also, obtain a copy of Form 26AS (TDS withholding by the bank/ financial institution) and reconcile the interest reflected therein with the calculation shared by client.

(c) Fee from Students:

- (i) Check names entered in the Students Fee Register for each month or term, with the respective Class Registers, showing names of students on rolls and test amount of fees charged; and verify that there operates a system of internal check which ensures that demands against the students are properly raised.
- (ii) Check fees received by comparing counterfoils of receipts granted with entries in the Cash Book and tracing the collections in the Fee Register to confirm that the revenue from this source has been duly accounted for.
- (iii) Total up the various columns of the Fees Register for each month or term to ascertain that fees paid in advance have been carried forward and that the arrears that are irrecoverable have been written off under the sanction of an appropriate authority.
- (iv) Check admission fees with admission slips signed by the head of the institution and confirm that the amount has been credited to a Capital fund, unless the Managing Committee has taken a decision to the contrary.
- (v) See that free studentship and concessions have been granted by a person authorised to do so, having regard to the Rules prepared by the Managing Committee.

- (vi) Confirm that fines for late payment or absence, etc. have been either collected or remitted under proper authority.
- (vii) Confirm that hostel dues were recovered before student's accounts were closed and their deposits of caution money refunded.

6. (a) Some examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph.

- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.

(b) For additions during the period under audit, obtain a listing of all additions from the management and undertake the following procedures:

- (i) For all material additions, verify whether such expenditure meets the criterion for recognition of an intangible asset as per AS 26.
- (ii) Ensure that no intangible asset arising from research (or from the research phase of an internal project) should be recognised. Expenditure on research (or on the research phase of an internal project) should be recognised as an expense when it is incurred. Check the certificate or report or other similar documentation maintained by the entity to verify the date of use of the intangible which could be linked to date of commencement of commercial production/ economic use to the entity, for all additions to intangible assets during the period under audit.
- (iii) Verify whether the additions (acquisitions) have been approved by appropriate entity's personnel.
- (iv) Verify whether proper internal processes and procedures like inviting competitive quotations/ proper tenders etc. were followed prior to finalizing

the vendor for procuring item of intangible assets by testing those documents on a sample basis.

In relation to deletions of intangible assets, understand from the management the reason and rationale for deletion and the manner of disposal. Obtain the management approval and disposal note authoring disposal of the asset from its active use. Verify the process followed for sale of discarded asset, example inviting competitive quotes, tenders and the basis of calculation of sales proceeds. Verify that the management has accurately recorded the deletion of intangible asset (original cost and accumulated amortization up to the date of disposal) and the resultant gain/ loss on disposal in the entity's books of account.

- (c) The auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
- (i) Discuss the matter with management and, where appropriate, those charged with governance.
 - (ii) Determine whether the financial statements need amendment and, if so,
 - (iii) Inquire how management intends to address the matter in the financial statements.

OR

- (c) Professional skepticism refers to an attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

In this situation, several observations such as contradictory sales invoices, altered documents, evasive responses, and unusual transactions indicate that Rohit must increase the level of skepticism.

While exercising professional skepticism, an auditor must remain alert to the following:

- Audit evidence that contradicts other audit evidence obtained. (For example, dispatch records contradicting sales invoices.)

- Information that brings into question the reliability of documents and responses to inquiries used as audit evidence. (Such as altered documents or evasive explanations by management.)
- Conditions that may indicate possible fraud. (For example, unusual transactions and modifications in documents.)
- Circumstances that suggest the need for audit procedures in addition to those required by the SAs. (Given the inconsistencies, Rohit may need to perform additional procedures.)

Thus, based on the circumstances, CA Rohit should maintain professional skepticism, perform additional verification, and critically evaluate all evidence before forming his audit opinion.