Mock Test Paper - Series I: March, 2026

Date of Paper: 25th March, 2026

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 1-3]

M/s RGS & Co., Chartered Accountants, have been appointed as the statutory auditors of Nova Engineering Ltd., a company engaged in manufacturing specialised industrial machinery. During the first planning meeting, the engagement partner informed the audit team that the audit would be conducted in accordance with Standards on Auditing applicable to audits of financial statements relating to historical financial information.

While discussing the audit approach, the engagement partner first finalised the overall audit strategy considering the size of operations, complexity of transactions and available resources. Thereafter, the audit team was instructed to develop a detailed audit plan addressing matters identified in the strategy. The partner emphasised that before designing audit procedures, the team must obtain adequate knowledge of the client's business model, revenue cycle and procurement process, as without such understanding a proper audit plan cannot be developed.

During the risk assessment process, the audit team identified that the company had recently implemented a new revenue recognition system, which could potentially affect several items in the financial statements simultaneously. The team also noticed that inventory valuation and revenue transactions carried specific risks of misstatement because of complex pricing arrangements with customers.

The engagement partner explained that the first risk relates to financial statements as a whole, whereas the second relates to specific assertions for particular classes of transactions and account balances. Accordingly, the team decided to assess the risks at both levels so that appropriate further audit procedures could be designed.

On the basis of above, answer the following MCQs (1-3)

1. In the above case scenario of Nova Engineering Ltd. has clarified that the assignment would be carried out in accordance with the Standards on Auditing, which are applicable to audits of historical financial information.

   Based on the engagement partner's statement, which of the following engagements would most appropriately fall within the scope of such Standards in the present context?

   (a) Examination of financial projections prepared by Nova Engineering Ltd. for a proposed bank loan.

   (b) Certification of future cost estimates for a proposed expansion project.

   (c) Review of internal control procedures implemented for the new revenue system.

   (d) Audit of financial statements of Nova Engineering Ltd. for the year ended 31 March 2025.

2. In the planning meeting described in the case scenario, the engagement partner first established the overall audit strategy and then instructed the audit team to develop a detailed audit plan after obtaining knowledge of the company's business model and processes.

   In the context of the situation described in the case scenario, the primary reason for obtaining such knowledge before developing the audit plan is to:

   (a) Enable the auditor to design appropriate audit procedures relevant to the entity's operations and risks.

   (b) Determine whether the new revenue system complies with accounting standards.

   (c) Replace the need for performing risk assessment procedures later in the audit.

   (d) Ensure that the audit team uses the minimum possible audit resources.

3. In the case scenario, the audit team identified that:

   - the new revenue recognition system could affect several items in the financial statements simultaneously, and
   - inventory valuation and revenue transactions involved specific risks relating to particular transactions and balances.

   Based on the engagement partner's explanation in the case scenario, which of the following correctly classifies these risks?

   (a) Both risks relate to the financial statement level only.

(b) Both risks relate to assertion level risks only.

(c) The first risk relates to financial statement level, while the second relates to assertion level risks.

(d) The first risk relates to assertion level, while the second relates to financial statement level risks.

Case Scenario 2 [MCQs 4-7]

During the audit of Saraswati University for the year ended 31 March 2025, the auditor examined various income streams and administrative expenses of the university.

While reviewing student fee records for the July–September term, the auditor compared the Class Registers with the Students' Fee Register. The Class Registers showed 620 students on roll, whereas the Students' Fee Register reflected fee demands raised only for 590 students. Further examination revealed that counterfoils of receipts issued during August totalled ₹ 12,40,000, while the Cash Book recorded fee collections of ₹ 11,90,000 for the same period.

The university also operates a hostel with 200 rooms. During the year, the average occupancy rate was 80%, and the hostel fee charged per student was ₹ 6,000 per month. However, the hostel income recorded in the books amounted to ₹ 1.80 crore.

During the audit of Saraswati University, the auditor applied analytical procedures to evaluate the reasonableness of certain income statement balances. Instead of relying on prior period trends, the auditor used non-financial data relating to the current audit period. To evaluate whether the recorded hostel income appeared reasonable, the auditor used the occupancy rate and hostel fee structure to estimate the expected hostel income.

While examining certain administrative expenses, the auditor analysed monthly trends for electricity and fuel expenses. However, for travel expenses and repairs, supporting documents were examined in detail. During this examination, it was noticed that ₹ 75,000 spent on purchase of an air conditioner for the administrative office had been recorded under "Repairs and Maintenance" and some travel claims were not approved according to the delegation of authority matrix.

On the basis of above, answer the following MCQs (4-7)

4. Based on the given facts, which of the following best explains the implication of the difference between the Class Registers (620 students) and the Students' Fee Register (590 students)?

    (a) Fee demands may not have been raised for 30 students appearing on the rolls.

    (b) Hostel income of the university may be understated.

(c) The difference indicates advance fees collected from students.

(d) The difference represents fines for late payment of fees.

5. During the audit of Saraswati University, the auditor estimated hostel income based on 200 rooms, an 80% occupancy rate, and a monthly fee of ₹ 6,000. The recorded hostel income was found to be materially higher than the auditor's estimate.

   What would be the most appropriate course of action by the auditor?

   (a) Accept the recorded income since it is reflected in the books and supported by receipts.

   (b) Adjust the estimate to match the recorded income if minor differences exist.

   (c) Conclude that the income is overstated solely based on the analytical comparison.

   (d) Investigate the variance by examining supporting records, occupancy data, and assumptions used, and perform additional audit procedures as necessary.

6. Which of the following best describes the analytical procedure applied by the auditor to evaluate the reasonableness of hostel rent income?

   (a) Trend analysis comparing hostel income with the previous year.

   (b) Reasonableness test using non-financial data to estimate expected income.

   (c) Verification of hostel fee receipts with the Cash Book.

   (d) Test of controls over hostel fee collection.

7. With reference to the given facts, which aspect of examining expenses is primarily affected when ₹ 75,000 spent on purchase of an air conditioner is recorded under "Repairs and Maintenance"?

   (a) Whether the expenditure pertained to the current period under audit.

   (b) Whether the expenditure was supported by valid documents.

   (c) Whether the expenditure qualified as revenue and not capital expenditure.

   (d) Whether the expenditure related to the university's activities.

Case Scenario 3 [MCQs 8-12]

Ardent Precision Components Ltd. has been sanctioned a Cash Credit (CC) limit of ₹ 10 crore by a bank to finance its working capital requirements. As per the sanction terms, the borrower is required to submit monthly stock statements, on the basis of which the bank computes the

Drawing Power (DP) after applying margin on eligible current assets such as stock and receivables.

During the branch audit as on 31st March, the auditor observed that the branch had computed the drawing power at ₹ 8.20 crore based on the stock statement dated 30th November submitted by the borrower. However, the outstanding balance in the CC account as on 31st March was ₹ 8.60 crore. Further examination of the account revealed that the outstanding balance had remained continuously above the drawing power for more than 90 days preceding the balance sheet date.

While reviewing the borrower's records, the auditor compared the stock value appearing in the audited financial statements for the year ended 31st March with the stock value reported in the stock statement submitted to the bank and noticed a significant difference, indicating possible overstatement of stock in the statement submitted to the bank.

Further examination revealed that inventory worth ₹ 2 crore, which had been considered by the branch while computing drawing power, was stated to be lying at a third-party warehouse. However, the branch had not obtained any confirmation from the warehouse operator regarding ownership of such inventory.

After accumulating the differences between the stock reported to the bank and the stock appearing in the audited financial statements, the auditor observed that the aggregate misstatement was approaching the materiality level determined for the audit.

When the matter was discussed with the borrower's management, they stated that the difference arose due to variations in valuation methods used for internal reporting and expressed the view that no adjustment was necessary in the financial statements. Consequently, the identified misstatements remained uncorrected as on the reporting date.

During discussions on these matters, the branch manager informally suggested that the auditor should avoid highlighting these irregularities in the audit report, as doing so might adversely affect the borrower's banking relationship.

On the basis of above, answer the following MCQs (8-12)

8. Considering the facts given in the case regarding the relationship between the outstanding balance in the CC account and the drawing power determined by the branch, how should the auditor evaluate the status of the account as on the reporting date?

   (a) The account is regular since the sanctioned limit has not been exceeded.

   (b) The account should be treated as out of order since the outstanding balance has remained continuously in excess of the drawing power.

(c) The account is regular because the borrower had submitted stock statements earlier during the year.

(d) The account cannot be evaluated until audited financial statements are finalized.

9. While evaluating the security position of the CC account as on the reporting date, the auditor noted that the drawing power had been computed using stock information that was not contemporaneous with the reporting date, and that the borrowings in the account were already close to the level determined on the basis of primary security.

   Considering these facts together, which of the following conclusions would be most appropriate?

   (a) The borrowing position may not be reliable since it is being evaluated on the basis of outdated information regarding primary security.

   (b) The account should be treated as regular because the sanctioned limit itself has not been exceeded.

   (c) The drawing power computation can be accepted since the borrower had submitted a stock statement earlier during the year.

   (d) The auditor should rely only on the audited financial statements while evaluating the security position.

10. During the audit, the auditor noted that a portion of the inventory considered while determining drawing power was stated to be lying at a third-party warehouse and also observed differences between the stock reported to the bank and the stock appearing in the audited financial statements.

    Considering these facts together, which of the following audit procedures would most effectively address the risk arising in this situation?

    (a) Rely on the stock statements submitted by the borrower to the bank.

    (b) Accept management representation regarding the existence of inventory held outside the entity's premises.

    (c) Obtain confirmation from the third-party warehouse operator regarding the inventory held on behalf of the borrower.

    (d) Restrict verification only to purchase invoices relating to inventory.

11. The auditor accumulated the differences identified between the stock reported to the bank and the stock appearing in the audited financial statements and noted that the aggregate misstatement was approaching the materiality level determined for the audit. Management, however, decided not to make any adjustment in the financial statements.

In light of these facts, what should the auditor primarily consider while evaluating the implications for the audit?

(a) Conclude that the financial statements are materially misstated without further evaluation.

(b) Evaluate whether the uncorrected misstatements are material individually or in aggregate and consider the implications for the auditor's report.

(c) Accept management's explanation since the difference arose due to valuation methods.

(d) Ignore the misstatement since it does not exceed the materiality threshold.

12. During discussions on the above matters, the branch manager suggested that the auditor should avoid reporting the irregularities so that the borrower's banking relationship is not affected.

Considering this situation described in the case, which of the following ethical principles should primarily guide the auditor's response?

(a) Integrity and Objectivity.

(b) Confidentiality.

(c) Professional Behaviour.

(d) Professional Competence and Due Care.

13. BCD Ltd. is engaged in manufacturing of electronic components. During the audit of financial statements for the year ended 31st March 2025, the auditor assessed the risk of material misstatement at the assertion level for revenue and inventory balances. While designing further audit procedures, the auditor considered whether to perform tests of details, substantive analytical procedures, or a combination of both.

The auditor noted that reliable industry data was available and the relationship between sales volume and revenue had historically been predictable. However, certain unusual fluctuations were also observed during the current year. Accordingly, the auditor exercised professional judgment while deciding the nature of substantive procedures to be performed to reduce audit risk at the assertion level to an acceptably low level.

Which of the following statements correctly explains the basis for the auditor's decision regarding substantive procedures?

(a) Substantive analytical procedures must always be used instead of tests of details where reliable industry data is available.

(b) The auditor decides whether to use tests of details, substantive analytical procedures, or a combination of both based on professional judgment regarding their expected effectiveness and efficiency in reducing audit risk at the assertion level to an acceptably low level.

(c) Substantive analytical procedures can only be used when control risk is assessed as low.

(d) Tests of details are mandatory for all material account balances irrespective of the auditor's judgment.

14. CDE Ltd. is engaged in manufacturing and has a turnover of ₹ 500 crores. During the audit, for the year ending on 31st March 2025, the auditor, CA R determined materiality at the planning stage based on a percentage of profit before tax. During the course of audit, certain misstatements were identified, individually immaterial but collectively approaching the materiality threshold. Further, management refused to correct some of these misstatements.

At the completion stage, CA R re-evaluated materiality considering revised financial results and assessed the impact of uncorrected misstatements before forming the audit opinion.

Which of the following statements correctly reflects the application of materiality as per SA 320?

(a) Materiality is determined only at the planning stage and cannot be revised later.

(b) Only individually material misstatements need to be considered by the auditor.

(c) Materiality is applied in planning, performing, and evaluating the audit, including assessing uncorrected misstatements.

(d) Once management refuses to correct misstatements, the auditor must automatically issue a qualified opinion.

15. A Ltd. is engaged in manufacturing operations and has significant Work-in-Progress (WIP) inventory at year end. During the audit, the auditor evaluates measurement of stages of production, basis of estimates, inclusion of cost elements, allocation of overheads, and treatment of abnormal wastage.

Which of the following audit observations indicates inappropriate valuation of Work-in-Progress?

(a) Various stages of production/value additions are measured and where estimates are made, the basis for such estimates is understood.

(b) Overheads included in WIP are based on a method consistent with costing and financial data maintained by the entity.

(c) Auditor has ascertained what elements of cost are included in WIP.

(d) Material costs included in WIP include abnormal wastage factors.

PART II - Descriptive Questions (70 Marks)

Question No. 1 is compulsory.

Attempt any four questions from the Rest.

1. (a) WXY Biotech Ltd. is engaged in manufacturing specialised pharmaceutical products. During the financial year 2024–25, the company:

- Introduced a new product developed using advanced biotechnology;
- Entered into complex revenue-sharing agreements with foreign distributors;
- Adopted a newly issued Accounting Standard dealing with revenue recognition involving multiple performance obligations;
- Operates in an industry where several companies have recently faced insolvency due to regulatory restrictions and technological obsolescence.

The management has implemented internal controls over accounting and financial reporting. The audit team is in the process of identifying and assessing risks of material misstatement.

Explain the concept of inherent risk and discuss how it is relevant in the above case. **(5 Marks)**

(b) RKP & Co., Chartered Accountants, were appointed as the statutory auditors of Orion Engineering Ltd., a company engaged in manufacturing heavy industrial equipment. During the course of audit, certain shareholders raised concerns before the auditors regarding the following matters:

1. They asked the auditor to certify whether the sophisticated imported machinery installed in the factory was in perfect physical condition and to estimate its remaining useful life.

2. Some shareholders also requested the auditor to confirm the genuineness of certain supplier invoices and contracts, alleging that some documents might be forged.

3. A group of investors further demanded that the auditor conduct a detailed investigation into an alleged fraud by a senior employee, including questioning employees and recording statements under oath.

With reference to the above situation, explain the matters which fall outside the scope of an audit. Also distinguish between audit and investigation. **(5 Marks)**

(c) XYZ Limited is engaged in manufacturing activities. As at 31st March 2025, the Trade Receivables balance amounted to ₹ 8 crores. The statutory auditor selected 25 customer balances for external confirmation in accordance with the applicable Standard on Auditing relating to external confirmations.

The results of the confirmation procedure were as follows:

- 15 customers responded directly to the auditor indicating agreement with the information requested.
- 3 responses were received directly to the auditor indicating disagreement with the information provided in the request. These parties were supposed to respond only if they disagree with the information provided in the request.
- 5 customers did not respond despite follow-up requests.
- 2 customers responded stating that the balances as per their records were lower than those mentioned in the confirmation requests.

In the light of the relevant Standard on Auditing, explain how the auditor should evaluate the above responses and state whether further audit procedures are required. **(4 Marks)**

2. (a) Buildwell Limited, a manufacturing company engaged in production of industrial components, has reported total purchases of ₹ 48 crores for the year ended 31st March, 2025. During the audit, the statutory auditor noted that purchases constitute a significant portion of total expenses and directly impact inventory valuation and profitability.

During preliminary discussions, the management informed that the entity follows a centralized procurement process. However, internal audit reports indicated certain past instances of delayed Goods Receipt Notes (GRNs) and weak vendor onboarding controls.

The auditor is required to verify whether recorded purchases represent goods actually received / services availed during the period (Occurrence assertion) and ensure that purchases are neither understated nor overstated.

Explain the audit procedures (any five points) the auditor should perform to verify the occurrence of purchases. **(5 Marks)**

(b) You are the statutory auditor of ABC Bank Ltd., a scheduled commercial bank having 350 branches across India. During the audit for the year ended 31st March 2025, you observe the following:

- Operating expenses have increased by 28% compared to the previous year, whereas total income has increased only by 10%.
- Significant increase is noted in Staff Welfare Expenses, IT Maintenance Charges and Rent.
- Certain branch managers have discretionary powers to incur expenses up to specified limits.
- The Bank has recently migrated to a centralised expense processing system.
- Internal audit reports indicate delays in submission of supporting documents in few regional offices.

As the statutory auditor, explain the audit procedures you would perform in respect of Operating Expenses of the Bank. **(5 Marks)**

(c) RST & Co., Chartered Accountants, have been the statutory auditors of Bright Vision Ltd., a company engaged in wholesale trading of electronic goods, for the last 6 years.

During the financial year 2024–25, the company significantly changed its business model by:

- Introducing online sales through its own e-commerce portal;
- Appointing multiple third-party warehouse operators across India;
- Implementing a new ERP system from October 2024; and
- Revising its credit policy by extending credit from 30 days to 90 days to boost sales.

However, the audit team continued to follow the same audit programme that had been designed three years ago, which was primarily structured for a traditional wholesale model with centralised warehousing and manual accounting controls.

The engagement partner did not conduct any formal periodic review of the audit programme. The assistants carried out audit procedures strictly as per the existing programme without modifying the extent of checking, sampling plan, or procedures relating to inventory verification and receivables.

Subsequently, material misstatements were detected in revenue recognition and inventory records held with third-party warehouses. The management alleged that the auditor had conducted the audit negligently.

Discuss whether the auditor was justified in continuing with the old audit programme. What are the implications of not conducting periodic review of the audit programme? **(4 Marks)**

3. (a) Verma & Kapoor, Chartered Accountants, were appointed as the statutory auditors of Mor Components Ltd. for the financial year 2024–25. The company is engaged in manufacturing automobile spare parts and has a large number of sales transactions during the year.

While planning the audit of trade receivables amounting to ₹ 48 crore, the engagement partner decided to perform Test of Details using audit sampling in accordance with SA 530 "Audit Sampling". The audit team observed that the population of receivables consisted of a few large balances and a large number of small balances. Further, the engagement partner emphasised that sufficient assurance must be obtained that material misstatement in receivables is not overlooked.

Accordingly, the audit team discussed certain factors that would influence the sample size to be selected for the test of details.

With reference to SA 530 "Audit Sampling", explain briefly the following factors that the auditor may consider while determining the sample size for the Test of Details:

(i) The desired level of assurance

(ii) Stratification of the population **(5 Marks)**

(b) Mindset Appliances Limited, a listed company engaged in manufacturing electrical equipment, closed its books of account for the year ended 31st March 2025. The statutory audit is in progress and the auditor proposes to sign the audit report on 30th June 2025.

During the period between 31st March 2025 and 30th June 2025, the following events occurred:

1. A major debtor owing ₹ 8 crores as on 31st March 2025 was declared insolvent on 15th April 2025. No specific provision had been made against this debtor as at year-end.

2. A legal case for product liability, for which a provision of ₹ 3 crores was created as on 31st March 2025, was settled out of court on 10th May 2025 for ₹ 1.80 crores.

3. On 20th May 2025, the company issued fresh equity shares through a qualified institutional placement.

4. On 25th May 2025, the Board approved a plan to merge with another listed entity, subject to regulatory approvals.

5. On 5th June 2025, a major fire destroyed finished goods inventory worth ₹ 6 crores stored in a warehouse. The loss is expected to be fully covered by insurance.

The management has not made any adjustments in the financial statements but has disclosed all the above events in the Notes to Accounts.

(a) Classify the above events into appropriate categories of subsequent events.

(b) State the auditor's considerations and implications on the financial statements in each case with reasons.

(c) Conclude whether the management's treatment is appropriate. **(5 Marks)**

(c) GreenGrow Multi-State Co-operative Society Ltd. (GMSCSL) is engaged in procurement and export of agricultural produce and operates across 6 states in India. The Society has reported continuous expansion in turnover over the past 4 years. However, during the financial year 2024–25, the following issues came to the notice of the Ministry of Cooperation:

1. Large advances were granted to related parties without adequate security.

2. Procurement contracts were awarded without competitive bidding.

3. Internal audit reports highlighting diversion of funds were ignored by the management.

4. The debt-equity ratio increased abnormally due to heavy borrowings.

5. There were persistent cash flow mismatches and short-term loans were being used for long-term capital projects.

6. Trade associations complained that the Society's pricing practices were distorting the agricultural export market.

On the basis of preliminary inquiry, the Central Government is considering to direct a special audit of the Society.

(a) Examine whether the Central Government is empowered to order a special audit in the above case.

(b) State the statutory provisions governing such power.

(c) Conclude whether invocation of Section 77 is justified in the given case.

(4 Marks)

4. (a) KRT & Co., Chartered Accountants, have been appointed as the statutory auditors of First Heavy Engineering Ltd., a company engaged in the manufacture of specialised industrial equipment. The company operates through multiple manufacturing units and warehouses located across different states. During the preliminary discussions, the engagement partner noted that certain areas such as valuation of specialised inventory, warranty provisions, and long-term contracts may involve higher audit risk and technical complexity.

While planning the audit for the financial year ending on 31st March 2025, the engagement partner emphasised the need to determine the nature and extent of resources to be deployed, the timing of audit procedures at various locations and the manner in which the audit team will be supervised and reviewed.

In the above context, explain the concept of overall audit strategy. Also, state how the process of establishing the overall audit strategy would assist the auditor, subject to completion of risk assessment procedures, in determining such matters relevant to the planning and conduct of the audit. **(5 Marks)**

(b) SRT & Co., Chartered Accountants, are the statutory auditors of Dee Infra Projects Ltd., a listed company engaged in large infrastructure contracts.

During the audit for the year ended 31st March 2025, the Engagement Partner, Mr. A, came to know of the following matters:

1. The spouse of one of the senior members of the engagement team holds substantial equity shares in Dee Infra Projects Ltd.

2. The firm has recently provided consultancy services relating to internal financial controls implementation to the same client.

3. A partner of the firm has been offered a position on the advisory board of a group company of Dee Infra Projects Ltd.

Mr. A believes that certain situations may create threats to independence. However, due to the significance of the client, some partners of the firm are reluctant to consider withdrawal.

As per SA 220 "Quality Control for an Audit of Financial Statements", discuss the responsibilities of the Engagement Partner in relation to ethical requirements in the above circumstances. **(5 Marks)**

(c) Parmarth Ltd. is engaged in manufacturing and holds significant inventory. The management conducts physical verification of inventory at periodic intervals, but certain discrepancies were noticed during the year. The company has also been sanctioned working capital limits in excess of ₹5 crore from banks based on stock statements submitted periodically.

State the auditor's reporting requirements under Clause (ii) of Paragraph 3 of CARO, 2020 in the above situation. **(4 Marks)**

5. (a) While forming an opinion on the financial statements, the auditor is required to evaluate various aspects relating to the presentation and disclosures in the financial statements.

Explain the specific evaluations that the auditor is required to perform while evaluating the financial statements. Further, state the additional evaluation required when the financial statements are prepared in accordance with a fair presentation framework. **(5 Marks)**

(b) TSR & Associates, Chartered Accountants, are the statutory auditors of Gama Manufacturing Limited, a company engaged in manufacturing industrial equipment. The company has 650 employees working across factory and corporate office locations.

During the audit for the year ended 31st March 2025, the auditor noted the following:

- Payroll is processed through an automated payroll software based on attendance records.
- Employee benefit expenses have increased significantly compared to the previous year.
- There were substantial new recruitments and resignations during the year.

- The company provides benefits such as bonus, gratuity, leave encashment, provident fund (PF) and ESI.
- Management has represented that all statutory dues have been deposited on time.
- Year-end provisions have been made for certain employee benefits.

The engagement partner has asked the audit team to outline the audit procedures (any five points) generally required to be undertaken while auditing employee benefit expenses. **(5 Marks)**

(c) ABC Ltd. is engaged in manufacturing consumer appliances. During the year ended 31st March 2025, the company has recognized the following:

- Provision for warranty amounting to ₹ 2.80 crores in respect of products sold during the year, based on past failure trends and actuarial valuation.
- Provision of ₹ 1.50 crores towards an ongoing consumer litigation filed before the National Consumer Disputes Redressal Commission.
- Disclosure of a contingent liability of ₹ 3.25 crores in respect of a tax demand under appeal before the High Court.

The auditor is required to verify provisions and contingent liabilities in accordance with the applicable financial reporting framework and auditing standards.

State the audit procedures (any five points) generally required to be undertaken while auditing provisions and contingent liabilities. **(4 Marks)**

6. (a) OPQ Infrastructure Ltd. is engaged in the construction of large industrial projects. The company has significant estimates in its financial statements such as actuarial valuation of employee benefits, environmental restoration liabilities, and provisions relating to ongoing legal disputes.

CA R has been appointed as the statutory auditor of the company for the year ended 31 March 2025. During the course of the audit, the auditor noted that the preparation of the financial statements involved inputs from several specialists, including an actuary for employee benefit obligations, staff engineers for estimating environmental liabilities, and the company's internal legal counsel for assessing provisions relating to pending litigations.

While completing the audit, the auditor requested the management to provide written representations confirming that it has fulfilled its responsibilities for the preparation and presentation of the financial statements in accordance with the applicable financial reporting framework. Management agreed to provide such representations but proposed to include qualifying language stating that the representations are made "to the best of its knowledge and belief."

In the above circumstances, explain the written representation that the auditor may obtain from management regarding its responsibilities for the preparation of financial statements. Also comment on whether the auditor can accept representations containing such qualifying language. **(5 Marks)**

(b) Meet Electronics Ltd., a manufacturing company, is planning to appoint statutory auditor for the financial year 2024–25. The Board has approached CA S for accepting the audit engagement. During the preliminary discussions, the management informed CA S that the financial statements will be prepared using an internally designed accounting framework tailored to the company's reporting requirements.

Further, while discussing the audit engagement, management expressed reluctance in formally acknowledging its responsibilities regarding preparation of financial statements and internal control and indicated that certain internal records and personnel may be made available to the auditor only if considered necessary by management.

Before accepting the appointment, CA S intends to evaluate whether the preconditions for an audit are present as required under the relevant auditing standard.

With reference to the requirements of SA 210 – Agreeing the Terms of Audit Engagements, explain the matters CA S should determine before accepting the audit engagement in order to establish whether the preconditions for an audit are present. **(5 Marks)**

(c) Auditor of Sunshine Ltd. is of the view that due to greater management intervention to specify accounting treatment, the risk of material misstatement is greater for non-routine transactions. Is the view of the auditor correct? Specify the other matters due to which the risk of material misstatement is greater for significant non-routine transactions. **(4 Marks)**

OR

Bee Ltd. is a listed manufacturing company. The statutory auditor, CA P, conducted the audit of the financial statements for the year ended 31^{st} March 2025. During the course of audit, CA P and his audit team performed various audit procedures relating to revenue recognition, inventory valuation and verification of fixed assets. However, while reviewing the audit files, it was observed that the working papers prepared by the audit team were incomplete and lacked clear documentation explaining the basis for certain conclusions reached by the auditor.

A junior member of the audit team questioned CA P regarding the purpose and objective of maintaining proper audit documentation and how such documentation supports the auditor's report and compliance with auditing standards.

In context of the above, explain the objective of the auditor in preparing audit documentation and describe the nature of audit documentation as per the relevant Standards on Auditing. **(4 Marks)**

Mock Test Paper - Series I: March, 2026

Date of Paper: 25th March, 2026

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INTERMEDIATE: GROUP – II

PAPER – 5: AUDITING AND ETHICS

SUGGESTED ANSWERS / HINTS

Part I - Multiple Choice Questions

1. **(d)**

2. **(a)**

3. **(c)**

4. **(a)**

5. **(d)**

6. **(b)**

7. **(c)**

8. **(b)**

9. **(a)**

10. **(c)**

11. **(b)**

12. **(a)**

13. **(b)**

14. **(c)**

15. **(d)**

Part II - Descriptive Answers

1. **(a)** Inherent risk is the susceptibility of an assertion about a class of transaction, account balance or disclosure to a misstatement that could be material, either individually or when aggregated with other misstatements before consideration of any related controls as described in SA 200.

There is always a risk that before considering any existence of internal control in an entity, a particular transaction, balance of an account or a disclosure required to be made in the financial statements of an entity has a chance of being misstated and such misstatement can be material. This risk is known as inherent risk.

Inherent risk is higher for some assertions and related classes of transactions, account balances, and disclosures than for others. For example, it may be higher for complex calculations. In the given case, revenue-sharing agreements with foreign distributors and application of a newly issued Accounting Standard involving multiple performance obligations require complex judgment and calculations, thereby increasing inherent risk in revenue recognition assertions.

Inherent risk factors are considered while designing tests of controls and substantive procedures. Category of auditor's assessment lower or higher, each category covers a range of degrees of inherent risk. Auditor may assess the inherent risk of two different assertions as lower while recognizing that one assertion has less inherent risk than the other, although both have been assessed as lower.

It is important to consider the reason for each identified inherent risk even if the risk is lower, when auditor designs tests of controls and substantive procedures. For example, even if inventory valuation risk is assessed as lower, the auditor must understand why such assessment is appropriate in light of biotechnology products which may become obsolete quickly.

External circumstances giving rise to business risks may also influence inherent risk. For example, technological developments might make a particular product obsolete. In the present case, rapid technological advancements in the pharmaceutical industry and recent insolvencies in the sector increase inherent risk relating to inventory valuation, going concern, and impairment of assets. Factors in the entity and its environment may also influence the inherent risk related to a specific assertion.

Few examples of inherent risks could include:

- An accounting standard provides guidance on some complex issue which might not be understood by the management. Therefore, recording of this issue in financial statements carries inherent risk of being misstated. In the given case, adoption of a new revenue standard increases such risk.
- There are large number of business failures in an industry. Therefore, assertions in financial statements of an entity operating in such an industry

carry an inherent risk of being misstated. Here, recent insolvencies in the pharmaceutical sector increase inherent risk relating to recoverability of receivables and going concern assumptions.

Inherent risk exists independently of internal controls and represents the susceptibility of assertions to material misstatement. In the given case, complex revenue arrangements, adoption of a new Accounting Standard, technological changes, and industry instability significantly increase inherent risk. Accordingly, the auditor must carefully assess inherent risk for each relevant assertion and design appropriate tests of controls and substantive procedures to obtain sufficient and appropriate audit evidence.

(b) In the given case, the shareholders of Orion Engineering Ltd. have requested the auditor to perform certain activities which fall outside the normal scope of audit. The scope of audit does not include the following:

1. Matters outside the auditor's technical competence: An auditor is not expected to perform duties that require specialised technical expertise beyond accounting and auditing knowledge. For instance, determining the physical condition or useful life of sophisticated machinery or assessing the structural suitability of buildings requires technical skills of engineers or other experts. Therefore, the auditor cannot certify such matters.

2. Authentication of documents: An auditor is not an expert in detecting forgery or verifying the genuineness of documents. While the auditor may examine documents as audit evidence, he cannot guarantee their authenticity because he does not possess specialised expertise in forensic document verification.

3. Conducting an official investigation: An audit is not an official investigation into alleged wrongdoing. The auditor does not possess legal powers such as searching premises or recording statements of witnesses on oath, which are generally available to investigative authorities.

4. Audit is distinct from investigation: Investigation involves a critical examination of accounts with a specific purpose, such as determining whether fraud exists. Its scope is specific and narrow.

   On the other hand, the objective of audit is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion. The scope of audit is general and broad, whereas the scope of investigation is specific and narrow.

Accordingly, in the given case, the auditor of Orion Engineering Ltd. is justified in clarifying that certification of technical condition of machinery, authentication of documents, and conducting a detailed fraud investigation fall outside the normal scope of audit and such matters may require involvement of experts or a separate investigation.

(c) As per SA 505 relating to external confirmations, the auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence or whether performing further audit procedures is necessary.

When evaluating the results of individual external confirmation requests, the auditor may categorise such results as follows:

(a) Positive confirmation request

(b) Negative confirmation request;

(c) A non-response; or

(d) A response indicating an exception.

Applying the above principles to the given case:

1. 15 responses confirming balances without any difference: These fall under Positive confirmation request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.

2. 3 responses were received directly to the auditor only if they disagree with the information provided in the request: These fall under Negative confirmation request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.

3. 5 customers who did not respond despite follow-up requests: These fall under non-response. A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered. A non-response does not provide audit evidence and therefore alternative audit procedures may be required.

4. 2 responses indicating lower balances than those stated in the confirmation requests: These fall under a response indicating an exception. A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming

party. Such exceptions require investigation to determine whether they represent misstatements.

The auditor's evaluation of the above results, when taken into account with other audit procedures performed, shall assist in concluding whether sufficient appropriate audit evidence has been obtained, as required by SA 330.

2. (a) Recorded purchases represent goods actually received/ services availed during the period (OCCURRENCE): Ensure purchases are not understated/ overstated by performing following audit procedures:

- Whether any fictitious vendors have been booked or purchases have been recorded by reviewing the vendor selection process followed by the entity and also performing procedures to ensure existence of the vendors.
- Whether the goods were received at the factory gate and whether there exists an entry in the security gate inward register.
- Whether quality inspection of goods was done.
- Whether a goods receipt note was prepared and signed by an appropriate client personnel.
- Whether the purchase invoice was approved as per delegation of authority and whether a 3 or 2-way match was done.
- Whether stock record has been updated by the stores personnel.

In the given case, since purchases form a material component of the financial statements and weaknesses in controls have been indicated, the auditor must perform detailed substantive and control procedures as above to obtain sufficient and appropriate audit evidence that purchases recorded during the year represent genuine transactions relating to goods actually received or services availed. If these procedures provide satisfactory evidence, the occurrence assertion in respect of purchases may be considered as appropriately addressed; otherwise, appropriate modifications or reporting implications may arise.

(b) In the given case of ABC Bank Ltd., there is a substantial increase in operating expenses disproportionate to growth in income, along with system changes and decentralised authorisation. Accordingly, the auditor needs to design audit procedures addressing both control and substantive aspects.

The auditor should:

- study and evaluate the system of internal control relating to expenses, including authorisation procedures in order to determine the nature, timing and extent of his other audit procedures.

  (Considering that branch managers have discretionary powers and the bank has migrated to a centralised expense system, special attention should be given to approval hierarchies, maker-checker controls, system-based authorization limits, and monitoring controls.)

- examine whether there are any divergent trends in respect of major items of expenses.

  (In the present case, abnormal increase in staff welfare expenses, IT maintenance charges and rent requires detailed trend analysis branch-wise and region-wise to identify unusual patterns.)

- perform substantive analytical procedures in respect of these expenses. e.g. assess the reasonableness of expenses by working out their ratio to total operating expenses and comparing it with the corresponding figures for previous years.

  (The auditor may also compare expense ratios with industry averages of other scheduled commercial banks and correlate expenses with number of branches, employee strength and business volume.)

- verify expenses with reference to supporting documents and check the calculations wherever required.

  (Particular emphasis should be placed on high-value payments, year-end provisions, related party transactions and expenses incurred at branches where internal audit observations were adverse.)

In view of the significant increase in operating expenses and control weaknesses indicated by internal audit reports, the auditor should adopt a risk-based approach combining evaluation of internal controls, analytical procedures and detailed substantive testing. If adequate audit evidence is obtained and no material misstatements are found, the auditor may conclude that operating expenses are fairly stated. However, any material weakness in internal controls or unexplained abnormal trends may require appropriate reporting in the audit report or Long Form Audit Report (LFAR), as applicable to banks.

(c) There should be periodic review of the audit programme to assess whether the same continues to be adequate for obtaining requisite knowledge and evidence about the transactions. Unless this is done, any change in the business policy of the client may not be adequately known, and consequently, audit work may be carried on, on the basis of an obsolete programme and, for this negligence, the whole audit may be held as negligently conducted and the auditor may have to face legal consequences.

In the given case, Bright Vision Ltd. introduced significant changes in its operations, such as online sales, third-party warehouses, implementation of a new ERP system, and extended credit terms. These changes directly impacted revenue recognition, inventory control, receivables management, and internal controls. However, the audit firm failed to revise or review the existing audit programme and continued to apply procedures designed for a traditional wholesale model.

The utility of the audit programme can be retained and enhanced only by keeping the programme as also the client's operations and internal control under periodic review so that inadequacies or redundancies of the programme may be removed. Since no review was undertaken, the audit procedures became outdated and inadequate to address the changed risk environment.

Although assistants are required to strictly follow the audit programme as approved by the principal, the responsibility to update and revise the programme lies with the auditor. The argument that adherence to a fixed programme creates rigidity is not valid, provided periodic review is undertaken and assistants are encouraged to observe and report significant changes in the client's accounting functions.

The auditor was not justified in continuing with the obsolete audit programme without periodic review. Failure to revise the audit programme in light of significant business and control changes amounts to negligence, and the auditor may be held responsible for inadequately conducted audit and consequent legal implications.

3. (a) Examples of factors influencing Sample Size for Test of Details:

(i) **Desired Level of Assurance:** An increase in the auditor's desired level of assurance that tolerable misstatement is not exceeded by actual misstatement in the population will increase the sample size. Hence, greater the level of assurance that the auditor requires that the results of the sample are in fact indicative of the actual amount of misstatement in the population, the larger the sample size needs to be.

(ii) **Stratification of Population:** When stratification of the population is appropriate, then sample size will decrease as when there is a wide range (variability) in the monetary size of items in the population, it may be useful to stratify the population. When a population can be appropriately stratified, the aggregate of the sample sizes from the strata generally will be less than the sample size that would have been required to attain a given level of sampling risk, had one sample been drawn from the whole population.

Thus, while determining the sample size for test of details, the auditor considers factors such as the desired level of assurance and the possibility of stratifying the population, as these directly influence the extent of sampling required.

(b) 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:

- Those that provide evidence of conditions that existed at the date of the financial statements; and
- Those that provide evidence of conditions that arose after the date of the financial statements.

Classification and Application to the Case

1. **Events providing evidence of conditions that existed at the date of the financial statements:** Examples of events providing evidence of conditions that existed at the date of the financial statements -

   - Declaration of insolvency of a major debtor of the entity between the date of financial statements and the date of auditor's report providing evidence on the recoverability of the money due from debtor as on date of the financial statements.

     In the present case, insolvency of the debtor owing ₹ 8 crores indicates that the financial difficulty existed as at 31st March 2025. Therefore, this is an adjusting event. The financial statements require adjustment by creating appropriate provision / writing off the debtor. Mere disclosure is not sufficient.

   - Settling a legal claim outside the court at a reduced amount between the date of financial statements and the date of auditor's report for which provision has already been made in financial statements. It provides evidence on adjustment in provision amount already made in financial statements, if any.

In the present case, settlement at ₹ 1.80 crores provides evidence regarding the best estimate of liability as at 31st March 2025. Therefore, the excess provision of ₹ 1.20 crores should be reversed. This is also an adjusting event.

2. **Events providing evidence of conditions that arose after the date of the financial statements:** Examples of events providing evidence of conditions that arose after the date of the financial statements

- Issue of new share capital.
- Planned merger of the company.
- Destruction of substantial inventories due to fire between the date of the financial statements and the date of auditor's report.

In the present case:

- Issue of fresh equity shares is a non-adjusting event. It does not affect financial position as at 31st March 2025 but requires disclosure if material.
- Approval of merger plan is also a non-adjusting event requiring disclosure.
- Destruction of inventory due to fire occurred after the reporting date and relates to a new condition. Hence, it is a non-adjusting event. Only disclosure is required, unless it affects going concern assumption.

In the given case, management has merely disclosed all events without making adjustments.

- Non-provision for insolvent debtor and
- Non-reversal of excess legal provision

constitute material misstatements since they are adjusting events requiring modification of figures in the financial statements.

Therefore, unless management makes necessary adjustments, the auditor should modify the audit opinion in accordance with SA 705.

Disclosure alone is sufficient for issue of share capital, planned merger, and destruction of inventory due to fire, as they are non-adjusting events.

Accordingly, management's treatment is partially incorrect, and necessary adjustment is required.

(c) Power of Central Government to direct special audit in certain cases – Under Section 77 of the Multi-State Co-operative Societies Act, 2002, where the Central Government is of the opinion:

(a) that the affairs of any Multi-State co-operative society are not being managed in accordance with self-help and mutual aid and co-operative principles or prudent commercial practices or with sound business principles; or

(b) that any Multi-State co-operative society is being managed in a manner likely to cause serious injury or damage to the interests of the trade, industry or business to which it pertains; or

(c) that the financial position of any Multi-State co-operative society is such as to endanger its solvency,

the Central Government may, by order, direct that a special audit of the accounts of the society shall be conducted and may appoint a Chartered Accountant or such other qualified person as may be prescribed to conduct such audit.

Application to the Given Case: In the present case, the following circumstances are observed:

- Granting unsecured advances to related parties and ignoring internal audit findings indicate deviation from prudent commercial practices and sound business principles.
- Awarding procurement contracts without competitive bidding reflects non-adherence to co-operative principles and transparency.
- Abnormal increase in borrowings and use of short-term funds for long-term assets indicates weak financial discipline.
- Persistent cash flow mismatch and solvency concerns suggest that the financial position may endanger its solvency.
- Complaints from trade associations regarding market distortion indicate management in a manner likely to cause serious injury to the trade or industry concerned.

Thus, the facts satisfy clauses (a), (b), and (c) of Section 77.

Considering the above statutory provisions and the facts of the case, the Central Government is legally empowered under Section 77 of the Multi-State Co-operative Societies Act, 2002 to order a special audit of GreenGrow Multi-State Co-operative Society Ltd.

The invocation of special audit provisions is fully justified as the management practices, financial instability, and potential harm to trade clearly fall within the scope of Section 77.

4. (a) Concept of overall audit strategy: As per SA 300 – Planning an Audit of Financial Statements, the auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit and that guides the development of the audit plan.

In the given case, since First Heavy Engineering Ltd. has multiple locations and complex transactions such as specialised inventory and long-term contracts, the auditor is required to determine the appropriate deployment and management of audit resources while planning the audit.

The process of establishing the overall audit strategy assists the auditor to determine, subject to completion of the auditor's risk assessment procedures, such matters as:

(i) **The resources to deploy for specific audit areas**, such as the use of appropriately experienced team members for high-risk areas or the involvement of experts on complex matters like valuation of specialised inventory or long-term contract accounting.

(ii) **The amount of resources to allocate to specific audit areas**, such as the number of team members assigned to observe inventory counts at major warehouses, the extent of review of other auditors' work in case of multiple locations, or the audit budget in hours to allocate to high-risk areas.

(iii) **When these resources are to be deployed**, such as whether certain procedures should be performed during the interim audit stage or at the year-end and key cut-off dates.

(iv) **How such resources are managed, directed and supervised**, such as scheduling team briefing and debriefing meetings, determining how engagement partner and manager reviews will take place (on-site or off-site), and deciding whether an engagement quality control review is required.

Therefore, while auditing First Heavy Engineering Ltd., the auditor should establish an appropriate overall audit strategy to ensure proper allocation, timing, and supervision of audit resources so that the audit is conducted efficiently and in accordance with SA 300.

(b) In the given case, issues relating to independence and ethical requirements have arisen during the audit engagement. As per SA 220, the Engagement Partner is responsible for forming a conclusion on compliance with relevant ethical requirements, including independence.

The responsibilities of an engagement partner in relation to ethical requirements in an audit engagement are as under: -

- **Identifying a threat to independence regarding the audit engagement that safeguards may not be able to eliminate or reduce to an acceptable level.**

  In the present case, financial interest held by the spouse of a team member, provision of consultancy services, and offer of advisory position may create self-interest, self-review, and familiarity threats. The Engagement Partner must evaluate whether these threats are significant and whether available safeguards (such as removal of the concerned team member, independent review, or discontinuation of non-audit services) can reduce the threats to an acceptable level.

- **Reporting by engagement partner to the relevant persons within the firm to determine appropriate action, which may include eliminating the activity or interest that creates the threat, or withdrawing from the audit engagement, where withdrawal is legally permitted.**

  Accordingly, Mr. A must communicate these matters to the appropriate authority within the firm (such as the Ethics Partner or Managing Partner). If safeguards are not sufficient to mitigate the threats, appropriate action must be taken. This may include:

  – Disposal of the financial interest,

  – Removal of affected personnel from the engagement,

  – Discontinuation of conflicting services, or

  – Withdrawal from the audit engagement, where withdrawal is legally permitted.

  In the given case, the Engagement Partner is duty-bound under SA 220 to evaluate the identified threats to independence, ensure compliance with ethical requirements, and take appropriate corrective action. If the threats cannot be eliminated or reduced to an acceptable level through safeguards, the firm must either eliminate the underlying cause or withdraw from the engagement, as permitted by law. Failure to do so would amount to noncompliance with SA 220 and compromise the quality and credibility of the audit.

(c) As per Clause (ii) of Paragraph 3 of the Companies (Auditor's Report) Order, 2020, the auditor's report shall include a statement on the following matters relating to inventory:

(a) whether physical verification of inventory has been conducted at reasonable intervals by the management and whether, in the opinion of the auditor, the coverage and procedure of such verification by the management is appropriate; whether any discrepancies of 10% or more in the aggregate for each class of inventory were noticed and if so, whether they have been properly dealt with in the books of account;

(b) whether during any point of time of the year, the company has been sanctioned working capital limits in excess of five crore rupees, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

5. (a) **Specific Evaluations by the Auditor:** In particular, the auditor shall evaluate whether:

(a) The financial statements adequately disclose the significant accounting policies selected and applied;

(b) The accounting policies selected and applied are consistent with the applicable financial reporting framework and are appropriate;

(c) The accounting estimates made by management are reasonable;

(d) The information presented in the financial statements is relevant, reliable, comparable, and understandable;

(e) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions and events on the information conveyed in the financial statements; and

(f) The terminology used in the financial statements, including the title of each financial statement, is appropriate.

Further, when the financial statements are prepared in accordance with a fair presentation framework, the evaluation mentioned above shall also include an evaluation by the auditor as to whether the financial statements achieve fair presentation, which shall include consideration of:

(a) The overall presentation, structure and content of the financial statements; and

(b) Whether the financial statements, including the related notes, represent the underlying transactions and events in a manner that achieves fair presentation.

The auditor shall evaluate whether the financial statements adequately refer to or describe the applicable financial reporting framework.

(b) Audit procedures generally required to be undertaken while auditing employee benefits expenses:

1. Obtain an understanding of entity's process of capturing employee attendance. There is always a risk that an entity could record expense for fictitious employees. To address this risk, the auditor may choose to meet the employees in person, on a sample basis. Further, the auditor may choose to select a sample of employees and ask the payroll department to share their bank details/ identity proofs of the employees.

2. Obtain a list of employees as at the period- end along with a monthly movement split between new hires, leavers and continuing employees.

3. For a sample (selected randomly) of new hires, obtain the appointment letter and verify whether the salary for first month and subsequent months was processed as per the agreed terms.

4. For a sample (selected randomly) of resigned employees, obtain their full and final computation and verify whether all their dues including post-retirement benefits like gratuity, leave encashment have been paid and whether the respective employee's acknowledgement on final computation has been obtained.

5. Obtain the monthly salary registers for all 12 months. Compile a monthly payroll reasonability by calculating the average salary per employee per month and compare with the previous year and preceding month and analyse the reasons for variance which could be attributable to annual increments, an employee at senior level joining/ leaving the entity, bonus pay-out etc.

6. Verify if accrual/ provision has been made for all employee benefits and obligations like bonus, gratuity, leave encashment, etc.

7. In case provident fund (PF), employee state insurance (ESI) are applicable to the entity, compile a reasonability by applying the rate to the basic wages and comparing to the amount recorded in books and analyse reasons for variance, if any. Also, obtain monthly deposit challans to verify if the month on month liability was subsequently deposited with the authorities and within the defined timelines.

8. Perform analytical procedures to obtain audit evidence as to overall reasonableness of employee benefit expenses which may include production per employee analysis. Auditor should analyse units produced per employee and compare the same with previous years and present industry trends and ask for the reasons from the management, if any significant variations are found.

9. Where employee benefit expenses have increased significantly as compared to the previous year, perform a detailed variance analysis by obtaining a break-up of the increase into components such as increase due to headcount, annual increments, bonus payouts, change in salary structure, actuarial remeasurement losses, or change in statutory contribution rates. Correlate the increase with supporting documentation such as board approvals for increments, bonus declarations, revised employment contracts, actuarial valuation reports, etc., and obtain management explanations for any abnormal or unexplained variances.

Thus, in the given case of Gama Manufacturing Limited, considering the significant increase in employee benefit expenses, the auditor should perform the above procedures including detailed variance analysis to ensure the increase is justified and properly supported. If sufficient appropriate audit evidence is obtained and the increase is adequately explained and supported, the auditor may conclude that employee benefit expenses are fairly stated. Otherwise, the auditor shall consider the implications for reporting in accordance with the applicable Standards on Auditing.

(c) Audit procedures while auditing provisions and contingent liabilities:

1. Obtain a list of all provisions and compare them with balances in the ledger.

2. Inspect the underlying agreements like agreement with customers to assess warranty commitments, any legal and other claims on the entity i.e. litigations.

3. Obtain the underlying working and the basis for each of the provisions made, from the management and verify whether the same is complete and accurate.

4. Wherever required, obtain expert's report, calculation and underlying working for the provision amount, example for warranty involving complex calculations, some entities get that valued through an actuary.

5. In the above case, the auditor may request the management to share the actuarial valuation report and in case of any matter under legal dispute, the auditor should request for assessment made by a legal expert in relation to likelihood of a liability devolving on the entity i.e. whether probable or possible or remote as defined above.

6. The auditor should then verify the underlying assumptions used by the expert with the data shared by the management.

6. (a) Written representation about management's responsibilities involves confirmation of fulfilment of management's responsibilities in the preparation of the financial statements: The auditor shall request management to provide a written representation that it has fulfilled its responsibility for the preparation of the financial statements in accordance with the applicable financial reporting framework, including, where relevant, their fair presentation, as set out in the terms of the audit engagement.

Due to its responsibility for the preparation and presentation of the financial statements and its responsibilities for the conduct of the entity's business, management would be expected to have sufficient knowledge of the process followed by the entity in preparing and presenting the financial statements and the assertions therein on which to base the written representations.

In some cases, however, management may decide to make inquiries of others who participate in preparing and presenting the financial statements and assertions therein, including individuals who have specialized knowledge relating to the matters about which written representations are requested. Such individuals may include:

- An actuary responsible for actuarially determined accounting measurements.
- Staff engineers who may have responsibility for and specialized knowledge about environmental liability measurements.
- Internal counsel who may provide information essential to provisions for legal claims.

In some cases, management may include in the written representations qualifying language to the effect that representations are made to the best of its knowledge and belief. It is reasonable for the auditor to accept such wording if the auditor is satisfied that the representations are being made by those with appropriate responsibilities and knowledge of the matters included in the representations.

To reinforce the need for management to make informed representations, the auditor may request that management include in the written representations confirmation that it has made such inquiries as it considered appropriate to place it in the position to be able to make the requested written representations.

In the given case, the auditor may obtain written representations from management confirming that it has fulfilled its responsibility for the preparation and fair presentation of the financial statements. The inclusion of the phrase "to the best of its knowledge and belief" in the written representation may be accepted by the auditor, provided the auditor is satisfied that the representation is being made by management having appropriate responsibility and adequate knowledge of the matters concerned.

(b) SA 210 – Agreeing the Terms of Audit Engagements: In order to establish whether the preconditions for an audit are present, the auditor of Meet Electronics Ltd., CA S 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.

Therefore, CA S should accept the audit engagement only after determining that an acceptable financial reporting framework is used and after obtaining management's acknowledgement and understanding of its responsibilities relating to preparation of financial statements, internal control and providing necessary access and information required for the audit.

(c) Risk of Material Misstatement – Greater for Significant Non-Routine Transactions: Significant risks often relate to significant non- routine transactions or judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently.

Risks of Material Misstatement– Greater for Significant Non-Routine Transactions

Risks of material misstatement may be greater for significant non-routine transactions arising from matters such as the following:

(a) Greater management intervention to specify the accounting treatment.

(b) Greater manual intervention for data collection and processing.

(c) Complex calculations or accounting principles.

(d) The nature of non-routine transactions, which may make it difficult for the entity to implement effective controls over the risks.

Keeping in view above, view of Auditor of Sunshine Ltd. is correct.

OR

(c) Objective of the Auditor:

The objective of the auditor is to prepare documentation that provides:

(a) A sufficient and appropriate record of the basis for the auditor's report; and

(b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Nature of Audit Documentation

Audit documentation provides:

(a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and

(b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Therefore, in the given case, CA P is required to ensure that the audit working papers properly document the procedures performed, evidence obtained and conclusions reached. Proper audit documentation enables the auditor to support the auditor's report and demonstrate that the audit was conducted in accordance with the Standards on Auditing and applicable legal and regulatory requirements.