

Mock Test Paper - Series I: November, 2025

Date of Paper: 26th November, 2025

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

INTERMEDIATE GROUP – II

PAPER – 5: AUDITING AND ETHICS

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 out of the four given options. All MCQs are compulsory and carry 2 Marks each.

Case Scenario 1 [MCQs 1-5]

CA Arun, a Chartered Accountant, is conducting the statutory audit of Preeti Textiles Ltd. for the financial year ending March 31, 2025. As part of his professional duty, he is required to express an opinion on whether the financial statements present a true and fair view of the company's financial results and state of affairs.

To form his opinion based on the conclusions drawn, CA Arun is adhering to the requirements of SA 500 – “Audit Evidence”, which requires obtaining sufficient appropriate audit evidence. He obtains and assesses relevant information during the audit. This information includes:

1. Reviewing the company's General Ledger and Journal Entries.
2. Examining supplier invoices and contracts for major purchases.
3. Scrutinizing work sheets used by finance team for calculating depreciation expense.
4. Reading minutes of the Board of Directors' meetings.
5. Inspecting documented internal control manual for sales process.

The auditor acknowledges that judgments arising from a negligent examination may lead to legal consequences and adversely affect his professional reputation. Accordingly, he conducts his examination with utmost objectivity, analytical rigor, and thoroughness.

As at 31st March 2025, Preeti Textiles Ltd. reported a trade receivables balance of ₹ 45 crore. During the course of the statutory audit, the auditor, CA Arun, decided to employ direct confirmation procedures to verify the existence and accuracy of the trade receivables.

The management requests CA Arun not to seek confirmation from two overseas customers, citing ongoing disputes and confidentiality clauses in export contracts. He evaluates this request and decides to apply alternative audit procedures, such as verifying subsequent receipts and reviewing correspondence for these balances.

While auditing travel expenses, the auditor observed several travel bills submitted by a director for foreign trips undertaken with family members during the festival period. The company had reimbursed entire amount, classifying it under "Business Promotion Expenses."

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

1. As per SA 500, which of the following best defines "Audit Evidence"?
 - (a) Only information contained in general ledger and journal entries.
 - (b) Only external confirmations received from trade receivables.
 - (c) The information used by the auditor in arriving at the conclusions on which the auditor's opinion is based, including both information contained in the accounting records and other information.
 - (d) Only work sheets and spreadsheets supporting cost allocations and computations.
2. In the scenario of Preeti Textiles Ltd., which of the following items is classified as "Information contained in the accounting records" as per SA 500?
 - (a) Minutes of the Board of Directors' meetings.
 - (b) Written confirmations from trade receivables.
 - (c) The documented internal control manual.
 - (d) Supplier invoices and the General Ledger.
3. Which of the following examples of audit evidence gathered by CA Arun falls under the category of "Other information that authenticates the accounting records"?
 - (a) Reviewing the company's Journal Entries.
 - (b) Obtaining written confirmations from major trade receivables.
 - (c) Scrutinizing work sheets for depreciation calculation.
 - (d) Examining contracts for major purchases.

4. When the management of Preeti Textiles Ltd. requested the auditor not to seek confirmation from certain overseas customers, the auditor's most appropriate course of action should be to:
 - (a) Accept the request without further consideration, since management is responsible for customer relationships.
 - (b) Refuse the request and qualify the audit report immediately.
 - (c) Evaluate whether valid grounds exist for the request. The Auditor needs to reconsider the nature, timing and extent of his audit procedures including the degree of planned reliance on management's representations.
 - (d) Proceed with confirmations only for domestic customers.
5. Which of the following audit verification procedures would be most appropriate for examining the Director's foreign travel expenses?
 - (a) Auditor should verify that all bills related to foreign travel should be in the name of the company and travel related to business.
 - (b) Auditor should verify whether the expenditure qualified as revenue expenditure
 - (c) Auditor should verify that the expenditure pertains to the current audit period.
 - (d) Auditor should verify whether the expenditure had valid supporting documents

Case Scenario 2 [MCQs 6-9]

The Comptroller and Auditor General of India (C&AG) deputed Mr. V. Sarkar, Chief Audit Officer, to conduct propriety audit of various departments of the State Government of Punjab for the financial year 2024-25. During the course of audit, the following instances were observed:

1. While auditing a government department's festival celebration expenses, the auditor notices that the department spent ₹ 10 lakh on decorations and gifts, which appears excessive considering the scale of the event.
2. The Chief Engineer of PWD Department sanctioned repair work worth ₹ 20 lakh on his residential quarters using departmental funds, justifying it as "official convenience."
3. Health Department purchased luxury office furniture worth ₹ 75 lakh when the existing furniture was still in usable condition.
4. ₹ 3 lakh spent on community welfare donations to a private housing society in which several officers of a department resided, citing "public relations improvement."

Mr. V Sarkar noted that while all expenditures were technically sanctioned and approved under existing rules, many appeared improper, avoidable, or not in public interest. He referred to principles of financial propriety laid down in the principles of financial propriety prescribed in Government Audit Guidelines.

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

6. The case of department spending ₹ 10 lakh on decorations and gifts represents which breach under the principles of financial propriety?
 - (a) Expenditure for the benefit of a particular section of the community.
 - (b) Expenditure prima facie more than the occasion demands
 - (c) Expenditure sanctioned to one's own advantage
 - (d) Expenditure not authorised under any rule
7. The Chief Engineer's sanction of repair work worth ₹ 12 lakh on his personal residential quarter using departmental funds violates which propriety principle?
 - (a) Exercise of powers for personal advantage
 - (b) Expenditure not in conformity with recognised policy
 - (c) Expenditure resulting in profit to recipients
 - (d) Expenditure lacking documentary evidence
8. Purchase of luxury office furniture when existing furniture was in usable condition primarily indicates a failure to exercise:
 - (a) Regularity audit compliance.
 - (b) Control over documentary evidence.
 - (c) Disciplinary control over subordinates
 - (d) Prudence expected in spending public money.
9. Spending ₹ 3 lakh on community welfare donations to a private housing society where several officials reside violates propriety because:
 - (a) It is not sanctioned under regularity audit
 - (b) It benefits a specific section of the community without policy backing
 - (c) It breaches limits on administrative expenses
 - (d) It lacks internal control documentation

Case Scenario 3 [MCQs 10-12]

Great Point Ltd., a software development company, has been under pressure to meet aggressive market expectations for revenue growth. For the Financial Year ended March 31, 2025, Great Point Ltd. reported a 25% increase in net profit, mainly attributed to a substantial increase in licensing revenue from a few large contracts signed in the last quarter.

During the audit planning phase, CA R, a member of the audit team, observed that the CEO and CFO are entitled to significant performance bonuses linked directly to the company's reported net income.

The audit team focused on the large licensing contracts. They discovered that one significant contract, contributing 15% to the reported revenue, was with a newly established entity, "Alpha Systems," which appeared to be a shell company with no operational history.

Further audit procedures revealed that the contract terms allowed Alpha Systems a "right of return" on the software license for any reason within 12 months, and Great Point Ltd.'s sales team had provided a side-letter guaranteeing a full refund if the license was unused. Also, a substantial amount of development expenditure, which should have been expensed in the current period, was improperly capitalized as an intangible asset, significantly overstating the reported profit.

The auditor concluded that if inappropriate revenue recognition (due to the right of return and side-letter) and the incorrect capitalization of expenditure are not corrected, these would give rise to risks of material misstatement that are pervasive to the financial statements as a whole and may affect multiple assertions.

The preliminary risk assessment suggested a high risk of material misstatement due to management override of controls and aggressive accounting policies.

Based on above, answer the following MCQs (10-12):

10. Which of the following best illustrates the concept of Audit Risk:
- (a) The risk that Great Point Ltd.'s management intentionally booked fake expenses.
 - (b) The risk that the auditor incorrectly classifies an expense as capital expenditure.
 - (c) The risk that CA R expresses an unmodified opinion when Great Point Ltd.'s financial statements are materially misstated due to improperly recognized revenue and capitalized expense.

- (d) The risk that a competitor sues Great Point Ltd. for patent infringement, causing an unexpected financial loss.
11. The risk arising from the CEO and CFO's performance bonuses, which creates pressure to overstate profits and leads to the improper capitalisation of development expenditure, is primarily an example of a risk of material misstatement at which level?
- (a) The overall financial statement level.
 - (b) The assertion level for the Intangible Assets account balance.
 - (c) The control environment level.
 - (d) The detection risk level.
12. The act of classifying the development expenditure as an Intangible Asset (capital expenditure) instead of an expense (revenue expenditure) is an example of a misstatement concerning:
- (a) Difference in disclosure.
 - (b) Selection or application of inappropriate accounting policies.
 - (c) Intentional booking of fake expenses.
 - (d) Charging of an item of capital expenditure to revenue or vice-versa.

MCQs

13. CA Meena is the statutory auditor of GLOW Ltd. Her husband has recently joined the company as CFO. CA Meena has undue dependence on professional fees from the company. She is also providing investment advisory service to GLOW Ltd. Which combination of threats to independence exists in this situation?
- (a) Only familiarity threat
 - (b) Self-interest, advocacy threats and self-review threats
 - (c) Advocacy and intimidation threats
 - (d) Familiarity, Self-interest, and self-review threats
14. During planning of an audit of XYZ Ltd., the engagement partner realises that complex valuation issues will arise. Accordingly, a valuation expert is engaged early in the audit process to support the team.
- Which benefit of audit planning is demonstrated here?
- (a) Assisting, where applicable, in coordination of work done by others such as experts

- (b) Helping the auditor organize and manage the audit effectively
 - (c) Helping the auditor identify and resolve potential problems on a timely basis
 - (d) Facilitating the direction and supervision of the audit team
15. During audit of FAN Pvt. Ltd., the auditor finds that the company has defaulted on loan repayments and is unable to pay creditors on time. The auditor is having doubts over going concern status of the company. The management refuses to make any assessment of its going concern status. Auditor is unable to obtain sufficient appropriate audit evidence regarding management's use of the going concern basis of accounting in the preparation of the financial statements. What implication does this have on the auditor's report?
- (a) Issue an unmodified opinion as auditor cannot predict future events.
 - (b) Issue a disclaimer or qualified opinion.
 - (c) No impact as management is responsible for assessment.
 - (d) Mention it only in the "Key Audit Matters" section.

PART II - Descriptive Questions (70 Marks)

Question No. 1 is compulsory.

*Attempt any **four** questions from the Rest.*

1. (a) Raman & Suman, Chartered Accountants, are the statutory auditors of Santosh Bank Ltd. The bank uses a centralized core banking system (CBS) for processing all transactions such as deposits, withdrawals, interest calculations, and loan repayments.
- The auditors identify a risk of material misstatement relating to interest income and customer deposits and conclude that substantive procedures alone cannot provide sufficient appropriate audit evidence due to the high level of automation. Therefore, they plan to rely on the operating effectiveness of controls built into the CBS, such as system-based authorizations and daily reconciliations.
- (i) Explain under what circumstances should an auditor design and perform tests of controls to obtain sufficient appropriate audit evidence about the operating effectiveness of relevant controls?
 - (ii) Discuss the type and level of audit evidence required to support the auditor's conclusion. Also explain the level of assurance the auditor should seek regarding the operating effectiveness of these controls in this situation.
- (5 Marks)**

- (b) An established audit firm, 'ABC & Co.', is preparing to commence the statutory audit for its long-standing client, Nitin Handlooms Private Ltd. The engagement partner, CA A is overseeing the planning process. Before finalizing the overall audit strategy, he is focusing on the preliminary engagement activities. He needs to ensure that the relationship with the company can be continued, that the engagement team remains independent and that the scope and terms of the engagement are clearly documented and understood by both parties to avoid any future misunderstandings.
- (i) Identify the three main preliminary engagement activities that CA A and his team must perform as part of the planning process.
 - (ii) Regarding the continuance of the client relationship, list three matters the firm should consider continuing the engagement with the company.

(5 Marks)

- (c) Sameer & Co., Chartered Accountants, are conducting the audit of ABC Ltd. for the year ended 31st March, 2025. While testing accounts payable, the audit team decided to examine the recorded balances appearing in the books to verify the existence and valuation of liabilities. However, the engagement partner pointed out that this may not be sufficient to detect possible understatement of payables. He advised the team to test subsequent disbursements, unpaid invoices, suppliers' statements, and unmatched receiving reports instead.
- (i) Explain with reference to above, concept of relevance of audit evidence.
 - (ii) State why the auditor should consider both the relevance and reliability of audit evidence while forming his opinion on the financial statements.

(4 Marks)

2. (a) WXY Ltd. is a trading company that maintains a large quantity of inventory in its warehouse. During the year, some inventory items belonging to the company were stored with a third-party transporter due to space constraints. At the same time, the warehouse also contained goods received on consignment basis from another entity. The auditor wants to verify whether the inventory balance included in the financial statements is complete and does not include inventories that do not belong to WXY Ltd.

In context of above, explain what the completeness assertion for inventory requires and state the audit procedures the auditor should perform to verify the completeness of inventories.

(5 Marks)

- (b) During the audit of SITU Bank Ltd, the auditor reviews the loan portfolio and comes across the account of M/s Neem Tree Infrastructure Ltd., which has an outstanding balance of ₹ 10 crore. The latest valuation report by an RBI approved valuer indicates that the realisable value of the security available against this loan is only ₹ 80 lakh. The value of the same security during the previous RBI inspection was ₹ 6 crore.

Additionally, in another borrower account, M/s Gayatri Textiles Pvt. Ltd., with an outstanding balance of ₹ 5 crore, the realisable value of security is estimated to be ₹ 40 lakh.

As an auditor, how should these two accounts be classified as per RBI's prudential norms on income recognition and asset classification? What would be the appropriate provisioning treatment in each case? **(5 Marks)**

- (c) An audit firm SPR &Co. is preparing the detailed audit plan for a new client, Rajeshwari Ltd. The overall audit strategy has already been established. The engagement partner emphasises that the plan must be sufficiently detailed to guide the entire engagement team and ensure compliance with Standards on Auditing (SAs), particularly SA 300.

Regarding the development of an audit plan, outline the three key descriptions that SA 300 requires must be included in the audit plan. Also, briefly explain that audit plan is more detailed than overall audit strategy and give an example of how the timing of planning about audit procedures might evolve during the course of the audit. **(4 Marks)**

3. (a) During audit of Kavita Ltd., the auditor performs various audit procedures such as inspection, observation, confirmation, recalculation, reperformance, and analytical procedures. Some information obtained supports management's assertions, while other information appears to contradict them. The auditor also considers data obtained from the entity's accounting records and from the previous year's audit.

Explain how the auditor obtains sufficient appropriate audit evidence to form an opinion on the financial statements. **(5 Marks)**

- (b) During statutory audit of Orient Chemicals Ltd., the auditor, CA Raj, obtained an understanding of the company's internal control system as part of identifying and assessing risks of material misstatement.

During the audit, the auditor observed the following:

- i. The same employee was responsible for recording supplier invoices and authorising payments.
- ii. Inventory counts were conducted without independent verification.
- iii. Certain purchase approvals were bypassed due to system overrides.

Auditor considers these deficiencies as significant deficiencies. As per SA 265, explain:

- (i) The auditor's objective in respect of such deficiencies.
- (ii) Auditor's responsibilities regarding communicating deficiencies in internal control to those charged with governance and management. **(5 Marks)**

- (c) ABC Ltd. is a government company whose statutory audit is being carried out by auditors appointed on the advice of the Comptroller and Auditor General of India (C&AG). During the audit, the C&AG considered it necessary to conduct a test audit of the company's accounts. He issued specific directions to the statutory auditors regarding the system of book-keeping and internal control. After completion of the statutory audit, the auditors submitted a copy of their report to the C&AG, who added certain comments and supplementary observations to it. The Board of Directors of ABC Ltd., however, decided not to provide any explanation or reply to the comments made by the C&AG.

Based on above, explain the powers of the C&AG in relation to the test audit of a government company and whether the Board of Directors is required to provide any explanation on the C&AG's comments. **(4 Marks)**

4. (a) Wonder Homes Pvt. Ltd. owns a commercial building divided into several apartments that are rented out. During the course of audit, the auditor decides to apply substantive analytical procedures to verify the rental income instead of performing detailed checking of individual rent agreements. The auditor predicts total rental income based on the number of apartments, monthly rental rate, and average vacancy rate.
- (i) Explain how the auditor's approach in the above case represents the use of substantive analytical procedures.

- (ii) State the circumstances where substantive analytical procedures are more applicable. Also, discuss how analytical procedures can provide persuasive audit evidence in such cases. **(5 Marks)**
- (b) As per SQC 1 - "The firm's system of quality control should include policies and procedures addressing each element." In this context, describe the essential elements that a firm's system of quality control should include and explain the importance of communicating these quality control policies and procedures to the firm's personnel. **(5 Marks)**
- (c) Describe the essential contents of the "Basis for Opinion" section in an auditor's report and explain why this section is important as per the requirements of SA 700 (Revised). **(4 Marks)**
5. (a) Sun and Moon Credit Co-operative Society Ltd., a large scale cooperative organisation operates in Maharashtra and engages in providing small loans to its members. During the audit, the auditor observed that the society maintains a Cash Book and Ledger but has not maintained separate registers for loan disbursement and recovery of loans from members' salaries. The management contends that since they maintain the main Cash Book, there is no need to maintain other subsidiary records. As an auditor, explain whether the society's practice is appropriate and what records should be maintained. **(5 Marks)**
- (b) During audit of PQR Ltd., the auditor observed that the company had incurred several types of expenditure in relation to its new manufacturing plant. These included costs for site preparation, installation of equipment, testing of machinery before use, and professional fees paid to engineers. The company had also spent amounts on staff training for operating the machinery and advertising expenses for launching a new product line.
- As the auditor of PQR Ltd., explain how you would analyse these expenditures to determine whether they should be capitalised as part of Property, Plant and Equipment (PPE) or charged to revenue based on the recognition and measurement criteria. **(5 Marks)**
- (c) Explain the circumstances under which a professional accountant may depart from specific procedures prescribed in the Standards and describe the documentation and reporting obligations arising from such departures. **(4 Marks)**

6. (a) During an audit, the auditor becomes aware that management has imposed a limitation on the scope of the audit after the engagement was accepted. Explain the steps the auditor should take and possible implications on the auditor's report if sufficient appropriate audit evidence cannot be obtained as per the requirements of SA 705. **(5 Marks)**
- (b) Hansa Airways has purchased a new aircraft for its fleet. The aircraft has an airframe and engines, both of which have significant cost in relation to total cost of the aircraft. During audit of the company's financial statements, the auditor noticed that the company applied a single depreciation rate to the total cost of the aircraft, without separating the airframe and engines. Also, the auditor observed that the company changed its amortisation method for software used for flight operations during the year but did not disclose this change in the financial statements.
- Explain the attributes auditor would consider related to depreciation and amortisation in this case that need verification. **(5 Marks)**
- (c) XYZ Ltd. finalized its financial statements for the year ended 31st March 2025. Audit is in progress and the auditor is expected to issue the report in July, 2025. On 10th April 2025, a major debtor of the company was declared insolvent and the company realised that the amount due from this debtor as on 31st March 2025 was not recoverable. In the month of May, 2025, the management also initiated discussions for a possible merger with another company. Auditors understand that financial statements may be affected by certain events that occur after the date of the financial statements. Auditors of XYZ Ltd. consider that financial reporting frameworks ordinarily identify two types of events. Explain how you would classify and deal with these subsequent events. **(4 Marks)**

OR

Explain the factors that determine the **form, content, and extent of audit documentation** as per the Standards on Auditing. **(4 Marks)**