

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 31st 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)**