Mock Test Paper - Series II: August, 2026

Date of Paper: 17th August, 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

XYZ & Co., Chartered Accountants, have been appointed as the statutory auditors of Ess Kay Engineering Limited, a listed company engaged in manufacturing heavy industrial equipment. During the year ended 31st March 2026, the company acquired a foreign subsidiary, implemented a new cloud-based ERP system across all manufacturing units and entered into long-term maintenance contracts involving multiple performance obligations.

At the planning stage of the audit, the Engagement Partner held discussions with the audit team and concluded that the audit would require significant attention in the areas of revenue recognition, consolidation of the foreign subsidiary, valuation of inventory and IT general controls. Accordingly, he decided to deploy IT specialists, assign experienced audit personnel to revenue recognition and consolidation, perform interim testing of selected controls before the year-end and commence audit work at the foreign subsidiary prior to the reporting date.

Based on these decisions, the Audit Manager prepared a detailed audit programme specifying the nature, timing and extent of audit procedures for each significant account balance, the allocation of work among engagement team members and the audit procedures to be performed in response to the identified risks.

While obtaining an understanding of the entity and its environment, the engagement team noted that revenue from maintenance contracts was recognised

through the ERP system based on inputs provided by project managers. The team also observed that manual journal entries relating to contract modifications required approval from the Chief Financial Officer (CFO). Internal audit reports highlighted deficiencies in monitoring manual overrides within the ERP system, and the newly acquired subsidiary had not yet fully integrated its financial reporting processes with the parent company's ERP environment.

During discussions with the audit team, the CFO stated that the manual approval controls were operating effectively and that adequate provision had been made for obsolete inventories. However, the Internal Audit Head informed the auditor that several contract modifications had been approved after considerable delay. Further, the Warehouse Manager stated that obsolete inventories identified during physical verification were still awaiting disposal because Board approval had not yet been obtained. Inventory ageing reports also reflected a significant increase in slow-moving inventory compared to the previous year.

The Engagement Partner instructed the audit team to evaluate all the information obtained from different sources before designing further audit procedures. He further emphasised that inquiry alone would not ordinarily provide sufficient appropriate audit evidence. Accordingly, management's oral explanations should be corroborated with other audit evidence and, wherever appropriate, confirmed through written representations.

Based on above, answer the following questions (MCQs 1-3)

1. Based on the facts given in the case, which of the following best distinguishes the Engagement Partner's decisions from the Audit Manager's subsequent actions?

   (A) The Engagement Partner's decisions constitute the audit plan because they determine the audit procedures to be performed, whereas the Audit Manager's detailed programme represents the overall audit strategy.

   (B) The Engagement Partner established the overall audit strategy by determining the scope, timing and direction of the audit, whereas the Audit Manager translated that strategy into a detailed audit plan specifying the nature, timing and extent of audit procedures.

   (C) Both the Engagement Partner's decisions and the Audit Manager's programme together constitute the audit plan, as the overall audit strategy is prepared only after completion of risk assessment procedures.

   (D) The Audit Manager's detailed audit programme supersedes the overall audit strategy once audit procedures have been assigned to engagement team members.

2. Considering the information obtained while understanding the entity and its environment, which of the following most appropriately explains why the Engagement Partner instructed the audit team to evaluate all information before designing further audit procedures?

(A) To determine whether the ERP system eliminates the need for substantive testing in the areas of revenue and inventory.

(B) To determine whether management's representations are sufficient evidence for issuing an unmodified audit opinion.

(C) To decide whether reliance can be placed exclusively on the work performed by the internal audit function.

(D) To identify and assess risks of material misstatement at the financial statement and assertion levels by considering contradictory information, evaluating whether identified risks are pervasive, relating them to relevant assertions and assessing the likelihood and magnitude of possible misstatements.

3. In the circumstances described in the facts, which of the following best justifies the Engagement Partner's direction that management's oral explanations should not be accepted without corroborative evidence?

(A) Since the Chief Financial Officer is responsible for the preparation of the financial statements and the design of internal controls, the auditor may ordinarily rely on management's oral explanations unless there is evidence of fraud.

(B) Since contradictory information was obtained from the Internal Audit Head, Warehouse Manager and inventory ageing reports, the auditor should disregard management's explanations altogether.

(C) Although inquiry may provide important audit evidence, it ordinarily does not provide sufficient appropriate audit evidence by itself. Therefore, the auditor should evaluate the inconsistent responses, obtain corroborative audit evidence and, where appropriate, obtain written representations from management before drawing conclusions.

(D) Written representations obtained from management are conclusive audit evidence and eliminate the need for any further audit procedures.

Case Scenario 2

PQR & Associates, Chartered Accountants, have been appointed as the statutory auditors of Star Electronics Limited.

During the planning stage, the engagement team identified trade receivables as a significant audit area due to rapid expansion of the company's dealer network during the year. Accordingly, the auditor performed analytical procedures by comparing the current year's debtor turnover ratio, ageing analysis, gross profit percentage and credit sales with those of previous years and industry averages.

The analytical procedures revealed that while credit sales had increased by only 12%, trade receivables had increased by 48%. The proportion of receivables outstanding for more than 180 days had also increased significantly compared to the previous year. On being questioned, the Finance Director explained that the increase was temporary because several customers were expected to clear their outstanding balances shortly after the year-end. However, the engagement team observed that some long-outstanding balances related to customers whose credit limits had been repeatedly extended during the year. The auditor, therefore, decided to obtain additional audit evidence by examining subsequent collections, reviewing correspondence with customers and evaluating the adequacy of the provision for doubtful debts.

While evaluating internal controls over trade receivables, the auditor noted that new dealers were approved by the Credit Control Department before sales were made. Sales invoices were generated automatically through the ERP system, collections were handled by a separate Finance Department, and periodic ageing reports were reviewed by senior management. However, the auditor also observed that follow-up of overdue balances was inconsistent in certain regional offices and legal notices had not been issued in several long-pending cases.

Throughout the engagement, the audit team maintained detailed working papers recording the planning discussions, significant audit judgements, analytical procedures performed, audit evidence obtained, conclusions reached and the basis for additional audit procedures performed in respect of trade receivables. Audit team considers that an important factor in determining the form, content and extent of audit documentation of significant matters is the extent of professional judgement exercised in performing the work and evaluating the results.

After the financial statements for the year ended 31 March 2026 had been prepared but before the auditor signed the audit report, one of the company's largest customers, Rajat Industries, owing approximately ₹18 crore, was declared insolvent by the National Company Law Tribunal (NCLT). The customer had been facing severe financial difficulties even before the year-end, and a substantial portion of its dues had remained outstanding for more than eight months as at 31st March 2026.

Based on above, answer the following questions (MCQs 4-7)

4. The auditor performed analytical procedures and identified a significant increase in trade receivables that was inconsistent with the comparatively modest growth in credit sales. What should be the auditor’s response?

   (A) Inquire of management about the unusual fluctuation, evaluate the explanation against other evidence and perform further procedures where necessary.

(B) Accept management's explanation since the increase in receivables is expected to reverse after the year-end and no further audit procedures are necessary.

(C) Conclude that the financial statements are materially misstated because the analytical procedures identified an unexpected relationship.

(D) Restrict further audit procedures to obtain written representations from management confirming the recoverability of trade receivables.

5. Based on the facts of the case, which of the following observations most strongly indicates that the auditor should perform additional audit procedures regarding the valuation and recoverability of trade receivables?

(A) New dealers were approved by the Credit Control Department before sales were made, indicating that credit controls were operating appropriately.

(B) possibility of errors in the recording of sales transactions.

(C) Significant overdue balances, repeated credit extensions, inconsistent follow-up and absence of legal action indicate heightened recoverability concerns.

(D) Customer collections were handled by the department independent of sales, providing a degree of segregation of duties within the process.

6. Which of the following would be most relevant in determining the form, content and extent of audit documentation of significant matters under SA 230?

(A) The extent of professional judgement exercised in performing the work and evaluating the results.

(B) The number of audit team members involved in performing procedures and reviewing the working papers during the engagement.

(C) The volume of accounting records maintained by the company and the number of transactions recorded during the financial year.

(D) The extent to which management relies on the auditor's working papers while preparing the financial statements for subsequent periods.

7. Which of the following is the most appropriate auditor's conclusion regarding Rajat Industries ?

(A) The insolvency provides evidence of conditions existing at the reporting date, requiring the auditor to evaluate whether the provision for doubtful debts requires adjustment.

(B) The insolvency provides evidence of conditions that arose after the reporting date and should only be disclosed in the notes to the financial statements.

(C) The insolvency is a non-adjusting event because it occurred after the reporting date, and therefore no adjustment to the financial statements is required.

(D) The insolvency occurred before the auditor's report was signed, and therefore the auditor should automatically modify the audit opinion without further evaluation.

Case Scenario 3

RKS & Associates, Chartered Accountants, were appointed as statutory auditors of National Prosperity Bank Ltd. for the financial year ended 31st March, 2026. The auditors were also appointed as the statutory auditors of Shiksha Jyoti Educational Society, one of the bank's major institutional borrowers.

During branch audit of the bank, the audit team examined a cash credit facility of ₹40 crore sanctioned to Sunrise Industries Ltd. against hypothecation of raw materials, finished goods and trade receivables. As additional comfort, the bank had also obtained an equitable mortgage over the company's factory land and building, together with the personal guarantee of the Managing Director.

While reviewing the loan account, the audit team observed that the account had remained irregular for almost three months. However, three days before the balance sheet date, the borrower deposited ₹ 8 crore, making the account appear regular. On verification of transactions immediately after the year-end, the auditors noticed that almost the entire amount had been withdrawn through fresh drawings and transferred to another group company. Similar year-end transactions had also occurred in the previous financial year.

The engagement partner directed the audit team to perform additional audit procedures to determine whether the apparent regularisation represented genuine recovery or merely an arrangement to avoid classification of the account as a Non-Performing Asset (NPA).

During the audit of Shiksha Jyoti Educational Society, the auditors observed that income tax had been deducted at source from interest earned on Government securities and fixed deposits. Although the Society was eligible for exemption under the Income-tax provisions, no refund claim had been filed. The auditors also noticed that separate statements of account had not been prepared for the Hostel Fund, Games Fund and Staff Provident Fund, all these transactions having been merged with the general accounts.

When the audit team insisted on extending audit procedures in both assignments, the Executive Director of the bank stated that if the auditors continued questioning the asset classification or insisted on additional audit work, the bank would recommend another audit firm next year, substantially reduce future professional fees and consider initiating legal proceedings for delaying the audit report. The engagement partner refused to modify the audit approach under such pressure, documented the matter, consulted the firm's Ethics Partner and instructed the audit team to continue performing all audit procedures necessary to obtain sufficient appropriate audit evidence before expressing an opinion.

Based on above, answer the following questions (MCQs 8-12)

8. With reference to the cash credit facility sanctioned to Sunrise Industries Ltd., which of the following constitutes the primary security for the advance?

   (A) Factory land and building mortgaged to the bank.

   (B) Personal guarantee of the Managing Director.

   (C) Raw materials, finished goods and trade receivables hypothecated to the bank.

   (D) Both the mortgage and the personal guarantee.

9. Considering the pattern of transactions in Sunrise Industries Ltd.'s account, which audit conclusion is most appropriate?

   (A) The account should be treated as a Standard Asset because ₹ 8 crore deposit made before year-end resulted in the account appearing regular on the reporting date.

   (B) The auditor should examine transactions immediately before and after the balance sheet date to determine whether the regularisation was merely an arrangement to prevent the account from slipping into the NPA category.

   (C) The auditor should disregard the subsequent withdrawals and transfers because such transactions relate to the next accounting period and cannot affect year-end classification.

   (D) The account need not be examined further for NPA classification because the bank holds sufficient collateral in the form of hypothecated assets and mortgaged property.

10. Which of the following should the auditors verify while auditing Shiksha Jyoti Educational Society?

   (A) Whether the Society is eligible for income-tax exemption and, accordingly, whether no further verification is required in respect of tax deducted from its investment income.

(B) Whether separate statements of account have been prepared only for the Hostel Fund, Games Fund and Staff Provident Fund maintained by the Educational Society.

(C) Whether the tax deducted from interest income has been refunded to the Society and whether the amount has been correctly credited to its general fund.

(D) Whether refund of tax deducted from investment income has been claimed and recovered, and whether separate statements of account have been prepared for Hostel Fund, Games Fund and Staff Provident Fund.

11. With reference to the conduct of the Executive Director towards the auditors, which of the following ethical threats is primarily involved?

(A) Self-interest threat.

(B) Familiarity threat.

(C) Advocacy threat.

(D) Intimidation threat.

12. After evaluating all matters arising during both audits, the engagement partner instructed the audit team to obtain sufficient appropriate audit evidence before expressing an opinion. Which of the following best describes the Further Audit Procedures to be performed?

(A) The auditor should perform substantive analytical procedures alone to obtain sufficient appropriate audit evidence regarding the identified risks.

(B) The auditor should perform tests of controls alone where controls have been identified as relevant to the audit and appear to be operating effectively.

(C) The auditor should perform tests of controls where required or where reliance on controls is intended, together with substantive procedures comprising tests of details and substantive analytical procedures.

(D) The auditor should perform inquiries of management and obtain written representations from management to address the identified risks and support the audit opinion.

13. An audit firm is engaged to audit a company for the financial year 2025–26. The financial statements prepared by management reflect a profit before tax of ₹1 crore.

As the audit is nearing completion, CA Y instructs his staff to prepare a draft audit report with a proposed date of 4th July, 2026. Meanwhile, certain audit evidence and events come to his notice:

A response to a pending external confirmation is received on 5th July, 2026 and it agrees with the balances recorded in the books.

On 3rd July, 2026, through local vernacular newspapers, CA Y becomes aware that one of the company's major customers—owing ₹50 lakhs—has fled the country after becoming insolvent. An FIR has been filed on the same date.

Written representations from management are received on 10th July, 2026.

The engagement partner now needs to determine the appropriate date to sign the audit report.

Based on the above scenario, on which date should the auditor sign the audit report?

(A) 10th July, 2026 or any date thereafter

(B) 3rd July, 2026 or any date thereafter

(C) 5th July, 2026 or any date thereafter

(D) 4th July, 2026 or any earlier date

14. While auditing the valuation of finished goods, the auditor examines the basis used by management for determining cost. The accountant provides costing sheets prepared for sample carpets, which were originally developed for obtaining customer orders. These costing details include higher design, development, and trial overheads, and the same basis has been used for valuing the finished goods inventory.

The auditor evaluates whether such costing is appropriate for inventory valuation in accordance with applicable principles.

Based on the above scenario, which of the following statements is most appropriate?

(A) The costing provided by the accountant is likely to be accepted by the auditor.

(B) The costing provided by the accountant is likely to be overstated, resulting in a misstatement of inventory.

(C) The costing provided by the accountant is likely to be understated, resulting in a misstatement of inventory.

(D) The costing is appropriate since it is based on management estimates supported by internal records.

15. A practitioner is engaged to perform two different types of assurance engagements—one requiring a high level of assurance and another requiring a moderate level of assurance. While planning the work, the practitioner evaluates the nature, timing and extent of procedures, as well as the evidence required and the form of conclusion to be expressed in each engagement.

    The audit team discusses the key differences between a reasonable assurance engagement and a limited assurance engagement in terms of procedures performed, evidence obtained and conclusions expressed.

    Which of the following statements is not true regarding the distinction between a reasonable assurance engagement and a limited assurance engagement?

    (A) A reasonable assurance engagement involves more extensive and detailed procedures compared to a limited assurance engagement.

    (B) A reasonable assurance engagement involves obtaining sufficient appropriate evidence, whereas a limited assurance engagement involves obtaining only limited evidence.

    (C) A reasonable assurance engagement provides a higher level of assurance than a limited assurance engagement.

    (D) A reasonable assurance engagement involves drawing reasonable conclusions whereas limited assurance engagement draws limited conclusions.

PART II - Descriptive Questions (70 Marks)

Question No. 1 is compulsory.

Attempt any four questions from the Rest.

1. (a) Prime Infrastructure Limited appointed K & Co., Chartered Accountants, as its statutory auditors for the year ended 31st March, 2026. During the audit, the Engagement Partner decided to obtain external confirmations from selected trade receivables to verify the outstanding balances.

    The audit team received different types of responses. Some customers confirmed the balances exactly as stated in the confirmation requests, one confirmation was received from an email address whose authenticity was doubtful, a few customers did not respond despite repeated follow-ups and one customer disputed the balance stated in the confirmation request.

While reviewing the results of the confirmation procedures, an audit assistant suggested that only the confirmations received without exception should be considered and that no further audit procedures were required in respect of the remaining cases. The Engagement Partner, however, emphasised that the results of all individual confirmation requests need to be appropriately evaluated before drawing an audit conclusion.

With reference to the above facts, explain how the auditor would evaluate the evidence obtained from external confirmation procedures. Also discuss the different categories into which the results of individual external confirmation requests may be classified and comment on the correctness of the audit assistant's view. **(5 Marks)**

(b) My Vision Electronics Limited, a company engaged in the manufacture of consumer electronic products, was undergoing statutory audit for the year ended 31st March, 2026. During the planning stage, the audit team identified that the company had introduced a new range of technologically advanced products involving complex revenue recognition and valuation issues. The industry was also experiencing rapid technological changes, resulting in frequent product obsolescence.

During the discussion on audit planning and risk assessment, an audit assistant stated that since the company had implemented a robust internal control system over financial reporting, there was no need to assess the possibility of material misstatements before evaluating those controls. He further stated that the same level of inherent risk should be assigned to all account balances and disclosures.

The audit team was required to consider whether these views were consistent with the concept of inherent risk and its assessment under the Standards on Auditing.

With reference to above facts, explain the concept of inherent risk. Also explain why inherent risk may vary across different assertions, how it is considered while designing audit procedures and illustrate your answer with suitable examples. Comment on the correctness of the audit assistant's views. **(5 Marks)**

(c) Nimbus Digital Solutions Limited, engaged in providing technology-enabled business services, has several intangible assets recorded in its financial statements, including software and specialised designs used in its operations.

During the audit for the year ended 31st March, 2026, the audit team reviewed the intangible assets appearing in the books of account. In the course of verification, it was observed that certain software had not been used during the year, while some designs relating to products that were no longer being manufactured continued to be included in the books.

Since intangible assets do not have physical substance, the auditor considered the manner in which their existence and continuing use could be established as at the period-end.

Explain how the auditor should establish the existence of intangible assets as at the period-end, with suitable examples. Also discuss the audit considerations in respect of intangible assets that are not in active use and comment on whether mere inclusion of such assets in the books of account is sufficient to establish their existence. **(4 Marks)**

2. (a) During the statutory audit of Very Good Electricals Limited for the year ended 31st March, 2026, S & Co., Chartered Accountants, considered the company's inventory records and related verification procedures.

As part of the year-end audit, the audit team reviewed the procedures followed by the company for determining and recording its inventories. The company maintained substantial inventories at its own premises, while certain inventories owned by it were lying with transporters, warehouses and port authorities. In addition, the company had received certain goods on consignment basis.

The audit team noted that the company had conducted a physical count of inventories at the year-end and had prepared inventory records based on the quantities physically counted. During the review, however, the auditors considered whether the physical count alone would identify all inventories that should have been included in the financial statements, particularly inventories held by third parties and transactions occurring immediately before and after the year-end. The auditors also considered the need to distinguish goods received on consignment from inventories owned by the company.

Accordingly, the audit team planned to perform analytical procedures, examine relevant non-financial information, carry out purchase and sales cut-off tests, verify inventory listings, reconcile physical inventory records with perpetual records and general ledger control totals, and obtain appropriate evidence regarding inventories held by third parties. The team also considered whether goods received on consignment had been properly segregated.

Explain the audit procedures to be performed to establish the completeness of inventories recorded in the financial statements. In the light of the above circumstances, discuss the significance of the procedures considered by the audit team. **(5 Marks)**

(b) Tablet Pharmaceuticals Limited, a listed company engaged in the manufacture of pharmaceutical products, appointed P & Co., Chartered Accountants, as its statutory auditors for the year ended 31st March, 2026.

During the course of the audit, the audit team identified several misstatements in different account balances. While each misstatement was individually small, their aggregate effect was significant. The Finance Director argued that none of the individual misstatements was material and, therefore, they could be ignored. He further stated that a disclosure should be considered material only if it affected the decision of a major shareholder, irrespective of its impact on other users of the financial statements.

The Engagement Partner disagreed and explained that the concept of materiality is applied throughout the audit and that materiality is determined with reference to the common financial information needs of users of the financial statements.

With reference to above facts, explain the auditor's responsibility relating to materiality in planning and performing an audit under SA 320. Also explain the concept of materiality in the context of financial reporting frameworks and comment on the correctness of the Finance Director's views. **(5 Marks)**

(c) While conducting the audit of Shree Engineering Limited for the year ended 31st March, 2026, A & Co., Chartered Accountants, were required to consider the opening balances, as the company had been audited by another firm in the previous year.

While planning the audit, the audit team considered the procedures required to obtain sufficient appropriate audit evidence regarding the opening balances. The team noted that the extent of such procedures would need to be determined having regard to the accounting policies followed by the company, the nature and significance of the opening balances, the risks of material misstatement and whether the previous year's financial statements had been audited.

With reference to the above facts, explain the factors that determine the nature and extent of audit procedures for obtaining audit evidence regarding opening balances. **(4 Marks)**

3. (a) During the statutory audit of Gala Retail Limited for the year ended 31st March, 2026, the Bank Reconciliation Statements (BRS) prepared for the company's bank accounts contained several reconciling items. These included cheques issued but not presented for payment, cheques deposited but not credited, and bank charges and other amounts debited or credited by the bank but not recorded in the books. Certain cheques were subsequently cleared, while some had become stale.

The auditors also considered the company's process and periodicity of preparing the BRS and the need to verify material reconciling items and make appropriate adjustments where necessary.

Explain the appropriate audit procedures for verifying the Bank Reconciliation Statements, including the examination of the above reconciling items. Also discuss the importance of understanding the company's process and periodicity of preparing BRS and the treatment of material items requiring adjustment.

(5 Marks)

(b) Green Manufacturing Limited was undergoing its statutory audit for the year ended 31st March, 2026. The company had been audited by R & Co., Chartered Accountants, in earlier years also.

At the commencement of the engagement, the audit plan included a discussion of the audit strategy, identification of areas involving significant risks, allocation of work according to the competence of team members and consideration of whether the assistance of an information technology expert would be required. Since the audit team was familiar with the company from previous years, a view was expressed that the audit could proceed directly to substantive procedures without a separate planning exercise.

With reference to the above facts, explain the objective of planning an audit under SA 300 and discuss the benefits of adequate audit planning. Also comment on whether prior experience with the entity eliminates the need for adequate audit planning. **(5 Marks)**

(c) Precision Auto Components Limited, a manufacturer of automobile parts, was undergoing its statutory audit for the year ended 31st March, 2026.

The company had recently implemented a new ERP system and introduced an automated inventory management process. While finalising the audit programme, the audit procedures used in another manufacturing engagement were proposed as the basis for the current audit. The proposed programme did not specifically address the changes in the company's systems and processes. During the audit, the audit assistant also came across certain significant matters that were not specifically covered by the programme.

With reference to the above facts, explain why evolving one audit programme applicable to all businesses is not practicable. Also explain the role of an assistant while carrying out an audit programme and the need for suitable modifications to the programme during the course of an audit. **(4 Marks)**

4. (a) PQR Ltd. has been sanctioned a cash credit facility of ₹30 crores by ABC Bank Ltd. During the financial year 2025-26, the drawing power available to PQR Ltd. varied between ₹26 crores and ₹29 crores. However, the amount outstanding in the cash credit account remained below ₹24 crores throughout the year. No amount was credited by PQR Ltd. to the cash credit account during the year, and there were no other credits in the account during the last two quarters of the financial year.

How should the cash credit account of PQR Ltd. be classified in the books of ABC Bank Ltd. as on 31st March 2026? Give reasons. **(5 Marks)**

(b) Zene Investments Limited, an investment company, held a significant portfolio of investments as at 31st March, 2026. During the audit, the Engagement Partner noted that the valuation of certain investments depended significantly upon management's stated intention regarding whether the investments would be held for the long term or disposed of in the near future.

The Audit Assistant stated that management's oral explanation regarding its intention should be sufficient, particularly because management had followed similar investment strategies in earlier years. The Engagement Partner, however, considered management's past actions, the reasons for choosing the proposed course of action, its ability to pursue that course of action and other audit evidence that might be inconsistent with management's stated intention. He also considered obtaining a written representation from management regarding its specific intention.

Explain the matters that an auditor may consider when obtaining evidence about, or evaluating, management's judgments and intentions. Also explain when written representations about specific assertions may be considered necessary, with a suitable example, and discuss whether such representations, by themselves, provide sufficient appropriate audit evidence. **(5 Marks)**

(c) Sunrise Foundation, a registered charitable trust engaged in providing free healthcare services in rural areas, appointed A & Co., Chartered Accountants, to audit its financial statements for the year ended 31st March, 2026.

During the preliminary discussions, the Managing Trustee informed the Engagement Partner that one of the partners of the audit firm was his real brother. He further stated that since the Foundation was a charitable organisation and did not earn any profits, the question of auditor's independence was not very important. He also remarked that audit was generally meant for companies and other profit-making organisations, whereas a charitable trust should not require the same level of audit.

The Engagement Partner explained that the principles governing an audit remain the same irrespective of the nature, size or legal form of the entity.

With reference to above facts, explain the meaning of auditing and give an incisive analysis of the principles emerging from its definition in the given situation.

(4 Marks)

5. (a) Riverdale Municipal Corporation incurred substantial expenditure during the year 2025–26 on various civic services and development projects. During the external audit of its accounts, the auditor noticed certain weaknesses in the financial control system. Some expenditure had also been incurred without following prescribed legal and administrative requirements. Further, certain projects appeared to have involved substantial expenditure without corresponding benefits to the public. The auditor also came across certain instances indicating possible errors, fraud and misuse of municipal resources.

Explain the important objectives of audit of municipal accounts and apply them to the circumstances described above. **(5 Marks)**

(b) Nova Industries Limited, a listed company engaged in the manufacture of industrial equipment, appointed KR & Co., Chartered Accountants, as its statutory auditors for the year ended 31st March, 2026.

During the audit, the Engagement Partner identified certain significant matters that required communication to those charged with governance. The auditor had concerns regarding the appropriateness of certain significant accounting estimates and financial statement disclosures adopted by the company. The audit team also faced significant difficulties in obtaining certain records from the management, which resulted in delays in completing the audit procedures.

Further, certain significant matters arising during the audit had been discussed with management and were also the subject of correspondence between the auditor and management. The auditor also requested written representations from management in relation to certain matters. The Engagement Partner was of the view that these matters were relevant to the oversight of the financial reporting process by those charged with governance.

Explain the significant findings from the audit that are required to be communicated by the auditor to those charged with governance under the applicable requirements. **(5 Marks)**

(c) Explain the factors that determine the type of modified opinion to be expressed by the auditor. In this context, explain how the nature of the matter giving rise to the modification and the auditor's judgement regarding the pervasiveness of its effects or possible effects on the financial statements determine whether a qualified opinion, adverse opinion or disclaimer of opinion is appropriate. **(4 Marks)**

6. (a) The State Government sanctioned expenditure for various public welfare and administrative activities during the year 2025–26. During the course of audit, the auditor came across the following transactions:

(i) A Government department purchased high-end office furniture at substantially higher prices than those prevailing in the market, although furniture of adequate quality was available at considerably lower prices.

(ii) The head of a department sanctioned a special expenditure for a facility that directly benefited a business entity in which a close relative of the sanctioning authority had a financial interest.

(iii) Public funds were used to provide a financial benefit to a particular group of persons. The expenditure was not insignificant, no legal claim existed against the Government for such payment and the expenditure was not covered by any recognised policy or established practice.

(iv) Certain officials were paid travelling allowances at rates substantially higher than the actual expenditure ordinarily incurred by them, resulting in the allowances becoming a source of profit rather than merely compensating them for expenditure incurred.

Examine the above transactions in the light of the principles of financial propriety and state whether the expenditure in each case satisfies the standards expected in the use of public money. Give reasons for your conclusions. **(5 Marks)**

(b) Explain the matters that are required to be stated in the "Auditor's Responsibilities for the Audit of the Financial Statements" section of the auditor's report. Also explain the additional matter required to be stated regarding the division of responsibility for financial information in a group audit engagement when SA 600 applies. **(5 Marks)**

(c) You are the auditor of a bank. During the audit, you are required to verify the provisions and contingencies recognised by the bank for the year.

What audit approach and procedures would you adopt for verifying the provisions and contingencies of the bank? **(4 Marks)**

OR

(c) What matters should a firm consider with regard to the integrity of a client while evaluating whether to accept or continue an engagement, as required under SQC 1? **(4 Marks)**