

PART – I

Case Scenario-I :

CA Rajesh and Co. are the statutory auditors of Ram Textiles Ltd. and are making arrangements to start the audit. CA Rajesh, planned to ensure that the work of engagement team members is properly directed, supervised and reviewed so as to conduct an effective audit by the team members. CA Rajesh understood that the nature, timing and extent of the direction and supervision of engagement team members and their review, depends on various factors relating to entity and firm. He ensured that planning of the audit is made so as to cover the scope of audit. Enough care has been taken to ensure that the scope does not include the matters which fall outside the domain of his competence and at the same time to obtain reasonable assurance whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion. The auditor understood the entity and its environment, internal controls, the IT environment and the related risks. Considering the large volume of transactions, the auditor preferred to go for audit sampling with proper checks and controls. The engagement team members were made aware that appropriate risk assessment procedures be designed to suit the circumstances and to strike a balance between the different components of audit risk, so as to reduce the overall audit risk to acceptable low-level and to adopt appropriate audit procedures as required. The auditors wish to determine the sample size by the application of statistical techniques or through the exercise of professional judgment, as would be appropriate in the particular circumstances and also decided in appropriate cases, to examine the entire population of items that make up a class of transactions or

account balance. Accordingly, CA Rajesh decided to use statistical sampling for verification of sales, and at the same time, verify all the sales transactions to related parties. The auditor considered various factors that determine the sample size for tests of control and observed that when circumstances are similar, the effect on sample size of factors will be similar, regardless of whether a statistical or non-statistical approach is chosen. Further, he designed and performed audit procedures that are appropriate in the circumstances for the purpose of obtaining sufficient and appropriate audit evidence and thereby enable to draw reasonable conclusions on which to base the auditor's opinion. The engagement team members were given instructions, that apart from the appropriateness and relevance of audit evidence obtained, the need for sufficiency of audit evidence and the factors affecting auditor's judgment as to sufficiency of audit evidence, shall also be considered.

Based on the above facts, answer the following Q. Nos. 1 to 6.

1. CA Rajesh decided to go for sampling for verification of controls, transactions and for applying substantive procedures. In this regard, select a statement from the below options, **which is not apt** :

- (A) 100% examination may be made of a population constituting a small number of large value items.
- (B) It is possible to make 100% examination of test of controls.
- (C) 100% examination is appropriate when there is a significant risk, and other means do not provide sufficient appropriate audit evidence.
- (D) The repetitive nature of calculation or other process performed automatically by an information system, makes a 100% examination cost effective.

HTF1

2. CA Rajesh wants to choose a sample size which enables him to make a proper risk assessment of the population. In selecting the sample size, which of the below option is not correct ? 2
- ✓ (A) If there is an increase in the tolerable rate of deviation, then the sample size will decrease.
- (B) The lower the risk the auditor is willing to accept, the greater the sample size needs to be.
- (C) Other things being equal, the greater the reliance the auditor places on the operating effectiveness of controls in the risk assessment, the greater is the extent of the auditor's tests of controls and thus the sample size will decrease. TOC
- (D) When there is an increase in the expected rate of deviation of the population to be tested, then sample size will increase.
3. The auditor's judgment as to sufficiency of audit evidence ^{quantity} is not dependent on one of the factors mentioned below. Choose one such factor from the below options :
- ✓ (A) Risk of Material Misstatement
- (B) Nature and source of audit evidence
- (C) Size and characteristics of population
- (D) Materiality
4. CA Rajesh had considered all the factors affecting the supervision and review of engagement team members' work. One of the following is not a factor in deciding the nature, timing and extent of the direction and supervision of engagement team members and review of their work.

(6)

HTF1

- (A) The availability of time and trained personnel to review the work
(B) Size and complexity of the entity
(C) The capability and competence of the individual team members performing the audit work
(D) The area of the audit

5. As per the understanding of CA Rajesh, which of the below options, falls within the scope of audit of financial statements ?

2

- (A) Responsibility of preparation and presentation of financial information.
(B) Reliability and sufficiency of financial information.
(C) Expertise in authentication of documents.
(D) Duties outside scope of competence of auditor.

6. Suggest the audit team members of CA Rajesh and Co. to match the apt combination from the following information regarding risk and their description :

2

Type of Risk	Description
1. Sampling Risk	a. Sample was not representative of the population. (1)
2. Audit Risk	b. Risk that the auditor gives an inappropriate audit opinion when the financial statements are materially misstated. (2)
3. Not an Audit Risk	c. Erroneous conclusion due to application of inappropriate audit procedure. (3)
4. Non-sampling Risk	d. Risk that the auditor might express an opinion that the financial statements are materially misstated, when they are not. (4)

HTF1

- (A) 1-c, 2-a, 3-b, 4-d
- ~~(B) 1-a, 2-b, 3-c, 4-d~~
- (C) 1-b, 2-d, 3-a, 4-c ✓
- ~~(D) 1-a, 2-b, 3-d, 4-c~~

Case Scenario-II :

Ravi Chopra and Associates are statutory auditors of a steel manufacturing company. The audit for the current financial year has been started. The engagement partner, as part of understanding and evaluating the internal controls of the company, chose to use Internal Control Questionnaire for collecting information about the existence, operation and efficiency of internal control in the organisation. Accordingly, the auditor handed over an Internal Control Questionnaire in respect of purchases, creditors, inventories and fixed assets, to the management.

In the process of verification of receivables of the company, the engagement partner performed certain Test of Controls and found them satisfactory. He then decided to use direct confirmation procedure and selected some of the parties for external confirmation, on the basis of his judgment. The partner decided to use both positive and negative confirmation request(s) depending on the circumstances, materiality and volume of transactions as would be appropriate for the class of transactions selected for verification. The responses received and the non-responses were carefully analysed for further audit procedures to be carried on, to corroborate evidence obtained from confirmation requests.

HTF1

The engagement partner observed during the course of verification, that the company is facing tight working capital conditions and also availed additional cash credit limits on ad-hoc basis for six months, from its banker, to meet the stressed working capital requirements. The partner verified whether appropriate charges were registered within the statutory time period with the Registrar of Companies and whether necessary disclosures are made in the financial statements.

Further, during the course of audit verification, the partner identified certain events or conditions that cast doubt on the entity's ability to continue as a going concern. The engagement partner held appropriate discussions with the management and those charged with governance, to resolve the matter on appropriateness of going concern assumption. The management demonstrated their plans to the satisfaction of the auditor, to dispel the doubts raised on going concern assumption.

The audit manager during the course of audit verification came across certain subsequent events but had confusion in classifying them, so as to decide on their treatment in the financial statements. The subsequent events are to be dealt, based on whether the evidence of conditions that existed on the date of the financial statements, or events providing evidence of conditions, that arose after the date of financial statements.

In the Board meeting held during the month of April, the company discussed on the settlement of certain legal claims on the company, plans for reconstruction of business by issue of new share capital and merger proposals by interested parties. The engagement partner properly analysed all such events and ensured that they are appropriately dealt with in the financial statements.

Based on the above facts, answer the following Q. Nos. 7 to 12.

HTF1

HTF1

7. In respect of registration or satisfaction of charges created on Borrowings of the company, following information is to be disclosed in the financial statements. Choose the correct option.

2

- (A) Charges or satisfaction yet to be registered with Registrar of Companies beyond the statutory period, details and reasons thereof shall be disclosed.
- (B) Charges or satisfaction yet to be registered with Registrar of Companies beyond the statutory period, details thereof shall be disclosed.
- (C) Charges yet to be registered with Registrar of Companies beyond 12 months from the date of creation of charge, the details and reasons thereof shall be disclosed.
- (D) Charges or satisfaction of charges made by the company during the year.

8. CA Ravi Chopra had considered all the events that cast a doubt on the going concern assumption. Consider the following examples of events or conditions that may cast significant doubt on the entity's ability to continue as a going concern :

2

- (1) Shortage of important supplies. f
- (2) Loss of major market share. e

HTF1

- (3) Inability to pay creditor on due dates.
- (4) Non-compliance with regulatory requirements.
- (5) Arrears or discontinuance of dividends.
- (6) Emergence of highly successful competitor.
- (7) Pending legal proceedings which may result in claims which the entity is unlikely to be able to satisfy.
- (8) Inability to obtain financing for essential requirements.

Choose the correct option which suits to events or conditions.

- (A) 1, 4-Financing events : 3, 2, 5-operating events : 6, 7, 8-other events
- (B) 1, 3, 4-Financing events : 2, 5, 6-operating events : 7, 8-other events
- (C) 1, 4-Financing events : 3, 7, 6-operating events : 2, 5, 8-other events
- ☒ (D) 3, 5, 8-Financing events : 1, 2, 6-operating events : 4, 7-other events

9. CA Ravi Chopra considered the subsequent events which require to be dealt with in the financial statements. Select from the below options, the one which is **not an event**, providing evidence of conditions that arose after the date of the financial statements :

- (A) Issue of new share capital.

- ✓ (B) Settling a legal claim outside the court at a reduced amount, between the date of financial statements and the date of auditor's report, for which provision has already been made in financial statements.
- (C) Planned merger of the company.
- (D) Destruction of substantial inventories due to fire between the date of the financial statements and the date of auditor's report.

10. The following are a part of Internal Control Questionnaire in respect of purchases, creditors, inventories and fixed assets. Match the apt combination from the following information regarding Related part of Internal Control Questionnaire and Description of item :

2

Related part of Internal Control Questionnaire	Description of item
1. Are materials inspected and counted, weighed or measured in the receiving department ? d	a. Creditors
2. In respect of raw material and supplies, are reconciliations made of quantities and/or values received as shown by purchase invoices, with receipt into stock records ? 2	b. Purchases
3. Are there norms for re-order level ?	c. Fixed assets
4. Is there a written procedure for periodic verification and discrepancies disclosed by such reports investigated and are the records and financial accounts corrected with appropriate authority ?	d. Inventories

1 - b
2 - A
3 - d
4 - c

(A) 1-b, 2-a, 3-d, 4-c

(B) 1-d, 2-a, 3-c, 4-b

(C) 1-a, 2-c, 3-d, 4-b

(D) 1-c, 2-b, 3-d, 4-a

11. In respect of the confirmations from the trade receivables, choose the statement **which is not correct**.

2

(A) The requested confirmation should preferably be without mentioning the balance outstanding, wherein the debtor is requested to respond with the balance outstanding as per his records. ✓

(B) Confirmation from trade receivables should necessarily be as on the date of balance sheet. ✓

(C) The method of selection of trade receivables to be circulated, should not be revealed to the client, until the trial balance of the trade receivables ledger is handed over to the auditor.

(D) The auditor employs direct confirmation procedure with the consent of the entity under audit.

12. Some of the parties to whom the confirmation requests were sent, have replied and some did not. CA Ravi Chopra analysed the responses received and discussed with his team members, the reasons for non-response and asked them to send the reminders. Choose the statement which is **not correct** from the following :

2

(13)

HTF1

- (A) Failure of a confirming party to respond to a negative confirmation request, provides significantly less persuasive audit evidence, than does a response to a positive confirmation request.
- (B) The failure to receive a response to a negative confirmation request, does not explicitly indicate receipt by the intended confirming party, of the confirmation request or verification of the accuracy of the information contained in the request.
- (C) Confirming parties may be less likely to respond in the case of disagreement with a confirmation request, when the information in the request is not in their favour and more likely to respond otherwise.
- (D) Confirming parties may be more likely to respond indicating their disagreement with a confirmation request, when the information in the request is not in their favour, and less likely to respond otherwise.

13. CA Student Ajay learnt the concept of classification of advances as per RBI prudential norms for agricultural advances. As per the prudential norms, agricultural advances shall be treated as NPA :

2

- (A) If instalment of principal or interest thereon remains overdue for two crop seasons in case of short duration crop and one crop season in case of long duration crops.
- (B) If instalment of principal or interest thereon remains overdue for one crop season in case of short duration crop and two crop seasons in case of long duration crops.

HTF1

HTF1

- (C) If instalment of principal and interest thereon remains overdue for two crop seasons in case of short duration crop and one crop season in case of long duration crops.
- (D) If instalment of principal and interest thereon remains overdue for one crop season in case of short duration crop and two crop seasons in case of long duration crops.

14. During the course of audit of a company CA Nitin has verified various assertions relating to Income Statement and Balance Sheet items. Consider the following statements :

2

Statement 1 : Occurrence and Valuation are assertions relating to Balance Sheet captions.

Statement 2 : Measurement and Existence are assertions relating to Income Statement captions.

Statement 3 : Measurement and Completeness are assertions relating to Income Statement captions.

Statement 4 : Existence and Rights & Obligations are assertions relating to Balance Sheet captions.

Choose the correct option from below :

- (A) Only 1 & 3 are correct.
- (B) Only 1 & 2 are correct.
- (C) Only 2 & 4 are correct. /
- (D) Only 3 & 4 are correct. ✓

(15)

HTF1

15. A Limited company has certain borrowings from a consortium of banks, classified into Funded loan and Non-funded facilities. The description of the facilities is as under -

- i. Letters of credit ✓
- ii. Cash credits ✓
- iii. Bank guarantees ✓
- iv. Overdrafts ✓
- v. Standby Letter of credit (SBLC) ✓
- vi. Bills discounted and purchased ✓
- vii. Participation on Risk sharing basis ✓

Choose the correct option with regard to Funded loans.

(A) ii, iv, vi, vii ✓

(B) i, ii, vi, vii ✓

(C) ~~ii, iii, iv, vi~~ ✓

(D) i, v, vi, vii ✓

HTF1

PART – II

1. (a) CA Student Kalyan was going through a topic on "Audit programme" and learnt that an audit programme is designed to provide most appropriate audit evidence by prescribing procedures and techniques to verify an assertion. Guide the student in answering the following :

(i) What type of audit evidence shall an auditor look into as the most appropriate evidence in verification of an assertion ? 3

(ii) Specify the most appropriate audit evidence in respect of : 2

– verification of Cash in hand

– verification of Investments pledged with bank

(b) CA Ram Manohar and his team have just started the statutory audit of a listed company which is into manufacture of agro pesticides. The auditors wish to plan and perform the audit so as to reduce the risk of material misstatement to an acceptably low-level. Discuss, how the auditors can satisfy the objective of identifying and assessing the risk of material misstatement. 5

Your answer should be in line with relevant Standards on Auditing.

(c) ABC Limited is a large drug manufacturing unit, having units at Hyderabad and Ahmedabad. The management has nominated an expert team from different functions of the organization, to conduct the year end verification of inventories and for finalization of accounts for the financial year 2024-25. The statutory auditors also, as a part of their audit verification, wish to attend the year end physical inventory verification planned by the management. The inventory at all the locations are considered material to the financial statements. 4

(3)

HTF2

The auditor encountered following situations :

Hyderabad unit : Due to administrative reasons, the management had taken up the stock verification of inventory on 15th March 2025 itself.

Ahmedabad unit : The Company had taken up the inventory verification as planned on 31st March 2025. However, there was news of local disturbances in the city of Ahmedabad during the last week of March 2025, whereby the auditor cancelled his planned visit for attending inventory verification.

In the above circumstances, what additional audit procedures are to be undertaken by the statutory auditor for inventory verification ?

Your answer should be in tune with relevant standards on auditing.

2. / (a) What do you mean by ' Deficiency in internal control' and ' Significant deficiency in internal control'? 5
- / (b) CA Student Ravi is learning the concept of "Key Audit Matters". However, he is confused between modification of audit report and reporting of key audit matters.

You are required to guide him in explaining the following :

- (i) Purpose of communicating Key Audit Matters 2
- (ii) Communicating Key Audit Matters is not a substitute for disclosure in financial statements. 3

HTF2

P.T.O.

(c) CA students Sriranga and Manga were discussing on the assurance, which the auditing services provide to the users, in the form of opinion on financial statements, by means of a written report. Such an assurance lends credibility to financial statements. You are required to state some of the aspects examined by the auditor, to ensure that the financial statements which are audited are not misleading.

4

3. (a) CA Student Manoj is studying on the exemptions available to a private limited company in respect of certain reporting requirements. You are required to guide Manoj on the following :

(i) Applicability of Reporting requirements on adequacy of Internal Financial Controls (IFCs) with reference to financial statements to a private limited company.

2

(ii) Applicability of Companies (Auditor's Report) Order, 2020 to a private limited company.

3

(b) Enumerate the factors that may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms.

5

(c) XYZ Developers, a property development firm, has secured a short-term construction loan from ABC Bank to finance a residential project. Upon completion of the project, XYZ Developers plan to refinance this loan with a long-term takeout loan from DEF Financial Institution. However, due to delays in the project's completion, XYZ Developers face difficulties in repaying the loan, and the bank classifies the loan as a Non-Performing Asset (NPA).

4

What is the meaning and primary objective of takeout finance in property development, and how does the classification of a loan as a Non-Performing Asset (NPA) impact income recognition by the lending bank ?

(5)

HTF2

4. (a) Takur and Co; Chartered Accountants were conducting an audit of an LLP. They have verified the Receivables and concluded that all the Receivables are genuine and recoverable. However, before the final completion of the audit, the auditors came to know of severe financial crisis of one of the Receivables, M/s. Raj Enterprises, whose outstanding account balance was material to the overall Receivables figure as on the date of financial statements. CA Takur had discussions with the appropriate level of management to address the issue, and the management finally agreed to make provision for the same, as suggested by the auditor.

You are required to –

- (i) Ensure how the auditor can fulfil the “Documentation” part of this matter.
- (ii) Mention any four different examples of “Audit Documentation”.

- (b) RK Associates, a leading Chartered Accountant firm were approached by SK Group, for appointment as statutory auditors for their new start-up company. It was learnt that some companies of the group faced raids by the Enforcement Directorate, in the recent past. The firm follows the SQC 1 and the firm's Quality control policy requires it to obtain vital information about the client before accepting an engagement. Specify the matters which the firm would consider for verifying the integrity of the client, to decide on acceptance of the engagement. Your answer should be in line with SQC 1.

HTF2

P.T.O

- (c) An auditor while verifying the sales during the year observed that the sales transactions in that year are more than 1 lakh in number. He wants to determine the sample size and its composition on the basis of his personal experience and knowledge and do the testing on his own judgment. Kindly advise him about the scientific approach to sampling and the method of sampling to be chosen in such a situation.

5. (a) CA Taman is the auditor of a company dealing in trading of mobile accessories. This year the company has also started assembling of mobile phones. The audit manager instructed the team to develop the audit programme based on the previous year's audit plan and proceed with the audit. However, CA Taman disagreed, explaining to the audit manager that before commencing the audit and throughout its course, she would plan the nature, timing and extent of direction and supervision for the engagement team members and the review of their work. Explain :

- (i) What factors will CA Taman consider when planning the nature, timing, and extent of direction and supervision of the engagement team members and review of their work ?
- (ii) If, during the course of the audit, CA Taman discovers information that significantly differs from what was available when the audit procedures were initially planned, then what must she do ?

(7)

HTF2

(b) Following is the extract from the Balance Sheet of Rain Pvt. Ltd. :

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- (i) Borrowings as on 31/03/2025 ₹ 10 Cr.
- (ii) Fresh borrowings from bank during the year ₹ 3 Cr.
- (iii) Borrowings repaid during the year ₹ 5 Cr.

Parri passu charge has been created on the assets of the company. Further, borrowing limits have not been exceeded.

From the above information, what audit procedures would you perform, to ensure that all borrowings reflected in the balance sheet, are valid claims owed to banks or other third parties ?

(c) State the auditor's duty regarding audit of LLP.

4

6. (a) State the required disclosures for inventories as required under Schedule III (Part I) to the Companies Act, 2013.

5

(b) A government department conducted an inventory audit and discovered that several items in inventory were found to be either damaged or obsolete, but they had not been removed from the records. There were no periodic physical verification reports of inventory, and the valuation of the materials in stock was outdated.

5

Explain, how the audit of stores and inventories, as part of the expenditure audit, under the duties and responsibilities entrusted to the Comptroller and Auditor General (C&AG), can help address these issues.

HTF2

P.T.O.

(8)

HTF2

- (c) CA Raj has just concluded the audit of a company and noted certain findings /exceptions in the IT environment and controls, which need to be assessed and reported accordingly. Specify, what points shall the auditor consider in assessing and reporting of audit findings in IT Environment and IT Controls.

4 ■

OR

- (c) Mentioned below are the threats to independence of auditors. Classify them, with reasons, into the appropriate type of threats viz. Advocacy threat, Intimidation threat, Familiarity threat, Self-review threat, Self-interest threat. (ANY FOUR)

4

- (i) Close business relationship with an audit client; *fami*
- (ii) Auditors perform services that are themselves subject-matter of audit; *review*
- (iii) Auditor deals with shares or securities of the audited company; *Advocacy*
- (iv) Long association between specific auditors and their specific client counterparts; *fami*
- (v) Auditor deterred from acting objectively with an adequate degree of professional skepticism. *Intimidation*

HTF2