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CA INTER (Jan 2026)
GROUP II – PAPER 5
AUDITING AND ETHICS
SUGGESTED ANSWERS
(Series 3)

PART – I (MCQs)

MCQ – 2 marks each														
1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.	14.	15.
B	C	B	C	D	B	A	C	C	C	B	D	A	B	C

PART – II (Descriptive Answers)

Answer 1A

Identify and assess the risks of material misstatement

(i) The auditor shall **identify and assess the risks of material misstatement** at:

- (A) the **financial statement level**
- (B) the **assertion level** for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures

(ii) For the purpose of Identifying and assessing the risks of material misstatement, the auditor shall:

- (A) **Identify risks** throughout the process of obtaining an understanding of the entity and its environment, **including relevant controls** that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
- (B) **Assess the identified risks**, and evaluate whether they relate more **pervasively to the financial statements** as a whole and potentially affect many assertions;
- (C) **Relate the identified risks** to what can go wrong **at the assertion level**, taking account of relevant controls that the auditor intends to test; and
- (D) **Consider the likelihood of misstatement**, including possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

Answer 1B

In conducting audit of financial statements, **objectives of auditor** in accordance with SA 200 “Overall Objectives of Independent auditor and the conduct of an audit in accordance with Standards on Auditing” are:

(i) To **obtain reasonable assurance** about whether the **financial statements** as a whole are **free from material misstatement**, whether due to fraud or error, thereby **enabling the auditor to**

express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and

(ii) **To report on the financial statements**, and communicate as required by the SAs, in accordance with the auditor's findings.

Audit of financial statements is carried out by the auditor with professional competence and skills in accordance with Standards on Auditing. Audit procedures are applied in accordance with SAs, audit evidence is obtained and evaluated. On basis of that, conclusions are drawn, and opinion is formed. **It leads to high level of assurance which is called as reasonable assurance, but it is not absolute assurance.**

It may be noted that absolute assurance is a complete assurance or a guarantee that financial statements are free from material misstatements. However, reasonable assurance is not a complete guarantee. Although it is a high-level of assurance, but it is not complete assurance.

Misstatements in financial statements can occur due to fraud or error or both. The auditor seeks to obtain reasonable assurance whether financial statements as a whole are free from material misstatements caused by fraud or error.

In the given case, Mr. Jai, CEO of JEN Ltd., questions the auditor's ability to detect all material misstatements and insists that auditor should provide absolute assurance. As per SA 200, the auditor's objective is to obtain reasonable assurance. Therefore, **contention of the CEO Mr. Jai is not correct.**

Answer 1C

In the given case, the audit assistant has kept a large chunk of draft inventory sheets and the final inventory sheet in the audit file which is not correct as the auditor is not required to document draft inventory sheets. Auditor should **ensure that only final inventory sheets will form part of the audit documentation**. Thus, **approach of the audit assistant of filing draft and final inventory sheet is not correct.**

As per SA 230, "Audit documentation", audit documentation **may be recorded on paper or on electronic** or other media.

The auditor **need not include in audit documentation**:

- **superseded drafts of working papers and financial statements,**
- **notes** that reflect **incomplete** or preliminary thinking,
- **previous copies** of documents corrected for typographical or other errors, and
- **duplicates** of documents.

Answer 2A

Adequate planning benefits the audit of financial statements in the several ways, including the following:

1. Helping the auditor to devote appropriate **attention to important areas** of the audit.
2. Helping the auditor identify and resolve **potential problems on a timely basis**.
3. Helping the auditor properly organise and manage the audit engagement so that it is performed in an effective and efficient manner.
4. Assisting in the **selection of engagement team** members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them.

5. Facilitating the **direction and supervision** of engagement team members and the review of their work.
6. Assisting, where applicable, in **coordination** of work done by others such as experts

Therefore, planning an audit ensures that audit risk is reduced to an acceptable low level. When audit work is adequately and properly planned, it reduces the risk of inappropriate opinion by the auditor.

Answer 2B

Meaning of Internal Control: As per SA-315, "Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment", the internal control may be defined as "the **process** designed, implemented and maintained by those charged with governance, management and other personnel to provide **reasonable assurance** about the achievement of an entity's objectives with regard to **reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets, and compliance with applicable laws and regulations**. The term "controls" refers to any aspects of one or more of the components of internal control."

Benefits of Understanding of Internal Control: An understanding of internal control assists the auditor in:

- i. identifying types of **potential misstatements**;
- ii. identifying factors that affect the **risks of material misstatement**, and
- iii. designing the **nature, timing, and extent** of further audit procedures.

The auditor shall **obtain an understanding of internal control relevant to the audit**. Although most controls relevant to the audit are likely to relate to financial reporting, not all controls that relate to financial reporting are relevant to the audit. It is a **matter of the auditor's professional judgment whether a control**, individually or in combination with others, is **relevant to the audit**.

Answer 2C

Management's assessment of the entity's ability to continue as a going concern involves making a judgment, at a particular point in time, about inherently uncertain future outcomes of events or conditions. **The following factors are relevant to that judgment:**

- The **degree of uncertainty** associated with the outcome of an event or condition increases significantly the further into the future an event or condition or the outcome occurs. For that reason, most financial reporting frameworks that require an explicit management assessment specify the period for which management is required to take into account all available information.
- The **size and complexity of the entity, the nature and condition of its business** and the degree to which it is affected by external factors affect the judgment regarding the outcome of events or conditions.
- Any judgment about the future is based on information available at the time at which the judgment is made. **Subsequent events** may result in outcomes that are inconsistent with judgments that were reasonable at the time they were made.

Answer 3A

Clause (iii) of Para 3 of CARO, 2020, requires the auditor to report whether during the year the company has **made investments in, provided any guarantee or security or granted any loans or**

advances in the nature of loans, secured or unsecured, to companies, firms, Limited Liability Partnerships or any other parties, if so:

(a) whether during the year the company has provided loans or provided advances in the nature of loans, or stood guarantee, or provided security to any other entity [not applicable to companies whose principal business is to give loans], if so, indicate:

(A) the aggregate **amount** during the year, **and balance outstanding** at the balance sheet date with respect to such loans or advances and guarantees or security **to subsidiaries, joint ventures and associates**;

(B) the aggregate amount during the year, and balance outstanding at the balance sheet date with respect to such loans or advances and guarantees or security **to parties other** than subsidiaries, joint ventures and associates;

(b) whether the investments made, guarantees provided, security given and the **terms and conditions** of the grant of all loans and advances in the nature of loans and guarantees provided are **not prejudicial** to the company's interest;

(c) in respect of loans and advances in the nature of loans, whether the **schedule of repayment of principal and payment of interest** has been stipulated and whether the **repayments** or **receipts are regular**;

(d) if the amount is overdue, state the total **amount overdue for more than ninety days**, and whether reasonable steps have been taken by the company for recovery of the principal and interest;

(e) whether any loan or advance in the nature of loan granted which has fallen due during the year, has been **renewed or extended or fresh loans granted to settle** the overdues of existing loans given to the same parties, if so, **specify the aggregate amount** of such dues renewed or extended or settled by fresh loans and the percentage of the aggregate to the total loans or advances in the nature of loans granted during the year [not applicable to companies whose principal business is to give loans];

(f) whether the company has granted any loans or advances in the nature of loans either **repayable on demand** or without specifying any terms or period of repayment, if so, **specify the aggregate amount**, percentage thereof to the total loans granted, aggregate amount of loans granted to Promoters, related parties as defined in clause (76) of section 2 of the Companies Act, 2013;

Answer 3B

The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan. One of the factors to be taken into consideration while establishing audit strategy relates to **ascertaining of reporting objectives** of engagement to plan the timing of the audit and the nature of the communications required. Some of the instances are given under:

- The **entity's timetable** for reporting
- **Organization of meetings** to discuss of nature, timing and extent of audit work with management
- Discussion with management regarding the **expected type and timing of reports to be issued** including the auditor's report
- Discussion with management regarding the **expected communications on the status of audit work** throughout the engagement.
- **Expected** nature and **timing of communications among engagement team members**, including the nature and timing of team meetings and timing of the review of work performed.

In the given case, working paper highlights that auditor has taken into account expected timelines to plan the audit and nature of the communications required. Since the working paper relates to the statutory audit of a company, the ascertaining of reporting objectives of engagement helps the auditor to plan timing of different audit procedures and also nature of communications.

Answer 3C

The auditor shall form an opinion on whether **the financial statements are prepared**, in all material respects, in accordance **with the applicable financial reporting framework**.

In order to form that opinion, the auditor shall conclude as to whether the auditor has obtained **reasonable assurance** about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

That conclusion shall take into account:

- (a) Whether **sufficient appropriate audit evidence** has been **obtained**;
- (b) Whether **uncorrected misstatements are material**, individually or in aggregate;
- (c) The **evaluations**.

Answer 4A

An effective risk management system in a bank generally requires the following:

- (i) **Oversight and involvement in the control process by those charged with governance:** Those charged with governance (BOD/Chief Executive Officer) should approve written risk management policies. The policies should be consistent with the bank's business objectives and strategies, capital strength, management expertise, regulatory requirements and the types and amounts of risk it regards as acceptable.
- (ii) **Identification, measurement and monitoring of risks:** Risks that could significantly impact the achievement of bank's goals should be identified, measured and monitored against pre-approved limits and criteria.
- (iii) **Control activities:** A bank should have appropriate controls to manage its risks, including effective segregation of duties (particularly, between front and back offices), accurate measurement and reporting of positions, verification and approval of transactions, reconciliation of positions and results, setting of limits, reporting and approval of exceptions, physical security and contingency planning.
- (iv) **Monitoring activities:** Risk management models, methodologies and assumptions used to measure and manage risk should be regularly assessed and updated. This function may be conducted by the independent risk management unit.
- (v) **Reliable information systems:** Banks require reliable information systems that provide adequate financial, operational and compliance information on a timely and consistent basis. Those charged with governance and management require risk management information that is easily understood and that enables them to assess the changing nature of the bank's risk profile.

Answer 4B

As per SA 500, "Audit Evidence", auditor perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

- (i) **Inspection:** Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset.
- (ii) **External Confirmation:** An external confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
- (iii) **Inspection:** Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production.
- (iv) **Reperformance:** Reperformance involves the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control.
- (v) **Recalculation:** Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically.

Answer 4C

The auditor's determination of materiality is a matter of professional judgment and is affected by the auditor's perception of the financial information needs of users of the financial statements. In this context, it is reasonable for the auditor to assume that users:

- (i) Have a **reasonable knowledge** of business and economic activities and accounting and a **willingness to study** the information in the **financial statements** with reasonable diligence;
- (ii) **Understand** that financial statements are prepared, presented and **audited to levels of materiality**;
- (iii) **Recognize** the **uncertainties** inherent in the measurement of amounts based on the use of estimates, judgment and the consideration of future events; and
- (iv) Make **reasonable economic decisions** on the basis of the information in the financial statements.

Answer 5A

As per **SA 705**, "Modifications to the Opinion in the Independent Auditor's Report", if, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the **auditor shall request that management remove the limitation**.

If **management refuses** to remove limitation, auditor shall **communicate matter to those charged with governance**, unless all of those charged with governance are involved in managing the entity, and determine whether it is possible to **perform alternative procedures to obtain** sufficient appropriate audit **evidence**.

If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (1) If the auditor concludes that the **possible effects** on the financial statements of undetected misstatements, if any, could be **material but not pervasive**, the auditor shall **qualify** the opinion; or

(2) If the auditor concludes that the **possible effects** on the financial statements of undetected misstatements, if any, could be **both material and pervasive** so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:

- (i) **Withdraw from audit, where** practicable and **possible** under applicable law or regulation; or
- (ii) If withdrawal from the audit before issuing the auditor's report is **not practicable or possible**, **disclaim an opinion** on the financial statements.

If the auditor withdraws, before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

Answer 5B

As per SA 610, "Using the work of Internal Auditor", direct assistance refers to the use of internal auditors **to perform audit procedures under the direction, supervision and review** of the external auditor.

Prior to using internal auditors to provide direct assistance for purposes of the audit, CA Mukul, the external auditor shall:

- (a) Obtain written agreement **from** an authorized representative of the **entity** that the **internal auditors will** be allowed to **follow** the external auditor's **instructions, and that the entity will not intervene** in the work the internal auditor performs for the external auditor and
- (b) Obtain written agreement **from internal auditors** that they will **keep confidential specific matters** as instructed by the external auditor and inform the external auditor of any threat to their objectivity.

Examples of procedures in which CA Mukul shall not use internal auditor to provide direct assistance to him are:

- (a) Procedures which involve making **significant judgments** in the audit;
- (b) Procedures relating to **higher assessed risks of material misstatement where judgment required** in performing the relevant audit procedures or evaluating audit evidence gathered **is more** than limited.
- (c) Procedures relating to work with which the **internal auditors have been involved and which has already** been, or will be, **reported** to management or those charged with governance by the internal audit function; or
- (d) Procedures relating to **decisions** the external auditor makes in accordance with this SA **regarding the internal audit function** and the use of its work or direct assistance.

Answer 5C

Engagement Performance: As per SA 220, for audits of financial statements of listed entities, and those other audit engagements, if any, for which the firm has determined that an engagement quality control review is required, the **engagement partner shall**:

- (i) Determine that an **engagement quality control reviewer** has been **appointed**.
- (ii) **Discuss significant matters** arising during the audit engagement, including those identified during the engagement quality control review, **with the engagement quality control reviewer**.
- (iii) **Not date the auditor's report until the completion of** the engagement quality control review.

If **differences of opinion** arise within the engagement team, with those consulted or, where applicable, between the engagement partner and the engagement quality control reviewer, the engagement team shall **follow firm's policies and procedures for dealing with and resolving differences of opinion**.

Answer 6A

(i) In the given case, **CA Jatin's family relationship creates a conflict of interest** that could unduly influence his professional judgment. This indicates that "**Objectivity**" principle is being **violated**. The principle of objectivity requires an auditor **not to compromise professional judgment because of bias, conflict of interest or undue influence of others**. It requires that a professional accountant shall not undertake a professional activity if a circumstance or relationship unduly influences the accountant's professional judgment regarding that activity.

(ii) In the instant case, CA Jatin did not check the latest provision of the Income-tax Act while preparing return of income-tax, which allows for a major new deduction resulting in the client overpaying income tax. This indicates "**Professional competence and due care**" principle is being **violated**. A professional accountant shall comply with the principle of professional competence and due care, which requires an accountant **to attain and maintain professional knowledge and skill** at the level required to ensure that a client or employing organization receives competent professional service, based on current technical and professional standards and relevant legislation; and act diligently and in accordance with applicable technical and professional standards. Diligence includes responsibility to act carefully, thoroughly and on a timely basis in accordance with requirements of an assignment.

(iii) In the given situation, CA Jatin's client instructs him to intentionally underestimate the sales figures to reduce the tax liability. It **violates "integrity"** principle. A professional accountant shall comply with the principle of integrity, which requires an accountant **to be straightforward and honest** in all professional and business relationships. Integrity implies fair dealing and truthfulness. A professional accountant shall **not knowingly be associated with** reports, returns, communications or other **information** where the accountant believes that the information **contains a materially false or misleading statement**; contains statements or information provided negligently or omits or obscures required information where such omission or obscurity would be misleading.

Answer 6B

In the given situation, JB Limited has invested huge sums of money on establishment of new Property, Plant and Equipment and incurred an amount of ₹ 5,70,000 on dismantling of old plant which had become obsolete so that new plant can be set up at the existing location. An item of property, plant and equipment that qualifies for recognition as an asset should be measured at its cost. **The costs of dismantling, removing the item and restoring the site on which it is located referred to as decommissioning will form part of the new Property, Plant and Equipment.**

Elements of Cost: The cost of an item of property, plant and equipment comprises:

(i) **its purchase price, including import duties and non-refundable purchase taxes**, after deducting trade discounts and rebates.

- (ii) any **costs directly attributable to bringing the asset to the location and condition** necessary for it to be capable of operating in the manner intended by management.
- (iii) the **initial estimate of the costs of dismantling, removing the item and restoring the site on which it is located, referred to as decommissioning, restoration and similar liabilities'**, the obligation for which an enterprise incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Answer 6C

Disclosure in case of Benami Properties held by the Company: Where any proceedings have been initiated or pending against the company for holding any benami property under the relevant law relating to prohibition of such transactions, the company shall disclose the following:

- (a) **Details of such property, including year of acquisition**
- (b) **Amount thereof**
- (c) **Details of Beneficiaries**
- (d) **If property is not in the books, then the fact shall be stated with reasons**
- (e) **Where there are proceedings against the company under this law as an a better of the transaction or as the transferor, then the details shall be provided**
- (f) **Nature of proceedings, status of same and company's view on same.**