



PAPER – 5: AUDITING AND ETHICS



QUESTIONS

PART – I: Multiple Choice Questions based on Case Scenarios

Case Scenario

CA Anuj is in practice for the past few years as proprietor of Anuj & Associates. He is very keen on documentation aspects while performing assurance engagements. He handles audits of various corporate and non-corporate clients with team members. The proprietorship concern also handles review engagements as well as engagements to report on prospective financial information as per needs and requirements of its clientele. Presently, it is handling audit of "Buddy Enterprises", a partnership firm, for year 2024-25 in middle of busy audit season. This business enterprise is also availing cash credit limit of ₹ 10 lacs from CDB Bank. The firm's partnership deed contains a clause stipulating audit of its financial statements by a firm of Chartered Accountants every year. However, there is no legal requirement to get financial statements of partnership firm audited. Its Profit before tax is ₹ 15 lacs.

The audit team has planned everything right from risk assessment procedures to tests of controls as well as substantive procedures. Audit plan and audit programme have been duly documented. However, during the course of audit, some information has come to notice of audit team which requires change in audit plan and could lead to revision of audit strategy. J, junior team member is pondering over documentation requirements in this peculiar situation.

Another team member, K has understood meaning of "sufficient appropriate" evidence while conducting audits. However, he is wondering over obtaining

sufficient appropriate evidence in case of assurance engagements which may not be in nature of audit. At the initial stage, audit team has determined materiality for financial statements as whole @ 5% of Profit before tax (i.e. 5% of ₹ 15 lacs = ₹ 75000). K is also concerned about documenting materiality as part of audit documentation.

K vividly remembers that an assurance engagement involves three party relationship. However, another team member Q confronts him with meaning of three-party relationship.

In accordance with terms of sanction letter, it has been stipulated by CDB bank that partnership firm is required to submit quarterly stock statements to bankers. During quarter ended 31st December 2024, value of stocks declared by firm to bankers is ₹ 10 lacs and margin stipulated in sanction letter is 20%.

Based upon above, answer the following questions: -

1. Considering dilemma of J described in case scenario, which of the following statements is most appropriate?
 - (a) Only overall audit strategy needs to be documented by audit team.
 - (b) Only audit plan needs to be documented by audit team.
 - (c) Both overall audit strategy and audit plan need to be documented by audit team.
 - (d) Overall audit strategy, audit plan and any significant changes made during the audit engagement to the overall audit strategy or the audit plan and the reasons for such changes need to be documented by audit team.
2. Guide K regarding most appropriate statement concerning obtaining of "sufficient appropriate" evidence as described in case scenario.
 - (a) Sufficient appropriate evidence is to be obtained only in case of statutory audits. In the given case, there is no requirement of law to get accounts audited. Hence, there is no need to obtain sufficient appropriate evidence.

- (b) Sufficient appropriate evidence is to be obtained in audit engagements, review engagements and engagements involving examination of prospective financial information.
 - (c) Sufficient appropriate evidence is to be obtained in audit engagements and review engagements.
 - (d) Sufficient appropriate evidence is to be obtained in all audit engagements.
3. Advise K regarding most appropriate statement in respect of documenting materiality.
- (a) Materiality of ₹ 75,000 needs to be documented.
 - (b) Performance materiality which is set at more than materiality for financial statements as a whole requires to be documented along with materiality of ₹ 75,000.
 - (c) Performance materiality which is set at less than materiality for financial statements as a whole requires to be documented along with materiality of ₹ 75,000.
 - (d) Performance materiality (for certain transactions) which is set at par level materiality for financial statements as a whole requires to be documented along with materiality of ₹ 75,000.
4. Which of the following combinations best describes three party relationship in context of audit of partnership firm?
- (a) Anuj & Associates, management/partners of Buddy enterprises and income tax authorities.
 - (b) Individual team members assisting CA Anuj, management/partners of Buddy enterprises and income tax authorities.
 - (c) Anuj & Associates, management/partners of Buddy enterprises and bankers of Buddy Enterprises.
 - (d) Anuj & Associates, management/partners of Buddy enterprises and intended users.

5. Which of the following statements is true regarding drawing power on basis of facts given in case scenario?
- (a) DP is ₹ 10 lacs and firm can withdraw funds up to ₹ 10 lacs.
 - (b) DP is ₹ 12 lacs and firm can withdraw funds up to ₹ 12 lacs.
 - (c) DP is ₹ 8 lacs and firm can withdraw funds up to ₹ 10 lacs.
 - (d) DP is ₹ 8 lacs and firm can withdraw funds up to ₹ 8 lacs.

General MCQs

6. The auditor of PAC Pvt Ltd., a pickle manufacturing company, notices that the company is expanding its operations into North India States in Financial Year 2024-25, but the related internal control system remains the same to handle the increased volume of transactions and consequently auditor concludes that material misstatements would not be prevented, or detected and corrected by the entity's internal control. Type of risk involved in this situation is:
- (a) Detection Risk.
 - (b) Control Risk.
 - (c) Inherent Risk.
 - (d) Audit Risk.
7. The auditor of XYZ Ltd. performed audit procedures to obtain sufficient appropriate audit evidence covering each and every area impacting the financial statements of the company by 20th July 2025. Before signing the auditor's report on 16th September 2025, the auditor became aware of a fire accident at the company's Yarn Factory on 10th August 2025, destroying a large part of inventory. Auditor's responsibilities in such a situation are:
- (i) Perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of financial statements and the date of auditor's report that require adjustment or disclosure in the financial statements have been identified.

- (ii) If such subsequent events that require adjustment or disclosure in the financial statements have been identified, it shall be determined whether each such event is appropriately reflected in those financial statements.
 - (iii) Obtain a written representation from management that all events occurring subsequent to the date of financial statements and for which appropriate adjustment has been done or required disclosure has been made.
 - (a) (i)
 - (b) (i) and (ii)
 - (c) (i) and (iii)
 - (d) (i), (ii) and (iii)
8. While conducting audit of Sandhya Ltd., having turnover of ₹ 200 crores and borrowings from Banks ₹ 50 crores. Audit team is determining that the accounting policies and methods of recording debt are appropriate and applied consistently and also verifying loan balances with reference to sanction letter/ loan agreement. By doing above, audit team is trying to satisfy about:
- (a) Completeness.
 - (b) Existence.
 - (c) Valuation.
 - (d) Disclosure.

PART II – Descriptive Questions

Chapter 1 - Nature, Objective and Scope of Audit

9. Micky & Associates, Chartered Accountants, were appointed as the auditors of STI Ltd., a Textile manufacturing company, for the financial year 2024-25. Management of the company discussed with the newly appointed auditors that the company has been suffering losses for the last few years and also the Directors are suspecting that accounts are not properly maintained and might contain errors and frauds. So, in the given situation, management of the company requested the auditors to

give complete assurance/guarantee about the financial statements of the company.

Can the auditors give complete assurance/guarantee in the above situation? Discuss with reference to objectives of Audit.

Chapter 2 - Audit Strategy, Audit Planning and Audit Programme

10. MICA Associates., Chartered Accountants, are appointed as statutory auditors of B Ltd. for the first time in F.Y. 2024-25. Before commencing the audit, the engagement partner considers the integrity of Directors, evaluates compliance with ethical requirements including independence, sends an engagement letter to avoid misunderstanding.

Explain the above stage of the audit planning process as considered by the engagement partner.

Chapter 3 - Risk Assessment and Internal Control

11. SPOM & Co. is a firm of Chartered Accountants established in 2010 with major focus on Audit Practice. In F.Y. 2024-25, firm has four partners and 15 articled assistants handling various Internal audit and Statutory Audit assignments. Partners and articled assistants meet monthly to discuss various aspects of practical as well as academic issues. While discussing about various aspects of Audit Risk, Risk of material misstatement etc., Partner S asks one of the articled assistants to explain the concept of misstatement with the help of at least five examples.

Chapter 4 - Audit Evidence

12. With respect to SA 505, "External Confirmations", name the appropriate term that may be used in relation to the below statements:
- (a) Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.
 - (b) A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or disagrees with the information in the request, or providing the requested information.

- (c) A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.
 - (d) A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.
 - (e) A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.
13. SIME & Co., Chartered Accountants, have been appointed as statutory auditors of Delight & Delight, a Partnership firm, for the first time for F.Y. 2024-25. The previous year's financial statements were not subject to audit. During the audit, the new auditors noticed differences in some opening balances brought forward from previous year. With respect to relevant SA, explain the objective of Auditor with respect to opening balances.

Chapter 5 - Audit of Items of Financial Statements

14. In the Balance Sheet of Watches Ltd., additions worth ₹ 20 Crores are appearing under Property, Plant & Equipment. Auditor of the company, in addition to the procedures undertaken for verifying completeness of additions to PPE during the period under audit, while performing testing of additions also want to verify that all PPE purchase invoices are in the name of the company. Name the relevant assertion for verification of ownership and procedure to verify the same.

Chapter 6 - Audit Documentation

15. FSY & Co., Chartered Accountants, completed the statutory audit of HIMMAT Ltd. for the year ended 31st March 2025. The audit partner instructed the audit team to finalize and assemble the audit documentation immediately after signing the auditor's report on 15th September 2025. However, audit team took this instruction lightly and forgot to assemble the audit documentation. After six months, audit team started assembling the file and completed its documentation. When audit partner became aware of this, he called a meeting of staff and discussed policies and procedures for timely completion of audit

files, changes to audit documentation and period of retention of engagement documentation.

Explain various points discussed by audit partner with reference to relevant standard on auditing.

Chapter 7 - Completion and Review

16. GEM Ltd has appointed GSP & Co., Chartered Accountants as its Statutory Auditors. While conducting its audit, the audit partner requested the management to provide a written representation that it has fulfilled its responsibility for the preparation of financial statements in accordance with the applicable financial reporting framework. The Manager (Finance) is of the view that since all records and evidence have already been given, a separate written representation is not required. Explain.

Chapter 8 - Audit Report

17. SA 701 deals with the auditor's responsibility to communicate key audit matters in the auditor's report. It is intended to address both the auditor's judgement as to what to communicate in the auditor's report and the form and content of such communication.

In the above context, explain the purpose of communicating key audit matters.

Chapter 9 - Special Features of Audit of Different Type of Entities

18. You are appointed as an auditor of Great Eastern Hotel, a Five Star hotel, for Financial Year 2024-25. As an auditor what are the special points that need to be considered in verifying the Inventories in the nature of food and beverages?

Chapter 10 - Audit of Banks

19. While verifying provisions of advances of a branch of HFC Bank as part of statutory branch audit, CA Mini notices that credit facilities consisting of term loan to JT Mills have been classified under doubtful asset (D2) category.

The outstanding balance in above term loan account as on 31.3.2025 is ₹ 150 lakhs. Value of security held in account is ₹ 100 lakhs. The branch has made provision of ₹ 75 lakhs. Is provision made by branch proper? Discuss.

Chapter 11 - Ethics and Terms of Audit Engagements

20. CA Jatin is auditor of XYZ Pharma, his brother-in-law's Partnership Firm. His family relationship creates a conflict of interest that could unduly influence his professional judgment, making it difficult for him to provide an unbiased opinion on the firm's financial statements.

In another assignment of Tax Audit of a company, CA Jatin is also required to prepare the company's tax return. He fails to check the latest provision of the Income-tax Act which allows for a major new deduction resulting in the client overpaying income tax.

CA Jatin is also preparing GST returns of one of his clients. The client instructs him to intentionally understate the sales figures to reduce the tax liability.

Identify and explain the fundamental principles of professional ethics involved in above situations.

**SUGGESTED ANSWERS****PART – I: Answers to Multiple Choice Questions**

MCQ No.	Answer
1.	(d)
2.	(b)
3.	(c)
4.	(d)
5.	(d)
6.	(b)
7.	(d)
8.	(c)

PART – II: Answers to Descriptive Questions

9. As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", auditor's objective is to obtain a reasonable assurance whether financial statements as a whole are free from material misstatement whether due to fraud or error.

- (i) Reasonable assurance is to be distinguished from absolute assurance. 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.

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 reasonable assurance but it is not absolute assurance.

- (ii) 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. He has to see effect of misstatements on financial statements as a whole, in totality.
- (iii) Obtaining reasonable assurance that financial statements as a whole are free from material misstatements enables 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.
- (iv) The opinion is reported and communicated in accordance with audit findings through a written report as required by Standards on Auditing.

Thus, it can be concluded that auditors can provide reasonable assurance instead of absolute assurance.

10. Preliminary engagement activities

The auditor considers whether relationship with client should be continued and whether ethical requirements including independence continue to be complied with. It includes:

- (A) Performing procedures regarding the continuance of the client relationship. It should be ensured that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed and that conclusions reached in this regard are appropriate.

The firm should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.

Matters such as integrity of principal owners and key management, competence of engagement team to perform the audit engagement and implications of matters that have arisen during current and previous audit engagement may need to be considered.

Besides, in case of initial engagements, communication with predecessor auditor should be made, where there has been a change of auditors.

- (B) Evaluating compliance with ethical requirements, including independence. The auditor shall continuously evaluate compliance with ethical requirements including independence. "Independence" means that the judgement of a person is not subordinate to the wishes or direction of another person who might have engaged him.

Throughout the audit engagement, the engagement partner shall remain alert, through observation and making inquiries as necessary, for evidence of non-compliance with relevant ethical requirements by members of the engagement team.

- (C) Establishing an understanding of terms of engagement. It is in the interests of both the entity and the auditor that the auditor sends

an audit engagement letter before the commencement of the audit to help avoid misunderstandings with respect to the audit. It ensures that there is no confusion with the client regarding terms of the engagement.

- 11.** Misstatement refers to difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.

Few examples of misstatements are:

- i. Charging an item of capital expenditure to revenue or vice versa.
- ii. Difference in disclosure of a financial statement item vis-vis its requirement in applicable financial reporting framework.
- iii. Selection or application of inappropriate accounting policies.
- iv. Difference in accounting estimate of a financial statement item vis-a-vis its appropriateness in applicable financial reporting framework.
- v. Intentional booking of fake expenses in statement of profit and loss.
- vi. Overstating receivables in financial statements by not writing off irrecoverable debts.
- vii. Overstating or understating inventories.

12.

(a)	Audit evidence obtained as a direct written response to the auditor from a third party (the confirming party), in paper form, or by electronic or other medium.	External Confirmation.
(b)	A request that the confirming party respond directly to the auditor indicating whether the confirming party agrees or	Positive Confirmation request.

	disagrees with the information in the request, or providing the requested information.	
(c)	A request that the confirming party respond directly to the auditor only if the confirming party disagrees with the information provided in the request.	Negative confirmation request.
(d)	A failure of the confirming party to respond, or fully respond, to a positive confirmation request, or a confirmation request returned undelivered.	Non-response.
(e)	A response that indicates a difference between information requested to be confirmed, or contained in the entity's records, and information provided by the confirming party.	Exception.

- 13.** As per SA 510, "Initial Audit Engagements – Opening Balances", in conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether:
- (a) Opening balances contain misstatements that materially affect the current period's financial statements; and
 - (b) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.
- 14.** Relevant assertion for verification of ownership of PPE in the given situation is Rights and Obligation.

Procedure to verify the ownership rights over PPE is as under:

- i. The auditor while performing testing of additions should also verify that all PPE purchase invoices are in the name of the entity that entitles legal title of ownership to the respective entity.
 - ii. For all additions to land and building in particular, the auditor should check the conveyance deed/ sale deed to verify whether the entity is the legal and valid owner or not.
 - iii. The auditor should insist and verify the original title deeds for all immovable properties held as at the balance sheet date.
 - iv. In case the entity has given such immovable property as security for any borrowings and the original title deeds are not available with the entity, the auditor should request the entity's management for obtaining a confirmation from the respective lenders that they are holding the original title deeds of immovable property as security.
 - v. In addition, the auditor should also verify the register of charges, available with the entity to assess that any charge has been created against the PPE.
- 15.** As per SA 230, "Audit Documentation", the auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

SQC 1, "Quality Control for Firms that perform Audits and Review of Historical Financial Information, and other Assurance and related services", requires firms to establish policies and procedures for the timely completion of the assembly of audit files.

An appropriate time limit within which to complete the assembly of the final audit file is ordinarily not more than 60 days after the date of the auditor's report. The completion of the assembly of the final audit file after the date of the auditor's report is an administrative process that does not involve the performance of new audit procedures or the drawing of new conclusions.

Changes may, however, be made to the audit documentation during the final assembly process, if they are administrative in nature.

Examples of such changes include:

- ✓ Deleting or discarding superseded documentation.
- ✓ Sorting, collating and cross-referencing working papers.
- ✓ Signing off on completion checklists relating to the file assembly process.
- ✓ Documenting audit evidence that the auditor has obtained, discussed and agreed with the relevant members of the engagement team before the date of the auditor's report.

After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.

SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report.

- 16.** In the given case, GSP & Co., auditor of GEM Ltd. requested the management to provide written representation that it has fulfilled its responsibility for the preparation of financial statements in accordance with the applicable financial reporting framework. The Manager (Finance) is of the view that since all records and evidence have already been given, a separate written representation is not required. View of Manager (Finance) is not correct because written representations about management responsibilities are necessary due to the following reasons:

Audit evidence obtained during the audit that management has fulfilled its responsibilities regarding preparation of financial statements and about information provided and completeness of transactions is not sufficient without obtaining confirmation from management that it believes that it has fulfilled those responsibilities. This is because the auditor is not able to judge solely on other audit evidence whether management has prepared and presented the financial statements and

provided information to the auditor on the basis of the agreed acknowledgement and understanding of its responsibilities.

For example, the auditor could not conclude that management has provided the auditor with all relevant information agreed in terms of the audit engagement without asking it whether, and receiving confirmation that, such information has been provided.

The written representations requiring fulfilment of management responsibilities in relation to above draw on the agreed acknowledgement and understanding of management of its responsibilities in the terms of the audit engagement by requesting confirmation that it has fulfilled them. The auditor may also ask management to reconfirm its acknowledgement and understanding of those responsibilities in written representations.

This is particularly appropriate when: -

- Those who signed the terms of the audit engagement on behalf of the entity no longer have the relevant responsibilities;
- The terms of the audit engagement were prepared in a previous year;
- There is any indication that management misunderstands those responsibilities; or
- Changes in circumstances make it appropriate to do so.

- 17. Purpose of Communicating Key Audit Matters:** As per SA 701, "Communicating Key Audit Matters in the Auditor's Report", the purpose of communicating key audit matters is to enhance the communicative value of the auditor's report by providing greater transparency about the audit that was performed. Communicating key audit matters provides additional information to intended users of the financial statements to assist them in understanding those matters that, in the auditor's professional judgement, were of most significance in the audit of the financial statements of the current period. Communicating key audit matters may also assist intended users in understanding the entity and

areas of significant management judgement in the audited financial statements.

18. Verification of inventories in the nature of food and beverages:

The inventories in any hotel are both readily portable and saleable particularly the food and beverage inventories. It is therefore extremely important that all movements and transfers of such inventories should be properly documented to enable control to be exercised over each individual stores' areas and sales point. The auditor should carry out tests to ensure that all such documentation is accurately processed. Therefore, following points may be noted in this regard:

- (a) Areas where inventories are kept must be kept locked and the key retained by the departmental manager.
- (b) The key should be released only to trusted personnel and unauthorized persons should not be permitted in the stores area.
- (c) Many hotels use specialized professional valuers to count and value the inventories on a continuous basis throughout the year.
- (d) The auditor should ensure that all inventories are valued at the year end and that he should himself be present at the year-end physical verification, to the extent practicable, having regard to materiality consideration and nature and location of inventories

19. The provision for advances falling in D2 category is required @ 40% of secured portion and 100% of unsecured portion.

Therefore, provision in above case is arrived as under: -

Outstanding balance as on 31.3.25	150 lakhs
Less: Value of security	<u>100 lakhs</u>
Unsecured portion	<u>50 lakhs</u>

Therefore, outstanding balance of ₹ 150 lakhs is secured to the extent of ₹ 100 lakhs and balance ₹ 50 lakhs is unsecured.

Provision calculation	₹
40% of secured part i.e., 40% of ₹ 100 lakhs	40 lakhs
100% of unsecured part i.e., 100% of ₹ 50 lakhs	<u>50 lakhs</u>
Required provision	<u>90 lakhs</u>

In view of above, provision made by branch is not proper. It should have made provision of ₹ 90 lakhs instead of ₹ 75 lakhs.

20. (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 understate 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.