Skillshort

Self-Study Preparation Pack

CA INTERMEDIATE

Paper 5: Auditing and Ethics

Mock Test 2 – Full Paper with Model Answers

ICAI new-scheme pattern: 100 marks · 3 hours · Part I 15 MCQs × 2 marks · Part II Q1 compulsory + any 4 of Q2–Q6 (14 marks each) · Original Skillshort questions

Time: 3 hours | Max marks: 100 | No negative marking | Model answers in ICAI style | Answers follow the paper

Contents

Part I – Multiple Choice Questions (30 marks) 2

Part II – Descriptive Questions (70 marks) 5

Model Answers – Part II 6

This subject pack has 6 parts

1 Chapter-wise notes

2 Important topics & weightage

3 Past papers: trends & links

4 Mock tests + solutions

5 Chapter practice questions

6 Last-week plan & strategy

Prepared by Skillshort for self-study. Original explanations and questions; not an official ICAI/ICMAI/ICSI publication. Items marked VERIFY should be checked against the latest official material.

Part I – Multiple Choice Questions (30 marks)

Instructions: Each MCQ carries 2 marks. Choose the most appropriate option.

CASE LAW Case Scenario I – Vayu Motors Ltd. (MCQs 1–5)

RK & Associates are auditing Vayu Motors Ltd., an electric-scooter maker, for 2025-26. The company made a **loss** this year after two profitable years. Revenue is ₹600 crore. During planning, the engagement partner CA Rekha discussed the timing of the inventory count with the CFO. Midway through the audit, the team found that a new **ERP system** had been implemented in October 2025 without parallel run. The team also noticed that the warranty provision depends on estimates with high uncertainty. Management requested that the auditors **share the detailed audit programme** in advance "to help staff prepare".

1. The most appropriate benchmark for overall materiality this year is

(a) Profit before tax
(b) Total revenue or total expenses
(c) Share capital
(d) Number of employees

2. Discussing the timing of the inventory count with the CFO is

(a) Prohibited, as it compromises independence
(b) Permitted – elements of planning may be discussed with management, but the strategy and plan remain the auditor's responsibility
(c) Permitted only with the Audit Committee's approval
(d) Required by SA 210

3. On discovering the unplanned ERP implementation midway, the auditor should

(a) Continue with the original plan
(b) Update and change the overall audit strategy and audit plan, and document the changes and reasons
(c) Withdraw from the engagement
(d) Issue a disclaimer

4. The warranty provision, with high estimation uncertainty, is most likely to be

(a) A clearly trivial matter
(b) A significant risk and potentially a key audit matter if the company is listed
(c) An Other Matter paragraph
(d) Outside the scope of the audit

5. Sharing the detailed audit programme with management

(a) Is required by SA 230
(b) Should be avoided, as it may make audit procedures predictable and compromise the effectiveness of the audit
(c) Is mandatory under the engagement letter
(d) Has no effect

CASE LAW Case Scenario II – Seva Jyoti Trust (MCQs 6–10)

Seva Jyoti Trust, a registered charitable trust, runs a hospital and a school. It receives donations in India, a grant from a German foundation, school fees, and an annual Government grant for free treatment of poor patients. CA Varun is its auditor. He observed: (i) the foreign grant was received in the trust's **general savings account**; (ii) school fee concessions were given without the trustees' approval; (iii) ₹40 lakh of the Government grant was spent on a new administrative car for the chairman; (iv) the trust's accountant is CA Varun's cousin.

6. Under the FCRA, 2010, foreign contributions must be received in

(a) Any bank account of the trust
(b) The designated **FCRA account** at the specified branch of SBI, New Delhi
(c) A cash account
(d) An account of a trustee

7. For fee concessions given without approval, the auditor should

(a) Ignore them as immaterial
(b) Verify the authority for concessions and report unauthorised concessions to the trustees
(c) Recompute fees at full rates and adjust the accounts himself
(d) Treat them as donations

8. Spending the Government grant on the chairman's car mainly violates

(a) Audit against provision of funds
(b) The conditions of the grant and the canons of financial propriety
(c) SA 230
(d) AS 2

9. CA Varun's cousin being the trust's accountant creates a

(a) Advocacy threat
(b) Familiarity threat
(c) Self-review threat
(d) No threat

10. The first step in auditing receipts of an NPO is to

(a) Send confirmations to all donors
(b) Study the trust deed/constitution and rules to understand objects and authorised sources of income
(c) Prepare the trust's accounts
(d) Count the cash

11. Under SA 610, which work of internal auditors can be used for direct assistance?

(a) Evaluating significant accounting estimates
(b) Routine procedures like tracing invoices to despatch documents in a low-risk area
(c) Work they performed themselves earlier in the year
(d) Deciding the materiality level

12. Written representations under SA 580 should be dated

(a) The balance sheet date
(b) As near as practicable to, but not after, the date of the auditor's report
(c) Any date after the report
(d) The date of the AGM

13. An LLP must get its accounts audited if, in the year,

(a) Its turnover exceeds ₹40 lakh or its contribution exceeds ₹25 lakh
(b) It has more than two partners
(c) Its turnover exceeds ₹1 crore
(d) It has a designated partner who is a CA

14. Fraud of ₹1.5 crore by employees is detected by the statutory auditor of a company. He must

(a) Report it to the Audit Committee only
(b) Forward his report to the Board/Audit Committee within 2 days, then report to the Central Government within 15 days of receiving the reply or after 45 days without a reply
(c) Report it to the police
(d) Mention it only in CARO

15. A related-party transaction in which a director lets the company use his building **free of rent** is

(a) Not a related-party transaction, as no consideration is paid
(b) A related-party transaction to be identified and disclosed
(c) Outside the scope of SA 550
(d) A KAM in all cases

Part I – Answer key with reasons

Q	Ans	Explanation / working
1	(b)	When the entity has a **loss** or volatile profit, profit before tax is not a stable benchmark, so total revenue or total expenses is more appropriate (SA 320).
2	(b)	SA 300 A3 allows the auditor to discuss elements of planning with management to coordinate the audit. The overall audit strategy and audit plan remain the **auditor's responsibility**.
3	(b)	SA 300 para 10 – the strategy and plan are updated as necessary during the audit, and significant changes and their reasons are documented (SA 300 para 12).
4	(b)	Estimates with high estimation uncertainty receive significant auditor attention. Such risks are typical KAM candidates under SA 701 for listed entities.
5	(b)	SA 300 A3 cautions that discussions with management should not compromise effectiveness. Detailed procedures should remain **unpredictable**.
6	(b)	Foreign contribution must be received only in the designated "FCRA account" opened at the **SBI New Delhi Main Branch**. Receiving it in the general account is a violation that must be reported.
7	(b)	Concessions and scholarships must be authorised by the competent authority. Unauthorised concessions are reported to the management/trustees.
8	(b)	Grants must be used for the purpose specified in their conditions (free treatment of patients), and using them for personal benefit violates financial propriety. The utilisation certificate would be misleading.
9	(b)	A close relationship with a person in a position to influence the accounts creates a **familiarity threat**. Safeguards include EQCR, and declining the engagement if the threat cannot be reduced.
10	(b)	The constitution (trust deed or bye-laws) defines the objects, powers and authorised receipts and expenditure – the starting point of an NPO audit.
11	(b)	Direct assistance is not used for procedures involving **significant judgements**, higher assessed RMM, or work the internal auditors were involved in. Routine low-risk procedures are acceptable.
12	(b)	SA 580 para 14.
13	(a)	Rule 24(8) of the LLP Rules, 2009 – audit is exempt only if turnover does not exceed ₹40 lakh **and** contribution does not exceed ₹25 lakh.
14	(b)	s. 143(12) read with Rule 13 – fraud of **₹1 crore or more** is reported to the Central Government in Form ADT-4.
15	(b)	Related-party transactions include transfers of resources, services or obligations **regardless of whether a price is charged** (AS 18). SA 550 requires the auditor to identify and evaluate them.

Part II – Descriptive Questions (70 marks)

Question 1 is compulsory. Answer any four of the remaining five questions.

Q1 (a) (5 marks). As engagement partner, list the factors you would consider in establishing the overall audit strategy for a first-year audit of a multi-location company.

Q1 (b) (5 marks). Distinguish between tests of controls and substantive procedures. When must substantive procedures be performed regardless of the assessed risk?

Q1 (c) (4 marks). Explain the objective and procedures for subsequent events between the date of the FS and the date of the auditor's report.

Q2 (a) (5 marks). Kirti Pharma Ltd. faces several product liability suits. State the procedures the auditor should perform under SA 501 to identify litigation and claims, and the consequence if management refuses to allow communication with external legal counsel.

Q2 (b) (5 marks). Two months after issuing the audited FS of Ruby Ltd., the auditor learns that sales of ₹15 crore (material) recorded in March were fictitious. Explain the auditor's responsibility under SA 560.

Q2 (c) (4 marks). The FS of Sun Ltd. include corresponding figures audited by a predecessor auditor who gave a qualified opinion. What may the current auditor state, and where?

Q3 (a) (5 marks). State the audit procedures for verification of additions to property, plant and equipment.

Q3 (b) (5 marks). Describe the audit procedures for verifying the **existence** and **completeness** of borrowings.

Q3 (c) (4 marks). State the Schedule III disclosure for shareholding of promoters and for trade payables.

Q4 (a) (5 marks). Explain "deficiency in internal control" and "significant deficiency", and list indicators of significant deficiencies.

Q4 (b) (5 marks). Explain general IT controls and application controls with examples, and the auditor's approach to testing them in an automated environment.

Q4 (c) (4 marks). When are substantive analytical procedures suitable? What factors determine the reliability of data used?

Q5 (a) (5 marks). Explain take-out finance, its objectives, and how the lending bank recognises income in such accounts.

Q5 (b) (5 marks). State the special points to be covered in the audit of a co-operative society.

Q5 (c) (4 marks). State the audit procedures for a club.

Q6 (a) (5 marks). After significant work and finding inventory irregularities, the management of Delta Pvt. Ltd. asks the auditor to convert the statutory audit into a review engagement to "save cost". Advise.

Q6 (b) (5 marks). List the matters an audit firm considers about the integrity of a prospective client under SQC 1.

Q6 (c) (4 marks). Identify the fundamental principle breached: (i) a team member signs off a procedure he did not perform; (ii) a manager shares the client's unpublished results with a friend; (iii) a junior without IT knowledge is assigned to test ERP controls; (iv) a senior agrees to a doubtful treatment under pressure from the CFO.

OR

Q6 (c) (4 marks). Explain the requirement to communicate with the previous auditor before accepting an audit, and its purpose.

Model Answers – Part II

SOLUTION Q1 (a) Overall audit strategy – SA 300

The auditor establishes the overall audit strategy by considering: (1) **characteristics of the engagement** – financial reporting framework, industry-specific reporting, expected audit coverage including the number and **locations of components**, need for branch or component auditors, use of experts, availability of internal audit work, use of service organisations; (2) **reporting objectives** – deadlines for interim and final reporting, key dates for communications with management and TCWG, expected type and timing of reports; (3) **factors significant in directing the team's efforts** – materiality, preliminary identification of high-risk areas, significant changes in the business or framework, evidence of management's commitment to internal control, volume of transactions; (4) results of **preliminary engagement activities** and knowledge from other engagements; (5) **nature, timing and extent of resources** – who, how many, when (interim and final visits), budgets, briefings, review. In a **first-year audit**, the auditor also plans for communicating with the **predecessor auditor**, reviewing working papers, and obtaining evidence on **opening balances** (SA 510).

SOLUTION Q1 (b) Tests of controls vs substantive procedures – SA 330

Basis	Tests of controls	Substantive procedures
Purpose	Evaluate the **operating effectiveness** of controls in preventing, or detecting and correcting, material misstatements	Detect **material misstatements** at assertion level
When	When the auditor intends to rely on controls, or when substantive procedures alone cannot give sufficient evidence	Always, for each material class/balance/disclosure
Methods	Inquiry with observation, inspection, re-performance	Tests of details; substantive analytical procedures
Result	Deviations from the prescribed control	Monetary misstatements

Mandatory substantive procedures: irrespective of assessed RMM, the auditor designs and performs substantive procedures for **each material class of transactions, account balance and disclosure**; agrees the FS with the underlying records and examines material **journal entries and adjustments** made in preparing the FS; and, for **significant risks**, performs substantive procedures specifically responsive to them (tests of details if only substantive procedures are used).

SOLUTION Q1 (c) Subsequent events up to the report date – SA 560

Objective: to obtain sufficient appropriate evidence about whether events between the date of the FS and the date of the auditor's report that require adjustment or disclosure are appropriately reflected.

Procedures (covering the period up to the report date): (1) obtain an understanding of **management's procedures** for identifying subsequent events; (2) **inquire** of management and TCWG about events affecting the FS (new commitments, borrowings, sale or acquisition of assets, litigation, unusual adjustments, going-concern issues); (3) read **minutes** of meetings of owners, management and TCWG held after year-end; (4) read the latest **interim financial statements**; (5) obtain a **written representation** (SA 580) that all such events have been adjusted or disclosed.

SOLUTION Q2 (a) Litigation and claims – SA 501

Procedures: (1) inquire of **management** and, where applicable, **in-house legal counsel**; (2) review **minutes** of meetings of TCWG and correspondence between the entity and its external legal counsel; (3) review **legal expense** accounts and invoices from lawyers; (4) where there is a risk of material misstatement (as here), seek **direct communication with the entity's external legal counsel** through a **letter of general inquiry** prepared by management and sent by the auditor, requesting the lawyer to communicate directly with the auditor; a meeting may also be held with management present.

Refusal: if management **refuses** to give permission to communicate or meet with external legal counsel, or the counsel refuses to respond appropriately, and the auditor cannot obtain sufficient appropriate evidence by alternative procedures, the auditor **modifies the opinion** in accordance with SA 705. Written representations are also obtained that all known actual or possible litigation and claims have been disclosed and accounted for.

SOLUTION Q2 (b) Fact discovered after FS issued – SA 560

Provision: after the FS are issued, the auditor has no obligation to perform procedures, but if a fact becomes known that, had it been known at the report date, might have caused the report to be amended, the auditor shall (i) **discuss** it with management and TCWG; (ii) determine whether the FS need **amendment**; and (iii) if so, inquire how management intends to address it.

If management amends the FS: the auditor performs the necessary audit procedures on the amendment; reviews the **steps taken by management to ensure that anyone in receipt of the previously issued FS and report is informed**; extends subsequent-event procedures up to the new report date; and issues a **new auditor's report** with an **Emphasis of Matter or Other Matter paragraph** referring to a note that more fully discusses the reason for the amendment and to the earlier report.

If management does not take the necessary steps: the auditor notifies management and TCWG that he will **seek to prevent future reliance** on the report, and takes appropriate action, which may include legal advice. Fictitious sales may also be a fraud to be reported u/s 143(12).

SOLUTION Q2 (c) Predecessor auditor – SA 710

If the prior-period FS were audited by a predecessor auditor and law does not prohibit it, the current auditor may refer to the predecessor's report on the corresponding figures. In that case, he states in an **Other Matter paragraph**: (i) that the FS of the prior period were **audited by the predecessor auditor**; (ii) the **type of opinion** expressed by the predecessor auditor (here, qualified) and the **reasons** for the modification; and (iii) the **date** of that report. If the matter giving rise to the qualification is unresolved and affects the current period figures, the current opinion is also modified (SA 710 para 11).

SOLUTION Q3 (a) Additions to PPE

(1) Obtain the schedule of additions and agree it with the **fixed asset register** and general ledger. (2) Vouch with **suppliers' invoices**, purchase orders, capital expenditure **sanctions/Board approval**, and contracts. (3) Verify that **cost** includes only directly attributable costs – purchase price (net of trade discounts, plus non-refundable duties), site preparation, delivery, installation, testing, professional fees, borrowing costs for qualifying assets (AS 16) – and excludes administration overheads, training and abnormal costs. (4) Check **capital vs revenue** classification of repairs and spare parts. (5) **Physically inspect** major additions and verify that they are in use – date put to use for depreciation. (6) Examine **title deeds** for immovable property and registration for vehicles (CARO 3(i)(c)). (7) Check **capital work-in-progress** transfers and ageing (Schedule III). (8) Verify **GST input credit** treatment and charges created on new assets.

SOLUTION Q3 (b) Borrowings – existence and completeness

Existence: (1) obtain a schedule of borrowings and agree it with the ledger; (2) examine **loan agreements**, sanction letters and **Board/shareholder resolutions** (s. 179/180 limits); (3) obtain **confirmations** from lenders; (4) trace **fresh borrowings** and **repayments** to bank statements; (5) verify **charges** created, modified or satisfied and their registration with the ROC; (6) check compliance with **covenants** and any defaults (CARO 3(ix)).

Completeness: (1) review **minutes** for borrowings approved; (2) examine bank confirmations for all facilities including non-funded facilities; (3) review **interest expense** for unrecorded loans (analytical test of interest vs average borrowings); (4) review charges registered with the ROC (MCA portal) for loans not recorded; (5) check classification between long-term and short-term, and current maturities. Then verify **Schedule III** disclosure – security, terms of repayment, defaults, and charges not registered within the statutory period.

SOLUTION Q3 (c) Schedule III disclosures

Shareholding of promoters: shares held by promoters at the end of the year – promoter name, **number of shares**, **% of total shares**, and **% change during the year**.

Trade payables: ageing schedule – outstanding for less than 1 year, 1–2 years, 2–3 years, more than 3 years – separately for **MSME** and others, and disputed dues (MSME and others); **unbilled** and **not due** amounts also shown. Dues to micro and small enterprises are also disclosed with interest as per the MSMED Act, 2006.

SOLUTION Q4 (a) Deficiencies in internal control – SA 265

Deficiency: exists when (i) a control is designed, implemented or operated in such a way that it is **unable to prevent, or detect and correct, misstatements** on a timely basis; or (ii) a control necessary to do so is **missing**.

Significant deficiency: a deficiency or combination of deficiencies that, in the auditor's **professional judgement**, is of sufficient importance to merit the attention of **those charged with governance**.

Indicators: evidence of an ineffective **control environment** – e.g. fraud of any magnitude involving senior management; management's failure to implement remedial action on previously communicated significant deficiencies; the absence of a **risk assessment process** where one would be expected; evidence of an ineffective response to identified significant risks; **misstatements detected by the auditor** that the entity's controls did not prevent, or detect and correct; **restatement** of previously issued FS to correct a material misstatement; evidence of management's inability to oversee the preparation of the FS.

Significant deficiencies are communicated **in writing** to TCWG on a timely basis.

SOLUTION Q4 (b) IT controls

General IT controls (ITGCs) – policies supporting the effective functioning of applications: **access security** (user IDs, passwords, privileged access), **program change management** (testing and approval of changes), **data centre and network operations** (back-ups, job scheduling), **system development/acquisition**.

Application controls – automated or manual controls over input, processing and output within an application: edit and validation checks, **three-way match** of PO-GRN-invoice, sequence checks, credit-limit checks, automated calculations (depreciation, interest), exception reports.

Approach: understand the IT environment and document the flow of transactions; identify relevant applications and **key reports**; test **ITGCs** first, because effective ITGCs allow reliance on automated controls (a test of one instance may suffice – "test of one"); test application controls; use **data analytics** (full-population testing of journals, duplicates, gaps); evaluate deficiencies, compensating controls and the impact on substantive procedures.

SOLUTION Q4 (c) Substantive analytical procedures – SA 520

Suitability: they are generally more applicable to **large volumes of transactions** that tend to be **predictable over time** (e.g. salaries, interest, depreciation, rent), where relationships among data are plausible and stable. They are less effective for balances based on significant judgement or unusual transactions.

Reliability of data depends on: (i) the **source** of information (independent sources are more reliable); (ii) **comparability** (industry data may need adjustment); (iii) the **nature and relevance** of the information (budgets set as expectations rather than goals); and (iv) **controls** over the preparation of the information. The auditor develops a precise expectation, sets the amount of acceptable difference, and investigates significant differences.

SOLUTION Q5 (a) Take-out finance

Meaning: a financing arrangement in which an institution (the **taking-over institution**) agrees to **take over the loan** from the original lending bank after a specified period or on completion of a milestone, so the bank provides funds for long-gestation **infrastructure** projects for an initial period only.

Objectives: (i) to expand the sources of finance for infrastructure; (ii) to address **sectoral exposure** limits of banks; (iii) to address the **asset–liability mismatch** that arises when banks with short-term deposits fund long-term projects; (iv) to increase the availability of **longer-tenor** debt.

Income recognition: the lending bank applies the normal **IRAC norms** – if the account becomes an NPA before the take-over, interest is recognised only on **realisation** (not on accrual), and the asset is classified and provided for as per its own record of recovery, even if the take-out institution has agreed to take it over.

SOLUTION Q5 (b) Co-operative society audit – special points

(1) Verify compliance with the **Co-operative Societies Act** of the State (or the Multi-State Act), the Rules and the **bye-laws**. (2) Check **loans to members** – purpose, limits, security and recovery; prepare or review the **overdue** schedule with ageing. (3) Verify **share capital** – members' admission, share register and nominal membership. (4) Check the **appropriation of profits** – statutory reserve fund, dividend limits, education fund. (5) Verify investments as permitted by the Act. (6) Check **books and registers** required by the Act (members' register, loan register, share register) – if only a cash book and general ledger are kept, report this. (7) Report **irregularities**, defalcations, transactions against bye-laws, and the **audit classification** of the society. (8) Examine the working of the society – whether it meets its objects and the interest of members.

SOLUTION Q5 (c) Audit of a club

(1) Study the **rules and bye-laws**; (2) vouch **entrance fees and subscriptions** with the members' register – check arrears and that defaulting members' names are posted per the rules; (3) verify **bar and restaurant** sales, purchases and stock records – compare **gross margins** with the previous year; (4) check rent for rooms, halls and sports facilities with bookings; (5) verify **expenditure** is sanctioned by the managing committee; (6) verify fixed assets and investments; (7) check licences (liquor, entertainment) and statutory dues; (8) review committee **minutes**.

SOLUTION Q6 (a) Request to change the engagement – SA 210

Provision: an auditor shall not agree to a change in the terms of engagement where there is **no reasonable justification** for doing so. A change in circumstances affecting the need for the service, or a misunderstanding about the nature of the audit, may be reasonable. A change requested because of a **restriction on scope** – imposed by management or by circumstances – or to avoid unfavourable findings is **not** reasonable.

Facts: the request came **after** the auditor found serious inventory irregularities and asked for documents. "Cost" is not a reasonable justification. Moreover, a **statutory audit** is required by the Companies Act and cannot be converted into a review.

Conclusion: the auditor should **not agree**. If management does not permit the audit to continue, the auditor should **withdraw** where possible under law, determine whether there is an obligation to report the circumstances to TCWG, owners or regulators, and consider the s. 143(12) fraud reporting obligation if fraud is suspected.

SOLUTION Q6 (b) Client integrity – SQC 1

(1) The **identity and business reputation** of the client's principal owners, key management, related parties and TCWG; (2) the **nature of the client's operations**, including its business practices; (3) information on the attitude of the owners, management and TCWG towards matters such as **aggressive interpretation of accounting standards** and the internal control environment; (4) whether the client is aggressively concerned with **keeping the firm's fees as low as possible**; (5) indications of an **inappropriate limitation in the scope** of work; (6) indications that the client might be involved in **money laundering or other criminal activities**; (7) the **reasons for the proposed appointment** of the firm and the **non-reappointment of the previous firm**. Sources: communication with the previous auditor, inquiry of other professionals and bankers, and background searches of databases.

SOLUTION Q6 (c) Fundamental principles breached

(i) Signing off a procedure not performed – **integrity** (being associated with false information). (ii) Sharing unpublished results – **confidentiality**. (iii) Assigning an untrained junior – **professional competence and due care**. (iv) Giving in to the CFO's pressure – **objectivity** (undue influence; also an intimidation threat).

SOLUTION Q6 (c) OR Communication with the previous auditor

Requirement: Clause (8) of Part I of the First Schedule to the Chartered Accountants Act, 1949 – a member is guilty of professional misconduct if he accepts a position as auditor previously held by another chartered accountant **without first communicating with him in writing**. The communication should be by a mode that provides evidence of delivery (registered post or e-mail with acknowledgement).

Purpose: to learn whether there are any **professional or other reasons** why the appointment should not be accepted; to protect the interests of the previous auditor (ICAI's Council Guidelines bar accepting an audit where the previous auditor's **undisputed audit fees** remain unpaid, with limited exceptions VERIFY); to ensure that the change of auditors is not an attempt by the client to hide something; and to maintain professional courtesy. The incoming auditor must also verify that the appointment complies with **s. 139/140** (Clause 9).