

Mock Test Paper - Series II: April, 2024

Date of Paper: 5 April, 2024

Time of Paper: 2 P.M. to 5 P.M.

FINAL COURSE: GROUP I

PAPER-3: ADVANCED AUDITING, ASSURANCE AND PROFESSIONAL ETHICS

Time Allowed- 3 hours

Maximum Marks-100

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises Case Scenario based Multiple Choice Questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*

PART I - Case Scenario based MCQs (30 Marks)

Write the most appropriate answer to each of the following multiple-choice questions by choosing one of the four options given. All MCQs are compulsory and carries 2 Marks each.

1. An auditor was auditing the quarterly financial results prepared in accordance with Regulation 33 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015. The financial results are prepared using recognition and measurement norms of Ind AS 34 and include disclosures as prescribed by SEBI. These financial results would be hosted on the website of the entity and the stock exchange. Should the auditor include Key Audit Matters in the audit report on such financial results?
 - (a) No, SA 701 applies to audit of complete set of general-purpose financial statements of a listed entity.
 - (b) Yes, SA 701 applies to audits of any entity.
 - (c) No, SA 701 applies to review of the complete set of general-purpose financial statements of any entity.
 - (d) Yes, SA 701 applies to any audit of listed entity.
2. CA. Arvind and CA. Deepak were jointly appointed as auditors of Pullcord Ltd. to ensure efficient audit and reporting, Arvind and Deepak took the following steps:
 - i. After identification and allocation of work among themselves, the work allocation document was signed by both of them. Since in any case they were jointly responsible, they did not think it necessary to inform those charged with governance about the allocation.
 - ii. They decided to obtain a common engagement letter since their appointment was common.

- iii. Since their area of work was different, they decided to obtain a separate management representation letter so as not to mix up the matters.

Which of the above were not correct in view of SA 299?

- (a) i, ii and iii
 - (b) i and iii
 - (c) i and ii
 - (d) ii and iii
3. Mr. L, (friend of Mr. M) a CA in practice invited Mr. M to set up a 'Network Firm' along with 2 more friends. All the four auditors agreed to the same and decided to start a network firm by the name M/s LM & Co. However, one of the auditors suggested that they cannot use the term '& Co.' and it needs to be changed. But Mr. L informed that there is no such regulation regarding the firm's name. After further discussion, a suitable name, in accordance with the provisions of the Chartered Accountant Act, 1949 and Regulation was accepted by all the four partners.

Which among the name shall be suitable to the newly started 'Network Firm'?

- (a) LM and Co.
- (b) LM & Associates.
- (c) LM & Affiliates.
- (d) LM and Networks.

Case Scenario I [MCQ 4-8]

Maulik and Javeri Associates is a Firm of Chartered Accountants that provides assurance services to many companies, including listed companies. The Firm have offices across many locations in India, with subject matter experts in most of these locations. The firm has established a comprehensive quality management system covering leadership responsibilities for quality within the firm, ethical requirements, acceptance, and continuance of client relationships and specific engagements based on the SQC 1 issued by the ICAI. During the current year, the audit engagement of a listed company was picked up for an inspection by an appropriate authority. The inspection covered various aspects of the audit of financial statements and included an assessment of the firm's quality control system. The reviewer decided to discuss the following with the audit team members:

1. The reviewer enquired about the roles and responsibilities of CA Maulik. CA. Maulik explained that the engagement team is comprised of him as the engagement partner and other professionals, including the engagement in-charge. CA. Javeri was the engagement control quality reviewer. As the engagement partner, he was responsible for the direction, supervision and performance of the audit engagement in compliance with professional standards and applicable legal and regulatory requirements; and the auditor's report being

appropriate in the circumstances take responsibility for reviews being performed in accordance with the Firm's review policies and procedures. He also explained that he has already completed 7 years as an engagement partner and has decided to continue as an engagement partner for the next year as well. The Firm's policy permits that an engagement partner can continue consecutively for 15 years.

2. The reviewer enquired about the roles and responsibilities of CA. Javeri, the engagement control quality reviewer. CA. Javeri explained that the EQCR plays an important role in the quality control process of an audit and is key to safeguarding audit quality. The Firm has established a comprehensive system that prescribes the eligibility of EQCR, the need to maintain objectivity by EQCR, and considerations for carrying out effective EQC reviews. Specifically, in this engagement, CA. Javeri explained that he has rich experience in handling direct and indirect tax matters and was selected by CA. Maulik. There was no formal letter confirming his selection as EQCR. The listed company had significant GST litigations. CA. Javeri ensured that he was involved in forming the audit team's judgments relating to these litigations, including making relevant provisions. CA. Javeri confirmed that the EQC review was conducted in periodic intervals, and the engagement team had resolved all the observations raised during the EQC review.

3. The reviewer enquired about the areas that require discussion with management/ those charged with governance or areas that require significant efforts. CA. Maulik explained that during the current year, the engagement team observed material prior errors in recognition of revenue, including errors in recognition of revenue on a gross basis instead of a net basis. These errors were identified after the year end and required significant judgement and efforts by the engagement team. After many deliberations, the management agreed to correct the material prior to the period errors by restating the comparative information as per applicable GAAP. Relevant internal controls were accordingly modified after the year end. Considering the complexities involved, the measurement of revenue was identified as a key audit matter.

4. The reviewer enquired about the rational for material difference between the amount of revenue stated in the financial statements and the corresponding amount in the Board report included as a part of the Annual Report. CA. Maulik explained that auditors are required to comment on the true and fair view of the financial statements and are not required to comment on the Annual Report. He also explained that the Board Report was not provided to the auditor till the date of the audit report. Accordingly, after considering the requirements of SA 720, a specific statement was made in the audit report regarding the non-availability of the Board Report and that the auditor is not responsible to consider the Board Report which is expected to be received the date of the audit report. Thus, any discrepancy between the Board Report and the audited financial statements does not require any consideration. However, as good governance, CA. Maulik has obtained a reconciliation of the amount of revenue between the Board Report and the financial statements.

Based on the abovementioned facts, you are required to answer the following MCQs

4. Whether the selection of EQCR is as per the requirements of SQC 1?
 - (a) No. EQCR's objectivity was not maintained since it was selected by the engagement partner, and no formal communication was made regarding such selection.
 - (b) Yes. CA. Javeri is a perfect match for the engagement team, as his experience as a tax professional is directly relevant to the company's tax litigations.
 - (c) No. The EQCR's objectivity could not be maintained since it was selected by the engagement partner and made decisions for the engagement team.
 - (d) Yes. CA. Javeri is a perfect match for the engagement team, as his experience as a tax professional is directly relevant to tax litigation. The EQC review was conducted in a timely manner before the issuance of the audit report.
5. In the given situation, which threat will be created if CA. Maulik serves for the assurance engagement over a long period of time?
 - (a) Self-interest threat.
 - (b) Self-review threat.
 - (c) Familiarity threat
 - (d) Intimidation threat
6. Can CA. Maulik serve another year as the engagement partner?
 - (a) Yes. Companies Act, 2013 do not provide for mandatory rotation of engagement partner.
 - (b) No. SEBI Listing Regulation require mandatory rotation of engagement partner after completion of 5 years each.
 - (c) Yes. Since permitted as per Firm policies.
 - (d) No. Existing engagement partner of a listed company cannot serve as engagement partner beyond 7 years.
7. The reviewer is of the view that the audit opinion on internal controls under section 143(3)(i) of the Companies Act 2013 should have been modified as material weakness existed in the comparative information. Do you agree with the reviewer?
 - (a) Yes. Restatement of comparative information due to error is a strong indicator of material weakness in internal controls. Also, relevant internal controls were not corrected by the end of the year.
 - (b) No. All prior-period errors were corrected as per applicable GAAP by restating the comparative information.

- (c) No. Judgemental matters, where divergent views are possible, are not indicative of material weakness.
 - (d) No. Internal controls were corrected by the date of the audit report.
8. Whether CA. Maulik should consider the Board Report or not as the audit report was already issued:
- (a) The Board Report should not be considered as auditors don't have any obligation to consider Other Information obtained after such date.
 - (b) The Board Report should be considered since auditors' responsibility in relation to Other Information is uniform irrespective of the point of their availability.
 - (c) The Board Report should be considered since subsequent events are required to be assessed.
 - (d) The Board Report should not be considered to align with the audit report, which specifically excludes Other Information obtained after the date of the audit report.

Case Scenario II [MCQ 9-11]

Meera Films Ltd. is a distributor of movies in the state of West Bengal. The Company has a significant interest in other operating segments and operates through multiple subsidiaries. At the consolidated level, major operating segments comprise of movie distribution, selling tea from self-owned tea gardens at Darjeeling, real estate development for commercial purposes and investment in start-up entities. The Group was founded jointly by Mr. Madan Mohan (the Group Managing Director) and Mr. Kishore Kumar, an old confidant of Mr. Madan Mohan.

Unfortunately, Mr. Madan Paul met with an accident and expired. His untimely death rattled the entire Group and disrupted the business operations of the Group. The Board of the Parent Company decided to induct his son – Mr. Manish Paul – as the Managing Director of the Parent Company and the Group. The appointment of Mr. Manish Paul enraged Mr. Kishore Kumar, and he filed an application of oppression of mismanagement with the National Company Law Tribunal alleging various wrongdoings, including inappropriate related party transactions, siphoning off funds through connected entities and manipulation of financial statements. Considering the gravity of the allegations, the existing auditor of the Parent Company tendered its resignation. The Board appointed Mukesh and Rafi LLP as the new auditors. Mukesh and Rafi LLP informed the previous auditor over the phone and accepted the appointment.

After 5 months, Mukesh and Rafi LLP sent an email to the previous auditor as a professional courtesy stating that the appointment was for the auditor. The previous auditor replied by stating 'Received'.

To deal with these allegations, the Board of the Parent Company initiated a forensic investigation covering all the major operating segments through an independent professional services firm. The conclusion of the investigation significantly delayed the submission of financial statements for the current year of

the Parent Company. The outcome of the forensic investigation included the following:

1. SaltLake Ltd.—a subsidiary—is the real estate arm of the Group and has significant receivables from various Partnership Firms/ LLPs. The investigation revealed that these advances, which have been outstanding for more than a decade, were given for the purchase of land. Further, the identity of these entities could not be traced as no PAN/ GST details were available with the subsidiary company. Any attempt to contact these entities proved futile.

It was also noted that the auditors of SaltLake Ltd. had already completed the audit under the Companies Act 2013. Hemant and Manna LLP - the auditor of SaltLake Ltd. – informed the investigator that, in their view, the allegations do not affect the financial statements of SaltLake Ltd. and accordingly have issued an unmodified audit opinion on the financial statements of the current year. The financial statements and the audit report were adopted by the shareholders in the AGM.

2. Meera Films Ltd. - the parent company historically purchases music rights from Gaana Ltd., which is approximately INR 20 crores per annum. Gaana Ltd. is controlled by Mr. Kishore Kumar. At the beginning of the current year, an advance of INR 50 crores was given to Gaana Ltd. for the purchase of music rights. Any amount remaining unadjusted would be repaid over a period of 5 years. The advance amount is highly disproportionate to the expected purchase amount to be made, and the credit period is not in line with normal credit terms. The investigation revealed that the advance was given to provide financial support to Gaana Ltd. as it was undergoing financial distress. At the end of the year, INR 30 crores remained unadjusted. No interest was charged on the unadjusted amount.

3. Darjeeling Tea is a cash-generating unit of Chai Ltd., a subsidiary company. The unit generates negative cash flows and is expected to do so in the future. Accordingly, it should have been impaired. However, the cash flow projection was fabricated to avoid recognition of impairment expenses in the previous years.

There was a disagreement between the subsidiary management and its auditor. The auditor in the audit report under the Companies Act 2013 issued a qualified opinion stating that impairment loss was under-recorded. From the context, the consolidated financial statements understatement of impairment expense would reduce the consolidated:

- Net Profit by 1%
 - Total assets by 0.5%
 - Net worth by 2%
9. Is Mukesh and Rafi LLP guilty of professional misconduct for accepting the audit of Meera Films Ltd.?
- (a) Yes, Mukesh and Rafi LLP are guilty of professional misconduct. The email response of the previous auditor does not include reasons for their resignation.

- (b) Yes, Mukesh and Rafi LLP are guilty of professional misconduct. As a matter of professional courtesy, Mukesh and Rafi LLP should have intimated its appointment as auditor to the previous auditor through registered post (instead of sending an email).
 - (c) Yes, Mukesh and Rafi LLP are guilty of professional misconduct. As a matter of professional courtesy, Mukesh and Rafi LLP should not have intimated its appointment by telephone.
 - (d) Yes, Mukesh and Rafi LLP are guilty of professional misconduct. As a matter of professional courtesy, Mukesh and Rafi LLP should have communicated to the predecessor auditor via email before accepting appointment.
10. Management of Meera Films (Parent Company) reconciled its balances with the customers and vendors at an interim period. Mukesh and Rafi LLP also decided to send independent requests to the customers and vendors to confirm their balances as of the year's end. With the risk of material misstatement assessed to be low, the top 15 parties, comprising 5% of customers and 7% of vendors, were selected to obtain external confirmations. Is the sampling strategy appropriate?
- (a) Inappropriate. Sample size appears to be insufficient. Method of sample selection does not allow each item in the population a chance of selection.
 - (b) Inappropriate. Sampling method is judgmental and not statistical based.
 - (c) Inappropriate. Considering the underlying audit risk, external confirmation from all customers and vendors should have been obtained.
 - (d) Inappropriate. Rely on confirmations obtained by management and perform roll-forward procedures to arrive at the year-end balance.
11. Would the advance for purchasing music rights to the extent remaining unadjusted as at the year-end (i.e. INR 30 crores) require reporting under Clause 3(iii) of CARO 2020 (i.e. grant of loans, etc.)?
- (a) No. Advance for purchase of goods is not a loan/ advance in the nature of loans. Thus, it is not covered under the above clause.
 - (b) No. In the absence of interest charges, the advance would neither qualify as a loan nor be an advance in the nature of a loan. Thus, it is not covered under the above clause.
 - (c) Yes. The intent was to provide financial support, not purchase goods. The amount of the advance and settlement period are excessive and not as per normal trade practice. It should be reported as an advance in the nature of a loan.
 - (d) Yes. Advance for purchase of goods is covered under the above clause.

12. Mukesh and Rafi LLP considered the qualification of the auditor of Chai Ltd. They conclude that the audit opinion on the consolidated financial statements of the Group should be:
- (a) Unmodified as the effect of misstatement is not material to the Group.
 - (b) Unmodified as the effect of misstatement is not material. However, the subsidiary auditor's issued qualified opinion should be highlighted in the audit report through an Emphasis of Matter paragraph.
 - (c) Qualified as the subsidiary auditor has issued a qualified opinion.
 - (d) Qualified to the extent it relates to the subsidiary and unmodified to the extent it relates to the remaining part of the Group.

Case Scenario III [MCQ 13-15]

M/s Vrinda & Associates (referred to as 'auditor') have been appointed as one of the statutory central auditors of ICCB Bank, (referred to as 'Bank') for the Financial Year 2022-23.

During the course of the audit, the auditor found that the bank has a balance with a Swiss based bank. The auditor understands that such balance is a matter of important consideration in the audit of the bank.

The engagement partner, Mr. Mitansh, has also advised the audit staff to check in detail the following items appearing in the financial statements of the bank during the year under audit.

Amount of interest accrued and not due on deposits amounting to ₹ 87,75,000/-.

The balance of Interest rate swaps amounting to ₹ 81,26,500/-.

Further, the statutory auditors understand that one of the most important areas to be checked in the audit of a bank is the compliance with CRR and SLR requirements.

The audit staff apprised the engagement partners about the few unaudited branches of the Bank and the course of action in this regard was discussed in detail within the engagement team. The details with respect to unaudited branches are as under:

Interest Income: ₹ 27,86,000/-.

Interest Expense: ₹ 13,38,220/-.

Total advances: ₹ 5,10,22,000/-.

Total deposits: ₹ 3,38,00,000/-.

The auditors also discussed the following with the audit staff and the bank management during the course of the audit:

Computation of Demand and Time Liabilities.

Computation of Tier I & Tier II capital of the Bank.

Based on the above facts, answer the following:

13. What should be the treatment of Interest on deposits accrued but not due amounting to ₹ 87,75,000/- appearing in the financial statements of ICCB Bank.
 - (a) The amount should be included in deposits amount.
 - (b) The amount should not be included in amount of deposits.
 - (c) The amount should be shown under the head other liabilities and provisions.
 - (d) Both b & c.
14. The amount of Interest Rate Swaps amounting to ₹ 81,26,500/- should appear as in the financial statements of the bank :-
 - (a) Contingent Liabilities.
 - (b) Other Liabilities and provisions.
 - (c) Current Liabilities.
 - (d) Deposits.
15. Which of the following is correct statement related to the requirement laid down by the RBI for Vrinda & Associates while verifying the compliance with the SLR requirements of the bank?
 - (a) M/s Vrinda & Associates are required to verify the compliance with SLR requirements at the start and end date of the year under audit.
 - (b) M/s Vrinda & Associates are required to verify the compliance with SLR requirements at 12 odd dates in different months of the financial year not being Fridays.
 - (c) M/s Vrinda & Associates are required to verify the compliance with SLR requirements at 24 odd dates in different months of the financial year not being Fridays.
 - (d) M/s Vrinda & Associates are required to verify the compliance with SLR requirements at 10 odd dates in different months of the financial year not being Saturdays.

PART II – Descriptive Question (70 Marks)

Question No.1 is compulsory.

*Attempt any **four** questions from the rest.*

1. (a) Nandini Ltd. a chemical manufacturing company, having its factory located at Kanawali Village, for the year 2022-23 appointed Vasu & Co. as their statutory auditors. During the course of the audit, Vasu & Co. identified that Nandini Ltd. received a show cause notice from National Green Tribunal based on the investigation performed by the regional forest department for violating environmental laws. Upon gathering a further understanding of the said matter, it was identified that Nandini Ltd. was dumping toxic solid waste, without treating it, on the nearby

grounds, and because of this, the nearby water bodies were getting polluted. Based on the preliminary investigation performed by the regional forest department under the directions of the National Green Tribunal, it was identified that these practices were carried out since 2009 and a lot of damage has been done to the environment by Nandini Ltd. A show cause notice was already issued to Nandini Ltd. by the National Green Tribunal for levying the penalty of an amount of ₹700 crore. The unaudited profit for the financial year 2022-23 of Nandini Ltd. was ₹ 49 crore and the unaudited turnover was ₹ 120 crore. Upon inquiry it was identified that Nandini Ltd. has disclosed this matter in the financial statements by way of footnote, the extract of which is provided below:

“The company has received a show cause notice from the National Green Tribunal for some potential violation of environmental laws and the company’s legal department has assessed and found that the judgment would be in favour of the company. Accordingly, no provision has been created for such notices.”

In the light of the above scenario kindly provide what should be the appropriate option for the statutory auditor of the company to report this matter. **(5 Marks)**

- (b) Pine & Associates is the statutory auditor of BB Ltd., a listed company and started its operations 6 years ago. The fieldwork during the audit of the financial statements of the company for the year ended 31st March, 2023 was completed on 1st May, 2023. The auditor’s report was dated 15th May, 2023. During the documentation review of the engagement, it was observed that the engagement quality control review was completed on 18th May, 2023. The engagement partner had completed his reviews in entirety by 12th May, 2023. Comment **(4 Marks)**
- (c) Aditya Ltd. was engaged in the business of owning and managing hotels and resorts, selling tourism packages and performing airline bookings for corporate and individuals. It appointed Sanjay & Co. as its statutory auditor for the financial year 2022-23. While planning the audit, the audit team decided that the risk of improper revenue recognition from hotel business should not be treated as a fraud risk. This conclusion was based on the assessment of earlier years, wherein no fraud was identified in revenue recorded from such business. While testing the internal financial controls over the process of revenue recognition, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. As a result, the audit team decided to perform additional substantive testing. However, the audit team still were to the conclusion that there is no risk of fraud in revenue recognition. During the course of substantive testing, it was identified that the management did not account for revenue received from corporate hotel bookings amounting to ₹ 43 crore. These amounts were partially received in the company’s bank accounts and partially received in the CFO’s personal account.

The amounts received in the bank account of the company were disclosed as advances received against the future bookings.

In the light of above scenario, kindly guide the statutory auditors with respect to their responsibility relating to fraud in an audit of a financial statement. **(5 Marks)**

2. (a) Suneel was appointed as the auditor of PCM Ltd. for the financial year 2022-23. During the course of planning for the audit, CA. Suneel intends to apply the concept of materiality for the financial statements as a whole. Please guide him with respect to the factors that may affect the identification of an appropriate benchmark for this purpose.

What benchmark should be adopted by CA. Suneel, if PCM Ltd. is engaged in:

- (i) the manufacture and sale of air conditioners and is having regular profits.
- (ii) the construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic.

(5 Marks)

- (b) Gravity Ltd. is a medium-sized manufacturing company that is planning to implement a new digital system to streamline its production processes and improve efficiency. The company appointed Mr. Ravi as IT manager. However, he is aware that merging technologies can bring significant benefits but also pose various risks to the organization. In this context, he needs to identify examples of technological risks associated with the implementation of the new digital system and the control considerations necessary to mitigate these risks effectively.

(4 Marks)

- (c) Mr. S is a practising Chartered Accountant based out of Chennai. During the weekends, he involved himself in equity research and used to advise his friends, relatives and other known people who are not his clients. Apart from this, he was also involved as a paper-setter for Accountancy subject in the school in which he studied. He also owned agricultural land and was doing agriculture during his free time. During the year 20X1, heavy losses were incurred in agricultural activity due to natural calamities and misfortune, and he lost almost all of his wealth and became undischarged insolvent. After a few court hearings, finally, in the year 20X3, he was declared discharged insolvent and obtained a certificate from the court stating that his insolvency was caused by misfortune without any misconduct on his part. You are required to comment on the above situation with reference to the Chartered Accountants Act, 1949 and Schedules thereto. **(5 Marks)**

3. (a) BPMP and Associates, a renowned audit firm in the field of CA practice for the past three decades, was appointed to conduct the statutory audit of Rexlon Ltd., an unlisted company engaged in the business of paper manufacturing. The firm decided to commence the audit for the

recently concluded financial year. After making significant progress in the audit, the auditors made the following observations:

Observation 1: The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material.

Observation 2: Due to the flood, few records maintained by the Company with respect to a particular transaction was completely destroyed and there was no duplicate record maintained by the Company. However, those details were not pervasive, but material.

You are required to advise whether BPMR and Associates should report Observation 1 and 2 in its audit report? If so, under which heading should it be reported? **(4 Marks)**

- (b) NRF Bank Ltd. is suffering from huge number of NPAs. During the month of April 2023, the management of the bank decided to sell some of its NPAs. Bank is doing this exercise for the first time. The management has selected following NPA accounts for sale:

Name	NPA since F.Y.	Amount (₹ In Lakh)
Fin Pvt. Ltd.	2019-20	36.55
Dairy Works	2021-22	55.24
Book Store	2018-19	29.85
Fancy Corp.	2017-18	61.42
RSM and Associates	2020-21	19.25

Being internal auditor of the bank, you are required to scrutinize the proposal made by the branch and help them by providing specific points to be considered. **(5 Marks)**

- (c) A special notice has been issued for a resolution at 4th annual general meeting of TRIM Ltd., providing expressly that CA. Lucky shall not be re-appointed as an auditor of the company. Consequently, CA. Lucky submitted a representation in writing to the company with a request to circulate to the members. In the detailed representation, CA. Lucky included the contributions made by him in strengthening the control procedures of the company during his association with the company and also indicated his willingness to continue as an auditor if reappointed by the shareholders of the company. Comment with reference to the Chartered Accountants Act, 1949 and schedules thereto. **(5 Marks)**

4. (a) Naveen Ltd. is a chair manufacturing company having its corporate office in Maharashtra. The company is in the process of expansion and has acquired five companies during the year. Soni & Co. is the principal auditor of the company while the audit of all the companies acquired during the year is being conducted by Rahul K & Associates.

During the course of audit, CA. Soni, the engagement partner asked the management of Naveen Ltd. at the corporate office that in order to conduct the audit of the consolidated financial statements, his audit firm is required to conduct audit of the financial statements of all the components also (Companies acquired during the year). To this, the management asked CA. Soni to consider the audit reports of the component auditor already provided to his audit team and to communicate with the component auditor for any discussion they wish to have. CA. Soni contended that for the purpose of audit of consolidated financial statements either his firm is required to conduct an audit of all the component's financial statements, or he needs the working papers of the component auditors. Is the contention of CA. Soni correct? **(5 Marks)**

- (b) You have recently joined a listed company after qualifying CA final exams through campus placement programme conducted by ICAI. The company you have joined is not amongst top 1000 listed companies in the country. However, it wants to include "Sustainability reporting" in accordance with Global Reporting Initiative framework (GRI) in its annual report on voluntary basis. "Sustainability reporting" seems to be new buzzword in corporate circles and you are assigned responsibility for collating all the information required for such reporting.

In above context, dwell upon what is your understanding of "Sustainability reporting"? You are also required to list its expected benefits. **(4 Marks)**

- (c) STU & Associates have been the statutory auditors of the listed company "First and Last Ltd.," operating in the petrochemical industry, for the past three years. CA. K, the engagement partner, had designed certain substantive procedures on some selected assertions in response to the assessed risk of material misstatements for the year under audit. These particular assertions were not examined by him in previous years due to materiality or risk considerations.

Mr. X leads the internal audit department of the company and reports to the company's audit committee. During the course of audit, a senior member of the engagement team decides to engage Mr. X for providing direct assistance in performing the above substantive procedures. Comment with respect to the relevant Standards on Auditing.

Also, indicate the activities to be performed by the statutory auditor prior to using internal auditor for providing direct assistance. **(5 Marks)**

5. (a) Jinchandra & Co., Chartered Accountants, has been appointed statutory auditor of Gurudeva Ltd. for the F.Y. 2022-23. The audit team has completed the audit and is in the process of preparing the audit report. Management of the company has also prepared draft annual report.

The audit in-charge was going through the draft annual report and observed that the company has included an item in its annual report

indicating a downward trend in market prices of key commodities/raw material as compared to the previous year. However, the actual profit margin of the company as reported in financial statements has gone in the reverse direction. The Audit Manager discussed this issue with a partner of the firm who in reply said that auditors are not covered with such disclosures made by the management in its annual report, it being the responsibility of the management.

Do you think that the partner is correct in his approach on this issue? Discuss with reference to the relevant Standard on Auditing the Auditor's duties with regard to reporting. **(5 Marks)**

- (b) During the course of an audit of a state government department, the Office of the Comptroller & Auditor General of India (CAG) observed that the prescribed law in the state defined a "flat" based on the following two criteria in a premises:

- Dwelling units exceeding a threshold limit
- Buildings with a total area surpassing a threshold limit

However, it was noted during the audit that the relevant database did not include a column for entering the area of the building. Consequently, a certain number of buildings were identified as flats even though they had fewer dwelling units than the threshold limit. In the absence of data regarding the area, the audit team directed physical verification of these flats. The physical verification confirmed that these buildings were incorrectly classified as flats, resulting in the department under collecting water charges.

Identify type and nature of audit being performed by Office of Comptroller & Auditor General of India. To whom report of such audit was likely to have been submitted **(5 Marks)**

- (c) CA. Evan has been in practice for two years and runs his proprietorship firm in the name of "Evan & Co." He maintains notes in his mobile where he records the fees received from various clients. Using these records, he prepares and files his income tax return. Comment with respect to the provisions of the Chartered Accountant Act, 1949.

(4 Marks)

6. (a) You have been appointed to compile the financial statements of the Kings & Company (a partnership firm) for tax purposes. During the course of your work, you discover that the inventory is grossly understated, and the company has failed to apply applicable standards on accounting. On pointing out the same, the partners of the Kings & Co., inform you that it is outside your scope since you are not conducting an audit and the said figures duly certified by the firm should be accepted. Comment. **(5 Marks)**

Or

SAE 3400 explains that prospective financial information can take the form of a forecast, a projection, or a combination of both. In this context, how do you differentiate a forecast from a projection? Also provide an example. Additionally, explain the nature of assurance provided by the practitioner regarding prospective financial information in accordance with SAE 3400. **(5 Marks)**

- (b) The manager of Miskin (P) Ltd. approached CA. Rahul in need of a certificate in respect of a consumption statement of raw material. Without having certificate of practice (CoP), CA. Rahul issued the certificate to the manager of the company, acting as a CA in practice and applied for the CoP to the Institute on very next day to avoid any dispute. **(4 Marks)**

- (c) Mr. Rajat, while reviewing the anti-fraud controls for a construction company, found that the company has witnessed a few frauds in the past mainly in the nature of material theft from the sites and fake expense vouchers.

Mr. Rajat is evaluating options for verifying the process to reveal fraud and the corrective action to be taken in such cases. As an expert in fraud prevention, you have been asked to brief Mr. Rajat about the inventory fraud and verification procedure with respect to defalcation of inventory? **(5 Marks)**

Mock Test Paper - Series II: April, 2024

Date of Paper: 5 April, 2024

Time of Paper: 2 P.M. to 5 P.M.

FINAL COURSE: GROUP – I

**PAPER – 3: ADVANCED AUDITING, ASSURANCE AND
PROFESSIONAL ETHICS**

ANSWERS

PART I: MULTIPLE CHOICE QUESTION

1. (a)
2. (b)
3. (c)
4. (c)
5. (c)
6. (d)
7. (a)
8. (b)
9. (d)
10. (a)
11. (c)
12. (a)
13. (d)
14. (a)
15. (b)

PART II - DESCRIPTIVE QUESTION

1. (a) As per SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements", the auditor is required to obtain an understanding and need to evaluate the impact of other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations may therefore have a material effect on the financial statements.

The auditor shall perform the following audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements:

- (a) Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and
- (b) Inspecting correspondence, if any, with the relevant licensing or regulatory authorities

As per section 143(3)(j) read with Rule 11(a), the auditor is required to report whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

As per SA 570, “Going Concern”, if the auditor concludes that management’s use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:

- (i) Adequately disclose the principal events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and management’s plans to deal with these events or conditions; and
- (ii) Disclose clearly that there is material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall (a) Express a Qualified opinion or Adverse opinion, as appropriate, in accordance with SA 705; and (b) In the Basis for Qualified (Adverse) Opinion section of the auditor’s report, state that a material uncertainty exists that may cast significant doubt on the entity’s ability to continue as a going concern and that the financial statements do not adequately disclose this matter.

In the current scenario, Nandini Ltd. has received a show cause notice from the National Green Tribunal of an amount which is more than the net profit and the turnover of the company for the year. In the event of an unfavourable order for Nandini Ltd., there will be an impact on Nandini Ltd.’s ability to continue as a going concern.

As a result, appropriate disclosure should be provided by management for such events, which cast significant doubt on the entity’s ability to continue as a going concern. As no appropriate disclosure has been provided by Nandini Ltd. for such show cause notice, Vasu & Co. should report this matter in their audit report under “Going Concern Para” as per SA 570 and under clause (j) of section 143(3) of the Companies Act, 2013. Also, the auditor is required to issue an Adverse opinion as per SA 705, “Modifications to the Opinion in the Independent Auditor’s Report”.

- (b) As per SA 220, “Quality Control for an Audit of Financial Statement”, the engagement partner shall take responsibility for reviews being performed in accordance with the firm’s review policies and procedures.

For audits of financial statements of listed entities, the engagement partner shall:

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

Further, SA 700, "Forming an Opinion and Reporting on Financial Statements", requires the auditor's report to be dated not earlier than the date on which the auditor has obtained sufficient appropriate evidence on which to base the auditor's opinion on the financial statements. In cases of an audit of financial statements of listed entities where the engagement meets the criteria for an engagement quality control review, such a review assists the auditor in determining whether sufficient appropriate evidence has been obtained.

Conducting the engagement quality control review in a timely manner at appropriate stages during the engagement allows significant matters to be promptly resolved to the engagement quality control reviewer's satisfaction on or before the date of the auditor's report.

In this case, the audit of BB Ltd. for the year ending on 31st March 2023 was conducted by Pine & Associates and was completed on 1st May, 2023. Subsequently, the engagement partner reviewed the audit by 12th May, 2023. The audit report issued by Pine and Associates was dated 15th May, 2023. However, the engagement quality control review was finalized on 18th May, 2023, which is later than the date of the audit report. In view of above, the date of auditors' report before the completion of the engagement quality control review, is not correct.

- (c) As per SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" and SA 315, "Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment", the auditor shall identify and assess the risks of material misstatement due to fraud at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. When identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

In accordance with SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" and SA 330, "The Auditor's Responses to Assessed Risks" the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level and assertion level.

The presumption that there are risks of fraud in revenue recognition may be rebutted. For example, the auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property. However, when there is a complex revenue structure or when there is lack of controls on revenue recognition, then there is a high probability of fraud risk in revenue recognition.

Obtaining an understanding of the entity and its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating and analysing information throughout the audit.

In the current scenario, the company was earning revenue from multiple streams. Also, it was identified that the controls are not properly designed to mitigate the risk of fraud and risk of improper revenue recognition. During the year it was identified that the management did not account for revenue from corporate hotel bookings amounting to ₹ 43 crore. These amounts were partially received in the company's bank accounts and partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against future bookings.

Therefore, the auditor while performing the risk assessment procedures should consider the complexity and nature of the revenue for determining the fraud risks in revenue recognition. Also, there were no adequate controls addressing the risk of improper revenue recognition or fraud risk, the audit team rebutted the fraud risk. Moreover, the audit team should have recognised fraud risk by identifying the deficiencies of internal control over the revenue recognition process and should have treated the risk of improper revenue recognition as a significant risk. Also, as per Section 143(12), the auditor is required to report all the frauds identified during the course of the audit involving amounts above ₹ 1 crore within the prescribed time frame to the Central Government

2. (a) **Use of Benchmarks in Determining Materiality for the Financial Statements as a Whole:** As per SA 320, "Materiality in Planning and Performing an Audit" determining materiality involves the exercise of professional judgment. A percentage is often applied to a chosen benchmark as a starting point in determining materiality for the financial statements as a whole.

Factors that may affect the identification of an appropriate benchmark include the following:

- The elements of the financial statements (for example, assets, liabilities, equity, revenue, expenses);
- Whether there are items on which the attention of the users of the particular entity's financial statements tends to be focused (for

example, for the purpose of evaluating financial performance users may tend to focus on profit, revenue or net assets);

- The nature of the entity, where the entity is at in its life cycle, and the industry and economic environment in which the entity operates;
- The entity's ownership structure and the way it is financed (for example, if an entity is financed solely by debt rather than equity, users may put more emphasis on assets, and claims on them, than on the entity's earnings); and
- The relative volatility of the benchmark.

Determining a percentage to be applied to a chosen benchmark involves the exercise of professional judgment. There is a relationship between the percentage and the chosen benchmark, such that a percentage applied to profit before tax from continuing operations will normally be higher than a percentage applied to total revenue.

In case if PCM Ltd. is engaged in manufacture and sale of air conditioner, and is having regular profits: CA. Suneel, the auditor may consider profit before tax /Earnings.

In case if PCM Ltd. is engaged in the construction of large infrastructure projects and incurred losses in the previous two financial years, due to pandemic: CA. Suneel, the auditor may consider Revenue or Gross Profit as benchmarking. Alternatively, CA. Suneel, the auditor may consider the criteria relevant for audit of the entities doing public utility programs/ projects, Total cost or net cost (expenses less revenues or expenditure less receipts) may be appropriate benchmarks for that particular program/project activity. Where an entity has custody of the assets, assets may be an appropriate benchmark.

(b) Some examples of technology risks where Mr. Ravi should test the appropriate controls for relying on the digital systems

- Reliance on systems or programs that are inaccurately processing data, processing inaccurate data, or both
- Unauthorized access to data that might result in destruction of data or improper changes to data, including the recording of unauthorized or non-existent transactions or inaccurate recording of transactions (specific risks might arise when multiple users access a common database)
- The possibility of information technology personnel gaining access privileges beyond those necessary to perform their assigned duties, thereby leading to insufficient segregation of duties
- Unauthorized or erroneous changes to data in master files
- Unauthorized changes to systems or programs

- Failure to make necessary or appropriate changes to systems or programs
- Inappropriate manual intervention
- Potential loss of data or inability to access data as required
- Risks introduced when using third-party service providers
- Cybersecurity risks

Mr. Ravi should focus on the following control considerations to mitigate risks effectively:

1. Auditors should gain a holistic understanding of changes in the industry and the information technology environment to effectively evaluate management's process for initiating, processing, and recording transactions and then design appropriate auditing procedures.
2. Auditors, as appropriate, should consider risks resulting from the implementation of new technologies and how those risks may differ from those that arise from more traditional, legacy systems.
3. Auditors should consider whether digital upskilling or specialists are necessary to determine the impact of new technologies and to assist in the risk assessment and understanding of the design, implementation, and operating effectiveness of controls. E.g., cybersecurity control experts, IT specialists in the team etc.

(c) Given situation can be visualize in following parts:

- (i) Mr. S used to involve himself in equity research and used to advise his friends, relatives and other known people: As per the recent decisions taken by the Ethical Standards Board of ICAI, a Chartered Accountant in practice may be an equity research adviser, but he cannot publish a retail report, as it would amount to other business or occupation.

In the given case, though Mr. S is involved in doing equity research and in advising people, it is clear that he does not publish any retail report of his research. Hence, this act of Mr. S shall not make him guilty of professional misconduct.

- (ii) Mr. S is involved in paper-setting for the Accountancy subject in the school where he studied. He also owns agricultural land and does agriculture activities: As per Clause 11 of Part I of First Schedule of Chartered Accountants Act and regulation 190A of Chartered Accountants Regulations, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

Further, Regulation 190A mentions the 'Permissions granted Generally' to engage in a certain category of occupations, for which no specific permission of Council is required. Those cases include:

- Valuation of papers, acting as paper-setter, head examiner or a moderator, for any examination.
- Owning agricultural land and carrying out agricultural activities.

Therefore, in the given case, the activities of Mr. S as a paper-setter and involvement in agricultural activities do not make him guilty of professional misconduct.

- (iii) Mr. S was discharged insolvent: Disabilities for the Purpose of Membership : Section 8 of the Chartered Accountants Act, 1949 enumerates the circumstances under which a person is debarred from having his name entered in or borne on the Register of Members, If he, being a discharged insolvent, has not obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Here it may be noted that a person who has been removed from membership for a specified period shall not be entitled to have his name entered in the Register until the expiry of such period.

In addition, failure on the part of a person to disclose the fact that he suffers from any one of the aforementioned disabilities would constitute professional misconduct. The name of the person, who is found to have been subject at any time to any of the disabilities discussed in section 8, can be removed from the Register of Members by the Council.

In the given case, it is clearly stated that Mr. S was discharged insolvent, and he has also obtained from the court a certificate stating that his insolvency was caused by misfortune without any misconduct on his part. Hence, Mr. S has not violated the provisions of section 8, and he is not debarred from having his name entered in the Register of Members.

3. (a) **Observation 1** - The management had disclosed in the financials that, during the year, one of the warehouses of the Company was affected due to a major flood. As a result of the same, the Company had incurred some losses. But the management was of the view that it was not material. As per SA 706, "Emphasis of Matter Paragraph & Other Matter Paragraph in the Independent Auditor's Report", an Emphasis of Matter Paragraph refers to matter appropriately disclosed in the financials, that in the auditor's judgement is of such importance that it is fundamental to users' understanding of the financials. Hence, in this case, the auditor shall report about the consequences of the flood which affected the company's warehouse under Emphasis of Matter Paragraph.

Observation 2 - Due to flood, few records maintained by the Company with respect to a particular transaction were destroyed and no duplicate records were maintained by the Company. However, those details were

not pervasive, but material. As per SA 705, “Modifications to the Opinion in the Independent Auditor’s Report”, where the auditor is unable to obtain sufficient and appropriate audit evidence and where such matter is material but not pervasive, the auditor shall issue a Qualified opinion.

Thus, in the given situation, on account of flood few records pertaining to particular transactions were completely destroyed and in the absence of duplicate records, the auditor was unable to obtain sufficient and appropriate audit evidence and those details were material but not pervasive. Therefore, in accordance with SA 705, the auditor is required to issue Qualified opinion.

(b) In case of Sale of NPA by Bank, the auditor should examine that:

- The policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers including non-performing financial assets that may be sold, norms or such sale, valuation procedure and accounting policy.
- Only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.
- The assets have been sold “without recourse’ only i.e., the entire credit risk associated with the non-performing asset should be transferred to the purchasing bank.
- Subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs.
- The NPA has been sold at cash basis only. Under no circumstances, NPA can be sold to another bank at a contingent price. The entire sale consideration has to be received on upfront basis.
- The bank has not purchased an NPA which it had originally sold.
- On the sale of the NPA, the same has been removed from the books of the account of selling bank on transfer;
- If the sale is at a price below the net book value (NBV) (i.e., book value less provisions held), the shortfall should be debited to the profit and loss account of that year.
- If the sale is for a value higher than the NBV, the excess provision shall not be reversed but will be utilised to meet the shortfall/ loss on account of sale of other non-performing financial assets.

In the given situation, management of NRF Bank Ltd. is considering to sell following NPAs, during the month of April, 2023:

Name	NPA since F.Y.	Amount (₹ in lakh)
Fin Pvt. Ltd.	2019-20	36.55
Dairy Works	2021-22	55.24
Book Store	2018-19	29.85

Fancy Corp.	2017-18	61.42
RSM and Associates	2020-21	19.25

In view of above-mentioned conditions, the auditor is required to ensure that only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.

Considering the facts given in the question all the NPAs, except for Dairy Works, are prior to April 2021 i.e., 2 years prior to April 2023. In view of the above provisions, management of NRF Bank Ltd. can sell all the NPAs except for NPA of 55.24 lakh rupees of Dairy Works as it has remained NPA in the books of the banks less than 2-year duration.

- (c) **Soliciting Clients:** As per Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another Chartered Accountant in practice and responding to tenders.

Further, section 140(4)(iii) of the Companies Act, 2013, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of the company and to be read out at the meeting. However, the content of letter should be set out in a dignified manner how he has been acting independently and conscientiously through the term of his office and may, in addition, indicate, if he so chooses his willingness to continue as auditor, if re-appointed by the shareholders.

The proposition of the auditor to highlight contributions made by him in strengthening the control procedures in the representation should not be included in such representations because the representation letter should not be prepared in a manner to seek publicity.

Thus, highlighting contributions made by him in strengthening the control procedures, while submitting representation u/s 140(4)(iii) of the Companies Act, 2013 would amount to canvassing or soliciting for his continuance as auditor.

Therefore, CA. Anoop will be held guilty of professional misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

4. (a) As per SA 600, "Using the work of Another auditor", the principal auditor is normally entitled to rely upon the work of component auditor unless there are special circumstances to make it essential for him to visit the component and/or to examine the books of account and other records of the said component. The principal auditor might discuss with the other auditor the audit procedures applied or review a written summary of the other auditor's procedures and findings which may be in the form of a completed questionnaire or check-list. The principal auditor may also

wish to visit the other auditor. The nature, timing and extent of procedures will depend on the circumstances of the engagement and the principal auditor's knowledge of the professional competence of the other auditor.

The principal auditor should consider the significant findings of the other auditor.

The principal auditor may consider it appropriate to discuss with the other auditor and the management of the component, the audit findings or other matters affecting the financial information of the components. He may also decide that supplemental tests of the records or the financial statements of the component are necessary. Such tests may, depending upon the circumstances, be performed by the principal auditor or the other auditor.

Accordingly, CA. Soni, can perform the above-mentioned audit procedures. However, the audit of the component's financial statements by the principal auditor is not required.

So, the contention of CA. Soni that for the purpose of audit of consolidated financial statements he is required to conduct an audit of the components financial statements is not correct.

Further, SA 230 issued by ICAI on Audit Documentation, and "Standard on Quality Control (SQC) 1, provides that, unless otherwise specified by law or regulation, audit documentation is the property of the auditor. He may at his discretion, make portions of, or extracts from, audit documentation available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel.

Accordingly, it is the discretion of the component auditor as the working papers with respect to the components examined by the component auditor are the property of the component auditor.

So, the contention of CA. Soni is not correct.

- (b) Sustainability reporting is an organization's practice of reporting publicly on its economic, environmental, and/or social impacts, and hence its contributions – positive or negative – towards the goal of sustainable development

Sustainability reporting refers to the information that companies provide about their performance to the outside world on a regular basis in a structured way. It is a comprehensive mechanism of measuring and disclosing sustainability data with performance indicators and management disclosures.

Expected Benefits: It can help stakeholders to understand organizations performance vis a vis sustainability and impacts. The reporting process emphasizes the link between financial and non-financial performance.

Such reporting can help entities to focus on long-term value creation, by addressing environmental, social and governance (ESG) issues. Since investors are increasingly recognizing that environmental and social issues provide both risks and opportunities in respect of their investments and are seeking disclosures on environmental and social performance of businesses, they can use ESG performance of companies to make investment decisions.

Investing in social and environmental issues will not only improve own business continuity of companies but also put them in a better position with their B2B (Business to Business) customers as well as enable them to acquire new ones.

- (c) SA 610, "Using the Work of Internal Auditor" states that in determining the nature of work that may be assigned to internal auditors, the external auditor is careful to limit such work to those areas that would be appropriate to be assigned. Examples of activities and tasks that would not be appropriate to use internal auditors to provide direct assistance include the discussion of fraud risks, determination of unannounced audit procedures as addressed in SA 240 etc.

In the above case, engagement partner had designed certain substantive procedures on some selected assertions in response to assessed risk of material misstatements in year under audit. Such assertions were not tested by him in the previous years due to materiality or risk considerations. It is being done now for incorporating an element of unpredictability in audit procedures to be performed as individuals within the company who are familiar with the audit procedures normally performed on engagements may be more able to conceal fraudulent financial reporting.

Therefore, in such matters, using an internal auditor to provide direct assistance could prove to be counter-productive and defeat the very purpose of designing such substantive procedures. Hence, decision of senior engagement team member to use Mr. X to provide direct assistance on above said matters is not in accordance with SA 610 and is not proper.

Prior to using internal auditors to provide direct assistance for purposes of the audit, 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 the 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.

5. (a) **Responding When the Auditor Concludes That a Material Misstatement of the Other Information Exists:** As per SA 720, “The Auditor’s Responsibility in Relation to Other Information”, descriptions of trends in market prices of key commodities or raw materials is an example of amounts or other Items that may be included in the other information.

The auditor’s discussion with management about a material inconsistency (or other information that appears to be materially misstated) may include requesting management to provide support for the basis of management’s statements in the other information. Based on management’s further information or explanations, the auditor may be satisfied that the other information is not materially misstated. For example, management explanations may indicate reasonable and sufficient grounds for valid differences of judgment.

Auditor’s duties with regard to reporting in the given case are given hereunder:

As per SA 720, “The Auditor’s Responsibility in Relation to Other Information”, if the auditor concludes that a material misstatement of the other information exists, the auditor shall request management to correct the other information. If management:

- (i) Agrees to make the correction, the auditor shall determine that the correction has been made; or
- (ii) Refuses to make the correction, the auditor shall communicate the matter with those charged with governance and request that the correction be made.

Contention of the partner of the firm that auditors are not concerned with such disclosures made by the management in its annual report, is incorrect.

- (b) In the given case, it is a “Compliance Audit” performed by Office of Comptroller & Auditor General of India.

Compliance audit is the independent assessment of whether a given subject matter is in compliance with the applicable criteria.

This audit is carried out by assessing whether activities, financial transactions and information comply in all material respects with the regulatory and other rules which govern the audited entity. Compliance auditing is concerned with: -

- (a) Regularity- adherence of the subject matter to the formal criteria emanating from relevant laws, regulations, and agreements applicable to the entity.
- (b) Propriety- observance of the general principles governing sound financial management and the ethical conduct of public officials.

While regularity is emphasized in compliance auditing, propriety is equally pertinent in the public sector context, in which there are certain

expectations concerning financial management and the conduct of officials.

Under Article 151, audit reports of the C&AG relating to the accounts of the Central/ State Government should be submitted to the President/Governor of the State who shall cause them to be laid before Parliament/State Legislative Assemblies.

In the given situation, the report relates to the State Department. Therefore, report was likely to have been submitted to Governor of state to be laid before State legislative assembly.

- (c) **Maintenance of Books of Account by a CA in Practice:** Chapter V of the Council General Guidelines, 2008 specifies that a member of the Institute in practice or the firm of Chartered Accountants of which he is a partner, shall maintain and keep in respect of his professional practice, proper books of accounts including the following-

- (i) a Cash Book
- (ii) a Ledger

Thus, a Chartered Accountant in practice is required to maintain proper books of accounts.

In the instant case, CA. Evan does not maintain proper books of accounts and writes the fees received from various clients in notes on his mobile. Notes maintained by him in mobile cannot be treated as books of accounts.

Hence, CA. Evan, being a practicing Chartered Accountant will be held guilty of misconduct for violation of Council General Guidelines, 2008.

6. (a) As per SRS 4410, "Compilation Engagements", if the practitioner is unable to complete the engagement because management has failed to provide records, documents, explanations or other information, including significant judgments, as requested, the practitioner shall withdraw from the engagement and inform management and those charged with governance of the reasons for withdrawing.

If the practitioner becomes aware during the course of the engagement that:

- (a) The compiled financial information does not adequately refer to or describe the applicable financial reporting framework
- (b) Amendments to the compiled financial information are required for the financial information not to be materially misstated; or
- (c) The compiled financial information is otherwise misleading

the practitioner shall propose the appropriate amendments to management.

If management declines, or does not permit the practitioner to make the proposed amendments to the compiled financial information, the practitioner shall withdraw from the engagement and inform management and those charged with governance of the reasons for withdrawing.

If withdrawal from the engagement is not possible, the practitioner shall determine the professional and legal responsibilities applicable in the circumstances.

The practitioner shall obtain an acknowledgement from management or those charged with governance, as appropriate, that they have taken responsibility for the final version of the compiled financial information.

Or

- (a) Prospective financial information can be in the form of a forecast, a projection, or a combination of both, for example, a one year forecast plus a five- year projection.

“Forecast” means prospective financial information prepared on the basis of:

- Assumptions as to future events which management expects to take place and
- The actions management expects to take as of the date the information is prepared (best-estimate assumptions- an assumption that reflects anticipated experience with no provision for risk of adverse deviation).

Example- In present market conditions, supply availability, historical buying patterns and seasonal trends, the CFO of X Ltd. expects sales to increase by 5% over the next quarter. Therefore, a 5% sales increase is his financial forecast for the period.

“Projection” means prospective financial information prepared on the basis of:

- Hypothetical assumptions about future events and management actions which are not necessarily expected to take place, such as when some entities are in a start-up phase or are considering a major change in the nature of operations; or
- A mixture of best-estimate and hypothetical assumptions (imagined or suggested)

Example- X Ltd. may project a course of action to take when one or more hypothetical situations arise, such as creating a new product to meet the demand of expected market growth. As a result of assuming the possibility of different events occurring, financial projections typically serve as an outline for evaluating the desired outcomes X Ltd. expects to see, including its financial, cash flow and operational outcomes.

Prospective financial information relates to events and actions that have not yet occurred and might not occur. While evidence may be available to support the assumptions on which the prospective financial information is based, such evidence is itself generally future- oriented and, therefore, speculative in nature, as distinct from the evidence ordinarily available in the examination of historical financial information. Therefore, an opinion as to whether the results shown in the prospective financial information will be achieved cannot be expressed.

- (b) **Issuing Certificate without having Certificate of Practice:** As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the Regulations made thereunder or any Guidelines issued by the Council.

This clause requires every member of the Institute to act within the framework of the Chartered Accountants Act, 1949 and the Regulations made thereunder. Any violation either of the Act or the Regulations by a member would amount to misconduct.

In the given case, CA. Rahul has issued a certificate in respect of a consumption statement of raw material to the manager of Miskin (P) Ltd., as a Chartered Accountant in practice when he had not even applied for the CoP to the Institute, thereby contravening the provisions of section 6 of the Chartered Accountants Act, 1949.

Therefore, CA. Rahul will be held guilty of professional misconduct in terms of Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949 for contravention of provisions of this Act.

- (c) **Inventory Frauds**-Inventory frauds are many and varied but we are concerned with misappropriation of goods and their concealment.
- (i) Employees may simply remove goods from the premises.
 - (ii) Theft of goods may be concealed by writing them off as damaged goods, etc.
 - (iii) Inventory records may be manipulated by employees who have committed theft so that book quantities tally with the actual quantities of inventories in hand.
 - (iv) Inflating the quantities issued for production is another way of defalcating raw materials and store items.
 - (v) Stocks actually dispatched but not entered in sales/ debtor's account.

Verification Procedure for Defalcation of inventory - It may be of trading stock, raw materials, manufacturing stores, tools or of other similar items (readily) capable of conversion into cash. The loss may be the result of a theft by an employee once or repeatedly over a long period, when the same have not been detected. Such thefts usually are possible through collusion among a number of persons. Therefore, for

their detection, the entire system of receipts, storage and dispatch of all goods, etc. should be reviewed to localise the weakness in the system.

The determination of factors which have been responsible for the theft and the establishment of guilt would be difficult in the absence of: (a) a system of inventory control, and existence of detailed record of the movement of inventory, or (b) availability of sufficient data from which such a record can be constructed. The first step in such an investigation is to establish the different items of inventory defalcated and their quantities by checking physically the quantities in inventory held and those shown by the Inventory Book. Investigating accountant should ascertain the exact duties of persons handling the stocks received in and issued from store for production/ sale or any other purpose. Identify the excessive control in the hands of a single person, without any supervision as it will widen the scope of investigation.

Afterwards, all the receipts and issues of inventory recorded in the Inventory Book should be verified by reference to entries in the Goods Inward and Outward Registers and the documentary evidence as regards purchases and sales. This would reveal the particulars of inventory not received but paid for as well as that issued but not charged to customers. Further, entries in respect of returns, both inward and outward, recorded in the financial books should be checked with corresponding entries in the Inventory Book. Also, the totals of the Inventory Book should be checked. Finally, the shortages observed on physical verification of inventory should be reconciled with the discrepancies observed on checking the books in the manner mentioned above. In the case of an industrial concern, issue of raw materials, stores and tools to the factory and receipts of manufactured goods in the godown also should be verified with relative source documents.

Defalcations of inventory, sometimes, also are committed by the management, by diverting a part of production and the consequent shortages in production being adjusted by inflating the wastage in production; similar defalcations of inventories and stores are covered up by inflating quantities issued for production. For detecting such shortages, the investigating accountant should take assistance of an engineer. For that he will be more conversant with factors which are responsible for shortage in production and thus will be able to correctly determine the extent to which the shortage in production has been inflated. In this regard, guidance can also be taken from past records showing the extent of wastage in production in the past. Similarly, he would be able to better judge whether the material issued for production was excessive and, if so to what extent. The per hour capacity of the machine and the time that it took to complete one cycle of production, also would show whether the issues have been larger than those required.