

FINAL COURSE: GROUP I**PAPER-3: ADVANCED AUDITING, ASSURANCE AND PROFESSIONAL ETHICS****SUGGESTED ANSWERS****PART I - MCQs (2 Marks Each)**

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
C	B	A	C	B	C	B	D	C	C	C	B	A	A	C

Part II - DESCRIPTIVE QUESTION**Ques 1**

(a) **As per SQC 1**, "Quality Control for Firms that Perform Audit and Reviews of Historical Financial Information, and other Assurance and Related Services Engagements", the **review does not reduce the responsibilities of the engagement partner**. Hence, **contention of CA. P** that after engagement quality control review by CA. R, his responsibility will be reduced, **is not correct**.

However, CA. R needs to consider the following aspect while performing Engagement Quality Control Review for audit of financial statements of a listed entity ABC Ltd.:

1. The engagement **team's evaluation of the firm's independence** in relation to the specific engagement.
2. **Significant risks identified** during the engagement and the responses to those risks.
3. **Judgments made**, particularly with respect to materiality and significant risks.
4. Whether **appropriate consultation has taken place on matters** involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations.
5. The **significance and disposition of corrected and uncorrected misstatements** identified during the engagement.
6. The **matters to be communicated to management** and those charged with governance and, where applicable, other parties such as regulatory bodies.
7. Whether **working papers selected for review** reflect the work performed in relation to the significant judgments and support the conclusions reached.
8. The **appropriateness of the report** to be issued.

Engagement quality control reviews for engagements other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of these considerations.

(b) In the present case, with respect to the loans and advances of ₹75 Lacs given to Hariharan Pvt. Limited, the Company has not furnished any agreement to CA. Navya. In the absence of such an agreement, CA. Navya is unable to verify the terms of repayment, chargeability of interest and other terms. For an auditor, while verifying any loans and advances, one of the most important audit evidence is the loan agreement. Therefore, the absence of such a document in the present case, tantamount to a **material misstatement in the financial statements** of the company. However, the inability of CA. Navya to obtain such audit evidence is though **material but not pervasive** so as to require him to give a disclaimer of opinion.

Thus, in the present case, **CA. Navya should give a qualified opinion**.

The relevant extract of the Qualified Opinion Paragraph and Basis for Qualified Opinion paragraph is as under:

Qualified Opinion

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the financial statements of Lakshay Ltd. give a true and fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as on 31.03.2023 and profit/ loss for the year ended on that date.

Basis for Qualified Opinion

The Company is unable to furnish the loan agreement with respect to loans and advances of ₹75 Lacs given to Hariharan Pvt. Ltd. Consequently, in the absence of such an agreement, we are unable to verify the terms of repayment, chargeability of interest and other terms.

(c) **As per SA 800** "Special Considerations-Audits of Financial Statements Prepared in accordance with Special Purpose Frameworks", financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed.

While planning and performing audit of such special purpose framework-based company, the auditor should consider below mentioned factors:

(i) **To obtain an understanding of the entity's selection and application of accounting policies.** In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements.

(ii) **Compliance of all SAs relevant to audit**, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement.

(iii) **Application of some of the requirements of the SAs in an audit of special purpose financial statements may require special consideration** by the auditor. For example, in SA 320, judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. In the case of an audit of special purpose financial statements, however, those judgments are based on a consideration of the financial information needs of the intended users.

(iv) In the case of special purpose financial statements, such as those prepared in accordance with the requirements of a contract, **management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted.** The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing the audit of the special purpose financial statements.

(v) **Communication with those charged with governance in accordance with SAs** is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged with governance may not have such a responsibility.

Ques 2

(a) In the given scenario, CA. Z, as the statutory auditor of Happy Hospital, is concerned about the effectiveness of controls at the service organization, specifically the system managed by CT Contractors. To address this concern, **CT Contractors should provide a Type 2 assurance report** from a practicing-chartered accountant **as per SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation"**. This report will offer an opinion on the description of the system in use at Happy Hospital, as well as evaluate the effectiveness of the controls implemented by CT Contractors.

Using a Type 2 report as audit evidence that controls at the service organisation are operating effectively: If, the user auditor plans to use a Type 2 report as audit evidence that controls at the service organisation are operating effectively, the user auditor shall determine whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment by:

- (i) **Evaluating whether the description, design, and operating effectiveness** of controls at the service organisation is at a date or for a period that is appropriate for the user auditor's purposes;
- (ii) **Determining whether complementary user entity controls identified by the service organisation are relevant** to the user entity and, if so, obtaining an understanding of whether the user entity has designed and implemented such controls and, if so, testing their operating effectiveness;
- (iii) **Evaluating the adequacy of the time period covered by the tests of controls** and the time elapsed since the performance of the tests of controls; and
- (iv) **Evaluating whether the tests of controls performed by the service auditor and the results** thereof, as described in the service auditor's report, are relevant to the assertions in the user entity's financial statements and provide sufficient appropriate audit evidence to support the user auditor's risk assessment.

(b) The following are examples of facts and circumstances that might create threats for a professional accountant when undertaking a professional service:

- A professional accountant having a **direct financial interest in a client**.
- A professional accountant **quoting a low fee to obtain a new engagement** and the fee is so low that it might be difficult to perform the professional service in accordance with applicable technical and professional standards for that price.
- A professional accountant having a **close business relationship** with a client.
- A professional accountant having **access to confidential information** that might be used for personal gain.
- A professional accountant **discovering a significant error** when evaluating the results of a previous professional service performed by a member of the accountant's firm.

The following are examples of facts and circumstances that might create threats for a professional accountant when undertaking a professional activity:

- A professional accountant holding a **financial interest in, or receiving a loan or guarantee** from, the employing organization.
- A professional accountant **participating in incentive compensation arrangements** offered by the employing organization.
- A professional accountant having **access to corporate assets** for personal use.
- A professional accountant being offered a **gift or special treatment from a supplier** of the employing organization.

(c) In the given case, Internal Auditor notices several discrepancies in the disbursement records and suspects there might be weaknesses in the internal control system. He is concerned about maintaining his independence and objectivity while ensuring that management is aware of these issues. Responsibilities of Internal Auditor with respect to the accounting function and financial records of the organisation include:

- to ascertain **adequacy of system of internal control by a continuous examination** of accounting procedures, receipts and disbursements, and to provide adequate safeguards against misappropriation of assets.
- to **operate independently of the accounting staff** and must not in any way divest any of the responsibilities placed upon him.
- **not to involve in the performance of executive functions** in order that the objective outlook does not get obscured by the creation of the vested interest.
- **to observe facts and situations and bring them to notice of authorities** who would otherwise never know them; also, critically appraise various policies of the management and draw its attention to any deficiencies, wherever these require to be corrected.
- **to associate closely with management and keep knowledge up to date** by being informed about all important occurrences and events affecting the business, as well as the changes that are made in business policies.
- at all times, the internal auditor must **enjoy an independent status**.

Ques 3

(a)

Particulars	Other Audits	Forensic Accounting
Objectives	Express an opinion as to 'True & Fair' presentation	Whether fraud has actually taken place in books
Techniques	Substantive & Compliance. Sample based	Investigative, substantive or in-depth checking
Period	Normally for a particulars accounting period.	No such limitations
Verification of stock, Estimation realisable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation	Independent/verification of suspected/selected items where misappropriation in suspected
Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification	Legal determination of fraud impact and identification of perpetrators depending on scope.

(b) As per SA 510 “Initial Audit Engagements – Opening Balances”, while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether

(i) **Opening balances contain misstatements** that materially affect the current period’s financial statements; and

(ii) **Appropriate accounting policies reflected in the opening balances have been consistently applied** in the current period’s financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements.

Ordinarily, the **current auditor can place reliance on the closing balances contained in the financial statements** for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period’s audit procedures, say, the collection of opening accounts receivable during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In addition, according to SA 580 “Written Representations”, the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management’s judgment or intent in relation to, or the completeness of, a specific assertion. Although **such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.**

In the given case, the management of Captura (P) Ltd. has restrained CA. Mack, its auditor, from obtaining appropriate audit evidence for balances of Accounts Receivable outstanding as it is from the preceding year. CA. Mack, on believing that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Thus, CA. Mack should have requested the management to provide written representation for their views and expressions; and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme.

(c) As Mr. Jayprakash has been alleged of misconduct falling in **First as well as Second Schedule**, so the matter would be placed before the **Disciplinary Committee**.

The **maximum punishment** which could have been imposed on him by the said authority would be: -

- (i) **reprimanding** the member.
- (ii) removing name of the member **permanently or for any duration**, it thinks fit.
- (iii) imposing fine up to **₹ 5,00,000**.

Ques 4

(a) If there is any conflict of interest between the firm and client, it should be properly resolved before accepting the engagement. Where the firm obtains information that would have caused it to decline an engagement if that information had been obtainable earlier, policies and procedures on the continuance of the engagement and the client relationship should include consideration of:

- (i) The **professional and legal responsibilities that apply to the circumstances**, including whether there is a requirement for the firm to report to the person or persons who made the appointment or, in some cases, to regulatory authorities; and
- (ii) The **possibility of withdrawing from the engagement** or from both the engagement and the client relationship.

Policies and procedures on withdrawal from an engagement or from both the engagement and the client relationship address issues that include the following:

- **Discussing with the appropriate level of the client's management** and those charged with its governance regarding the **appropriate action** that the firm might take based on the relevant facts and circumstances.
- **If the firm determines that it is appropriate to withdraw, discussing** with the appropriate level of the client's management and those charged with its governance withdrawal from the engagement or from both the engagement and the client relationship, and the **reasons for the withdrawal**.
- **Considering whether there is a professional, regulatory or legal requirement for the firm to remain in place**, or for the firm to report the withdrawal from the engagement, or from both the engagement and the client relationship, together with the reasons for the withdrawal, to regulatory authorities.
- **Documenting significant issues**, consultations, conclusions and the basis for the conclusions.

(b) 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:

- (i) The **compiled financial information does not adequately refer to** or describe the applicable financial reporting framework
 - (ii) **Amendments to the compiled financial information are required** for the financial information not to be materially misstated; or
 - (iii) 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.

(c) Principle 9 - Provide value to the consumers in a responsible manner:

The primary purpose of any business is to create or provide useful products and services to the customer in exchange of reasonable profits.

The core elements associated with the principle are:

- i) Entities should put in their **efforts to reduce the negative impacts of their products and services** on consumers, natural environment, and society at large.
- ii) When conceptualizing, designing, and marketing their products, the organisation **should not in any manner prevent the freedom of choice and fair competition.**
- iii) When handling customer data, the **right to privacy of the customer needs to be maintained.**
- iv) Entities should **inform the customers on the safe and responsible ways** of usage, reuse, recycling, and disposal of their products, and ways to eliminate over-consumption.
- v) When advertising about their products, the organisations should ensure that **misleading and confusing information is not exposed to the customers** about their products or its usage.
- vi) Business enterprises should make available **transparent and accessible grievance redressal and feedback management system** for their customers to raise their voices or to seek clarifications.
- vii) Entities, when **in the business of providing essential goods and services** (e.g., Utilities), should enable universal access, including to those whose services have been discontinued for any reason, in a non-discriminatory and responsible manner.

Ques 5

(a) **According to Standards on Review Engagement (SREs)** review report is a **limited assurance engagement**. The practitioner provides a written report containing a conclusion that conveys the assurance obtained about the subject matter information. SAs, SRES and SAEs establish basic elements for assurance reports. In addition, the practitioner considers other reporting responsibilities, including communicating with those charged with governance.

In a **reasonable assurance engagement**, the practitioner expresses the **conclusion in the positive form**, this form of expression conveys "reasonable assurance". However, in a **limited assurance engagement**, the practitioner expresses the **conclusion in the negative form**, for example, "based on our work described in this report, **nothing has come to our attention that causes us to believe that** internal control is not effective, in all material respects, based on XYZ criteria". This form of expression conveys a level of "limited assurance" that is proportional to the level of the practitioner's evidence-gathering procedures given the characteristics of the subject matter and other engagement circumstances described in the assurance report.

The format of Review report in SRE in conclusion caption of the report provides as follows- "**nothing has come to our attention that causes to believe that these financial statements do not give a true and fair view of (Or presents fairly in all material respects) the financial position of the company and of its financial performance and cash flows for the period then ended in accordance with the Accounting standards** referred to in Companies Act 2013 and other accounting principles generally accepted in India".

Thus, in view of above it is clear that in a review report instead of positive form, the negative form of expression is being used. Also, it is to be noted that the **Review report contains caption-conclusion and not opinion.**

(b) CA H should consider the requirement of SA 600, "Using the Work of Another Auditor", if he decides to use the work of another auditor in relation to the audit of consolidated financial statements and he should comply with the requirements of SA 600.

In carrying out the audit of the standalone financial statements, the **computation of materiality** for the purpose of issuing an opinion on the standalone financial statements of each component **would be done component-wise on a standalone basis**.

However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following:

- (i) **The auditor is required to compute the materiality for the group as a whole.** This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments and current period consolidation adjustments) that are made by the management in the preparation of CFS.
- (ii) **The parent auditor can also use the materiality computed on the group level** to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components, and consider using the work of other auditors as applicable.
- (iii) **The principal auditor also computes materiality for each component and communicates to the component auditor**, if he believes is required for true and fair view on CFS.
- (iv) The principal auditor also **obtains certain confirmations from component auditors like independence**, code of ethics, certain information required for consolidation and disclosure requirements etc.

However, while considering the observations (for instance modification and /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the principles of SA 600 need to be considered i.e. CA H (the parent auditor) should comply with the requirements of SA 600, "Using the Work of Another Auditor".

(c) According to **Clause (7) of Part I of Second Schedule** of Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if **he does not exercise due diligence or is grossly negligent in the conduct of his professional duties**.

It is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. **The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.**

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard. He was guilty of professional misconduct under Clause (7).

Since Mr. D has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements, therefore, **the auditor is guilty of professional misconduct under Clause (7) of Part I of the Second Schedule** to the Chartered Accountants Act, 1949.

Ques 6

(a) **Clause (xviii) of Paragraph 3 of CARO, 2020:**

In the given situation of XMP Pvt Ltd, the auditors RS & Co. resigned due to concerns on the accounting matters of the company. However, all the compliances regarding resignation and appointments discussed in section 139 and 140 of the Companies Act, 2013 are also being complied with. **The auditor would be required to report the same in CARO, 2020 as per Clause (xviii) of Paragraph 3 of CARO, 2020** given hereunder:

Clause (xviii) of Paragraph 3 of CARO, 2020 requires the auditor to report **whether there has been any resignation of the statutory auditors during the year**, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

Clause (viii) of Paragraph 3 of CARO, 2020:

Further, the auditors noticed that a survey was conducted by the Income Tax Department and unrecorded sales of Rs 5 Lakhs were unearthed which had been made in cash on different dates during the year. XMP Pvt Ltd. has also purchased gold and the trans actions remained unrecorded. Though Company surrendered and disclosed these transactions before the

Assessing Officer and paid taxes thereon. **The auditor would be required to report in CARO as per Clause (viii) of Paragraph 3 of CARO, 2020.**

Clause (viii) of Paragraph 3 of CARO, 2020 requires the auditor to report - **whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income Tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year.**

Since it is a statutory obligation on the part of the auditor to report in terms of CARO, 2020 as given above and consequently **management's request to the auditor that not to report the above transactions is not tenable.**

(b) Phishing: Phishing is a **type of cyberattack that uses email, SMS, phone, social media, and social engineering techniques to entice a victim to share sensitive information** such as passwords or account numbers - or to download a malicious file that will install viruses on their computer or phone.

Types of Phishing

Spear Phishing

Spear-phishing is a type of phishing attack that targets specific individuals or organizations typically through malicious emails. The goal of spear phishing is to steal sensitive information such as login credentials or infect the targets' device with malware.

Whaling

A whaling attack is a type of social engineering attack specifically targeting senior or C-level executive employees with the purpose of stealing money or information or gaining access to the person's computer in order to execute further cyberattacks.

Smishing

Smishing is a type of fraudulent practice of sending text messages purporting to be from reputable companies in order to induce individuals to reveal personal information, such as passwords or credit card numbers.

Vishing

Vishing, a voice phishing attack, is the fraudulent use of phone calls and voice messages pretending to be from a reputable organization to convince individuals to reveal private information such as bank details and passwords.

(c)

(1) According to Clause (10) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if **he charges or offers to charge, accepts or offers to accept in respect of any professional employment fees which are based on a percentage of profits or which are contingent upon the findings**, or results of such employment, except as permitted under any regulations made under this Act.

However, **Regulation 192 exempts Chartered Accountants** in practice to charge fees based on a percentage of profits or contingent upon findings or results for professional work for certain professional services.

Regulation 192 specifically states that in the case of a valuer for the purposes of direct taxes and duties, the fees may be based on a percentage of the value of the property valued.

Conclusion: Consequently, **CA. Pankaj shall not be deemed to be guilty of professional misconduct**, as he is within the permissible scope of charging fees based on a percentage of the property valued.

(2) In accordance with Clause (2) of Part III of the First Schedule to the Chartered Accountants Act, 1949, a member, whether in practice or not, is considered to be engaged in professional misconduct if **he fails to provide the information requested or does not comply with the requirements set forth by the Institute, Council, or any of its committees**,

including the Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board, or the Appellate Authority.

Conclusion: Therefore, in the given scenario, CA. Anita has neglected to respond to the Institute's letters seeking confirmation of her appointment date and has not submitted her membership certificate. Consequently, she is deemed to be **guilty of professional misconduct as given in Clause (2) of Part III of the First Schedule** to the Chartered Accountants Act, 1949.

OR

(c) As per **Clause (12) of Part I of the First Schedule** of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if **he allows a person not being a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements.**

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed **may be delegated in the following instances** and such delegation will not attract provisions of this clause:

- (i) Issue of audit queries during the course of audit.
- (ii) Asking for information or issue of questionnaire.
- (iii) Letter forwarding draft observations/financial statements.
- (iv) Initiating and stamping of vouchers and of schedules prepared for the purpose of audit.
- (v) Acknowledging and carrying on routine correspondence with clients.
- (vi) Issue of memorandum of cash verification and other physical verification or recording the results thereof in the books of the clients.
- (vii) Issuing acknowledgements for records produced. Raising of bills and issuing acknowledgements for money receipts.
- (ix) Attending to routine matters in tax practice, subject to provisions of Section 288 of Income Tax Act.
- (x) Any other matter incidental to the office administration and routine work involved in practice of accountancy.

In the instant case, CA. Tanya, the auditor of KBC Pvt. Ltd. has delegated certain task to his articles and staff such as issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced and signing financial statements of the company.

Therefore, **CA. Tanya is correct in allowing first four tasks** i.e. issue of audit queries during the course of audit, issue of memorandum of cash verification and other physical verification, letter forwarding draft observations/financial statements, issuing acknowledgements for records produced to his staff and articles.

However, if the person signing the financial statements on his behalf is not a member of the institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, **CA. Tanya is wrong in delegating signing of financial statements to his staff.**

Conclusion: In view of this, **CA. Tanya would be held guilty of professional misconduct for allowing the person signing the financial statements on his behalf to his articles and staff under Clause 12 of Part 1 of First Schedule** of the Chartered Accountants Act, 1949.