

MOCK TEST PAPER - 2
FINAL COURSE: GROUP I
PAPER-3: ADVANCED AUDITING AND PROFESSIONAL ETHICS
SUGGESTED ANSWERS/HINTS

DIVISION A - MCQs (30 Marks)

Questions no. (1-10) carry 1 Mark each and Questions no. 11-20 carry 2 Marks each.

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

DIVISION B - DESCRIPTIVE QUESTIONS (70 Marks)

1. (a) SA 330 states that irrespective of the assessed risk of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure. In the given situation, the auditor has assessed the risk of material misstatement to be low. However, despite such assessment, substantive procedures have to be performed.

SA 330 further states that the auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures. External confirmation procedures frequently are relevant when addressing assertions associated with account balances and their elements but need not be restricted to these items. For example, the auditor may request external confirmation of the terms of agreements, contracts, or transactions between an entity and other parties.

Despite the low assessed risk of material misstatement, substantive procedures have to be performed due to the following reasons: -

- (i) The auditor's assessment of risk is judgmental and so may not identify all risks of material misstatement and
- (ii) there are inherent limitations to internal control, including management override.

It is also in accordance with the spirit of professional skepticism. Therefore, as discussed above, the approach of CA Y is in accordance with Standards on Auditing.

- (b) Section 177(9) of the Companies Act 2013 requires every listed company and certain other classes of companies to establish a vigil mechanism for their directors and employees to report their genuine concerns or grievances. The vigil mechanism under section 177(9) of the Act shall provide for adequate safeguards against victimisation of persons who use such a mechanism and make provisions for direct access to the Chairperson of the Audit Committee in appropriate or exceptional cases.

Regulation 4(2)(d) of the SEBI LODR Regulations also mandates all listed entities to devise an effective vigil mechanism/whistleblower policy enabling stakeholders, including individual employees and their representative bodies, to communicate their concerns about illegal or unethical practices freely. Regulation 46(2)(e) of SEBI LODR Regulations requires a listed company to disseminate on its website details of the establishment of a vigil mechanism/whistleblower policy. Further, the role of the audit committee also includes reviewing the functioning of the whistleblower mechanism.

Where the establishment of whistle bower mechanism is mandated by law, the auditor should check whether the company has an ethics/whistleblower/ hotline process with adequate procedures to handle anonymous complaints (received from inside and outside the company) and to accept confidential submission of concerns about questionable accounting, internal control, or auditing matters.

The auditor is required to consider every complaint received by the company, *including anonymous complaints*, while deciding the nature, timing and extent of audit procedures. The auditor should also evaluate whether whistleblower complaints are investigated and resolved by the company appropriately and timely.

Further, there exists a reporting duty of the auditor under para 3(xi)(c) under CARO, 2020, to state whether the auditor has considered whistle-blower complaints, if any, received during the year by the company.

- (c) CA Z has gained an understanding of various IT controls operating in the company including General IT controls and application controls. Such activities form part of "*control activities*", which is one of the components of internal control of an organization.

Control activities are the policies and procedures that help ensure management directives are carried out. Control activities, whether within IT or manual systems, have various objectives and are applied at various organisational and functional levels. Examples of specific control activities include those relating to the following:

Performance reviews

These control activities include reviews and analyses of actual performance versus budgets, forecasts, and prior period performance; relating different sets of data – operating or financial – to one another, together with analyses of the relationships and investigative and corrective actions; comparing internal data with external sources of information; and review of functional or activity performance.

Physical controls

Controls that encompass:

- The physical security of assets, including adequate safeguards such as secured facilities over access to assets and records.
 - The periodic counting and comparison with amounts shown on control records (for example, comparing the results of cash, security and inventory counts with accounting records).
2. (a) The indicated events or conditions in MZE Limited may cast significant doubt on ability of company to continue as going concern. SA 570 requires that if events or conditions have been identified that may cast significant doubt on the entity's ability to continue as a going concern, the auditor shall obtain sufficient appropriate audit evidence to determine whether or not a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern through performing additional audit procedures, including consideration of mitigating factors.

In the given situation, the auditor is studying management's assessment of the company's ability to continue as going concern, including its future plan of action containing projected profitability statements for the next two years containing estimates of turnover, expenses and profits. However, as required in SA 570, auditor's procedures should focus on **cash flow forecast** and not on future profit projections. It is quite possible that a company may continue to carry on as a going concern so long as it can meet its liabilities. Therefore, analysing the projected profitability statements alone is insufficient to support the conclusion on the going concern assumption followed by the company.

Therefore, the auditor should require management to prepare a cash flow forecast in the given circumstances. The auditor should then analyse the cash flow forecast in the evaluation of management's future plan of action. It includes: -

- (i) Evaluating the reliability of the underlying data generated to prepare the forecast and
- (ii) Determining whether there is adequate support for the assumptions underlying the forecast

Further, some major overseas payments of the company are stuck up. It is quite possible that the timing of cash inflows on account of these payments may affect the situation. The auditor would have to evaluate the reliability of data for preparation for such a forecast and its underlying assumptions. He should perform procedures to obtain evidence regarding assumptions and timing of cash inflows and outflows like any restructuring undertaken by bankers providing relief to the company, future sales and consequent cash realization in downturn conditions, willingness of creditors to provide credit in such a situation, incurring of expenditures to keep the company afloat. All these assumptions underlying such cash flow forecasts need to be challenged and examined.

- (b) The major areas to plug revenue leakage where concurrent auditor should focus audit procedures include: -
- (i) Verifying rates of interest as per terms of sanction in sanction letter vis-à-vis those fed in CBS as well as the calculation of interest through product rate sheets generated by CBS to satisfy that interest has been charged on all the performing accounts and interest rates charged are in accordance with the bank's internal regulations, directives of the RBI and agreements with the respective borrowers.
 - (ii) Verification of renewal charges in respect of existing customers enjoying cash credit and export credit facilities. Similarly, for fresh borrowers, proposal processing charges, including upfront fees for term loan, needs to be verified in accordance with Bank's circulars to ensure that all charges are debited at time of release of facilities to new customers. These charges also need to be levied proportionately in respect of customers whose credit facilities have been enhanced.

- (iii) Verification of penal charges for non-submission of stock statements on due dates in case borrowers availing cash credit and export credit facilities consisting of pre-shipment credit facilities.
 - (iv) Verification of commission /charges in case of letter of credit has been issued to importers in accordance with the Bank's circulars.
 - (v) As the branch has also granted export credit facilities in the nature of post-shipment credit facilities, verification of commission/charges on export bills purchased is required.
- (c) CARO, 2020 specifically provides that it shall not apply to the auditor's report on consolidated financial statements except clause (xxi) of paragraph 3. This means that the auditor will need to give a CARO report on the consolidated financial statements with respect to clause 3(xxix) of the Order only. Thus, the auditor is not required to report on rest of the clauses of paragraph 3.

Clause 3(xxix) of CARO 2020 requires the auditor to state whether there have been any qualifications or adverse remarks by the respective auditors in the Companies (Auditor's Report) Order (CARO) reports of the companies included in the consolidated financial statements. If yes, indicate the details of the companies and the paragraph numbers of the CARO report containing the qualifications or adverse remarks.

Therefore, it requires the auditor to provide details of the companies and the paragraph numbers of the respective CARO report containing the qualifications or adverse remarks only. Reporting under this is only required for those entities included in the consolidated financial statements to whom CARO 2020 is applicable.

3. (a) SQC 1 states that the engagement quality control reviewer is a partner, other person in the firm (member of ICAI), a suitably qualified external person, or a team made up of such individuals with sufficient and appropriate experience and authority to evaluate objectively, before the report is issued, the significant judgments the engagement team made and the conclusions they reached in formulating the report.

It also states that the engagement quality control reviewer for an audit of the financial statements of a listed entity is an individual with sufficient and appropriate experience and authority to act as an audit engagement partner on audits of financial statements of listed entities.

Further, the work of EQCR involves objective evaluation of the significant judgments made by the engagement team and ensuring that the conclusions reached by the team in formulating audit reports are appropriate. It is necessary for EQCR to have the requisite technical expertise and experience to enable her to perform the assigned role of evaluating the work of the engagement team so that any possible misstatement can be avoided. Without ensuring the appropriate technical expertise and experience, the whole purpose of EQCR is defeated. Therefore, it was not appropriate for her to accept an appointment as EQCR for the listed entity.

Further, SA 220 states that the engagement quality control reviewer shall document, for the audit engagement reviewed, that the procedures required by the firm's policies on engagement quality control review have been performed. It also states that it shall also be documented that the reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

In the given situation, there are no working papers to show that EQCR has done an evaluation on conclusions reached by the engagement team. Mere ticking of a Yes/No checklist and signing on some working papers of the engagement team shows that EQCR has made no such evaluation and review of work performed by the engagement team. Therefore, her approach was not proper in performing the work of EQCR.

As CA Ragini has allowed the issuance of an audit report of the company without carrying out due procedures as discussed above, she is guilty of professional misconduct under clauses 8 and 9 of Part I of the Second Schedule to Chartered Accountants Act, 1949. Under Clause 8, a Chartered

Accountant is held guilty of professional misconduct in case of failure to obtain sufficient information which is necessary for the expression of an opinion, or its exceptions are sufficiently material to negate the expression of an opinion.

Clause 9 is applicable in case of failure to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances. Therefore, she is guilty of professional misconduct, as discussed above.

- (b) Each Forensic Accounting assignment is unique. Accordingly, the actual approach adopted and the procedures performed will be specific to it. However, in general, many Forensic Accounting assignments will include the steps detailed below.

Step 1. Initialization

It is vital to clarify and remove all doubts as to the real motive, purpose and utility of the assignment. It is helpful to meet the client to obtain an understanding of the important facts, players and issues at hand. A conflict check should be carried out as soon as the relevant parties are established. It is often useful to carry out a preliminary investigation prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issues.

Step 2. Develop Plan

This plan will take into account the knowledge gained by meeting with the client and carrying out the initial investigation and will set out the objectives to be achieved and the methodology to be utilized to accomplish them.

Step 3. Obtain Relevant Evidence

Depending on the nature of the case, this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event. In order to gather detailed evidence, the investigator must understand the specific type of fraud that has been carried out, and how the fraud has been committed. The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, and the amount of financial loss suffered. It is important that the investigating team is skilled in collecting evidence that can be used in a court case within the stipulated time period, and in keeping a clear chain of custody until the evidence is presented in court. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible. Investigators must be alert to documents being falsified, damaged or destroyed by the suspect(s).

Step 4. Perform the analysis

The actual analysis performed will be dependent upon the nature of the assignment and may involve:

- calculating economic damages;
- summarizing a large number of transactions;
- performing a tracing of assets;
- performing present value calculations utilizing appropriate discount rates;
- performing a regression or sensitivity analysis;
- utilizing a computerized application such as a spread sheet, data base or computer model; and
- utilizing charts and graphics to explain the analysis.

Step 5. Reporting

Issuing an report is the final step of a forensic accounting. Accountant / Investigators will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence, a conclusion as to the amount of loss suffered as a result of the fraud and to identify those involved in fraud. The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope and findings and/or opinions. The report will include schedules and graphics necessary to properly support and explain the findings.

The report will also discuss how the fraudster set up the fraud scheme, and which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

Step 6. Court proceedings

The investigation is likely to lead to legal proceedings against the suspect, and members of the investigative team will probably be involved in any resultant court case. The evidence gathered during the investigation will need to be presented at court, and team members may be called to court to describe the evidence they have gathered and to explain how the suspect was identified.

- (c) The principle of integrity requires an accountant to be straightforward and honest in all professional and business relationships. Integrity implies fair dealing and truthfulness. A professional accountant shall not knowingly be associated with reports, returns, communications or other information where the accountant believes that the information: -

- Contains a materially false or misleading statement.
- Contains statements or information provided negligently; or
- Omits or obscures required information where such omission or obscurity would be misleading.

Under Section 271 J of the Income Tax Act, if an accountant, merchant banker or registered valuer furnishes incorrect information in a report or certificate under any provisions of the Act or rules made thereunder, the assessing officer or Commissioner (Appeals) during the course of any proceedings under the Income Tax Act may direct him to pay a penalty of Rs.10000/- for each such certificate or report. Therefore, he can be liable to a penalty of Rs.10000/- for wrong certification.

4. (a) The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committees. It is ensured as follows: -

- (i) His reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his reports
- (ii) He scrutinises the notes which the Ministries submit to the Committees and helps the Committees to check the correctness of submissions to the Committees and facts and figures in their draft reports
- (iii) The financial Committees present their report to the Parliament/ State Legislature with their observations and recommendations.

The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature

- (iv) In respect of those audit reports, which could not be discussed in detail by the committees', written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature.

This ensures that the audit reports are not taken lightly by the Government, even if the entire report is not deliberated upon by the Committee.

The functions of “Estimates Committee” are: -

- (i) to report what economies, improvements in organization, efficiency or administrative reform, consistent with the policy underlying the estimates may be effected
 - (ii) to suggest alternative policies
 - (iii) to examine whether the money is well laid out within the limit and
 - (iv) to suggest the form in which the estimates shall be presented to Parliament.
- (b)** The scope of an Enterprise Risk Management program is much broader than an internal control framework and encompasses both internal and external factors that are relevant to business strategy, governance, business process and transaction and activity level. The focus of an internal control framework is primarily around financial reporting, operations and compliance risks associated with an account balance, business process, transaction and activity level, which form a sub-set of the overall enterprise risks.

This Enterprise Risk Management – Integrated Framework expands on internal control providing a more robust and extensive focus on the broader subject of enterprise risk management. While it is not intended to and does not replace the internal control framework, but rather incorporates the internal control framework within it, companies may decide to look to this enterprise risk management framework both to satisfy their internal control needs and to move toward a fuller risk management process.

One of the most critical components of Enterprise Risk Management is the risk assessment process. The risk assessment process involves considerations for: -

- Risk identification
- Assessment criteria including qualitative and quantitative factors
- Definition of key performance and risk indicators;
- Risk appetite
- Risk scores, scales and maps
- Assess risks
- Use of data & metrics
- Prioritise risk
- Benchmarking

Two most widely used ERM frameworks are: -

COSO Enterprise Risk Management – Integrated Framework developed by the Committee of Sponsoring Organisations (COSO) to address the changes in business environment.

ISO 31000 Risk Management standard published by the International Organization for Standardization. It is a risk Management standard published by the International Organization for Standardization and provides guidelines on managing risk faced by organizations. The application of these guidelines can be customized to any organization and its context.

- (c)** Section 194 R of Income Tax Act mandates that a person responsible for providing any benefit or perquisite to a resident to deduct tax at source @ 10% of the value or aggregate of such benefit or perquisite before providing such benefit or perquisite. The benefit or perquisite may or may not be convertible into money but should arise either from carrying out of business, or from exercising a profession by such resident. This deduction is not required to be made if the value or aggregate of

value of the benefit or perquisite provided or likely to be provided to the resident during the financial year does not exceed twenty thousand rupees.

In the given situation, a pharma company has provided free medicine samples worth Rs.50000/- to employee doctors of hospitals. The TDS under section 194R of the Act is required to be deducted by the company in the hands of the hospital as the benefit/prerequisite is provided to the doctor on account of him being an employee of the hospital. Thus, the benefit/prerequisite is provided to the hospital in substance. A threshold of twenty thousand rupees of section 194R of the Act is also required to be seen with respect to the recipient entity.

Therefore, it should be verified that pharma company has deducted tax at source in hands of every hospital @ 10% as the benefit/perquisite is provided to each specialist doctor on account of his being employee of hospital. In case, company has not deducted TDS on above transactions, same should be reported under clause 21b specifying date of payment, nature of payment, name of payee and required details.

5. (a) The above instructions are not proper and these do not pertain to Division III of Schedule III applicable to NBFCs. Rather, such requirements are applicable for companies for which Division II of Schedule III is applicable. Hence, these should be revised in accordance with similar requirements applicable to listed NBFCs for whom Division III of Schedule III is applicable.

The similar disclosure requirements for a listed NBFC under Division III of Schedule III are as follows: -

- (i) Any item of other income or other expenditure which exceeds 1% of total income
- (ii) Disclosure of the following ratios: -
 - Capital to risks-weighted assets ratio (CRAR)
 - Tier I CRAR
 - Tier II CRAR
 - Liquidity coverage ratio

- (b) SA 705 states that the auditor shall modify the opinion in the auditor's report when:

- (a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement or
- (b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.

In the given situation, auditor has obtained evidence in relation to non-recoverability of outstanding trade receivable.

SA 705 further states that the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

In this scenario, the uncorrected misstatement stands at 200% of the profit before tax, while the materiality has been determined at 5% of the profit before tax. Hence, this misstatement should be considered as material. Additionally, if such a substantial amount is written off, it would significantly impact the financial position of the company. As a result, losses would have to be reported instead of profits. Taking the above factors into consideration, this misstatement should be classified as both material and pervasive. Therefore, adverse opinion needs to be expressed in accordance with the requirements of SA 705.

- (c) Part II of First Schedule of Chartered Accountants Act, 1949 deals with professional misconduct in relation to members of Institute in service. Clause 2 of Part II of First Schedule to Chartered Accountants Act states that a member of the Institute (other than a member in practice) shall be

deemed to be guilty of professional misconduct, if he being an employee of any company, firm or person accepts or agrees to accept any part of fees, profits or gains from a lawyer, a chartered accountant or broker engaged by such Company, firm or person or agent or customer of such Company, firm or person by way of commission or gratification.

Therefore, CA D is guilty of professional misconduct as discussed above.

6. (a) SA 600 requires auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor. For this purpose, the auditor would consider: -
- (i) the materiality of the portion of the financial information which the principal auditor audits
 - (ii) the principal auditor's degree of knowledge regarding the business of the components
 - (iii) the risk of material misstatements in the financial information of the components audited by the other auditor and
 - (iv) the performance of additional procedures as set out in SA 600 regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.

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

- 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.
 - The parent auditor can also use 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.
 - While considering the observations (for instance, modification and /or emphasis of matter/other matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the parent auditor should comply with the requirements of SA 600 "Using the Work of Another Auditor".
- (b) Central Government has constituted a Quality Review Board as an independent body under the Chartered Accountants Act, 1949 to review the quality of services provided by the Chartered Accountants in India including audit services.

Accordingly, u/s 28B of the Chartered Accountants Act, 1949, the Board shall perform the following functions, namely: -

- (a) to make recommendations to the Council with regard to the quality of services provided by the members of the Institute
- (b) to review the quality of services provided by the members of the Institute including audit services
- (c) to guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements and
- (d) to forward cases of non-compliance with various statutory and regulatory requirements by the members of the Institute or firms, noticed by it during the course of its reviews, to the Disciplinary Directorate for its examination.

In the given situation, AUFR has not performed audits of selected companies qualitatively and has failed to perform audits in accordance with Standards on Auditing, Further, it has issued clean

reports despite non-adherence to accounting standards by respective companies. Therefore, QRB is empowered to act on the lines mentioned above in respect of AUFR.

- (c) The Internal Auditor shall be free from any undue influences which force him to deviate from the truth. This independence shall be not only in mind but also in appearance. Also, the internal auditor shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives. The independence of the internal audit function and the Internal Auditor within the organization is a vital aspect of maintaining effective corporate governance. It is important to ensure that the internal audit function is free from any undue influence or pressure that may affect its ability to provide impartial and objective assessments of the organization's operations, risks, and controls.

Therefore, the given statement is proper.

To establish the independence of the Internal auditor, several factors need to be considered. Firstly, the overall organizational structure of key personnel plays a crucial role. The Internal auditor should be positioned in a way that allows them to operate independently and objectively. This includes having direct access to the Audit Committee, Board of Directors, and other senior executives. Secondly, the reporting line of the Chief Internal Auditor is an important consideration. The Chief Internal Auditor should report to the highest level of authority within the organization, such as the CEO or the Board of Directors. This ensures that the Internal auditor has the necessary authority and support to carry out their responsibilities effectively. Finally, the powers and authority derived from superiors further establish the independence of the Internal auditor. The Internal auditor should have the necessary resources, budget, and support to conduct their work without any undue influence or pressure from senior executives or other stakeholders.

OR

Section 6 of the Chartered Accountants Act, 1949 provides that: -

- i. No member of the Institute shall be entitled to practise whether in India or elsewhere unless he has obtained from the Council a certificate of practice:

It may be noted that this provision is not applicable to any person who, immediately before the commencement of this Act, has been in practice as a registered accountant or a holder of a restricted certificate until one month has elapsed from the date of the first meeting of the Council.

- ii. Every such member shall pay such annual fee for his certificate as may be determined, by notification, by the Council.
- iii. The certificate of practice obtained under sub-section (1) may be cancelled by the Council under such circumstances as may be prescribed.

Once the person concerned becomes a member of the Institute, he is bound by the provisions of the Chartered Accountants Act and its Regulations. If and when he appears before the Income-tax Tribunal as an Income-tax representative after having become a member of the Institute, he could so appear only in his capacity as a Chartered Accountant and a member of the Institute. Having, as it were, brought himself within the jurisdiction of the Chartered Accountants Act and its Regulations, he could not set them at naught by contending that even though he continues to be a member of the Institute and has been punished by suspension from practice as a member, he would be entitled, in substance, to practice in some other capacity.

In the current case, Mr. Raj, designating himself as Data Privacy consultant, did the work of filing Data Privacy related returns and made appearance as a consultant before various related authorities in other capacity other than Chartered Accountant in Practice. As a result, he is not appearing in the capacity of Chartered Accountant in Practice and hence he is not violating the suspension order.