

FINAL COURSE: GROUP I

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

ANSWERS

Part I: MULTIPLE CHOICE QUESTION

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

Part II - DESCRIPTIVE QUESTION

1. (a) As per SA 710, "Comparative Information – Corresponding Figures and Comparative Financial Statements", when the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

SA 710 further states that if the auditor's report on the prior period, as previously issued, included a qualified opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either:

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- (i) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
- (ii) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

In the instant case, if Neptune Ltd. does not make provision for diminution in the value of investment to the extent of ₹ 70 lakh, the auditor will have to modify his report for both the current and previous year's figures as mentioned above. If, however, the provision is made, the auditor need not refer to the earlier year's modification.

- (b) In the present case based on the audit evidence obtained, CA Shiv has concluded that a material uncertainty exists related to the outcome of the legal dispute, which is uncertain, but if it results in an unfavorable judgment, it could severely impact the Company's financial position and cash flows. In such circumstances, CA Shiv should express an adverse opinion because the effects on the financial statements of such omission are material and pervasive.

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

Adverse Opinion

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of the entity as at March 31, 2024, and of its financial performance and its cash flows for the year then ended in accordance with the Accounting Standards issued by the Institute of Chartered Accountants of India.

Basis for Adverse Opinion

The financing arrangements of Pratibha Ltd. has expired, and the amount outstanding was payable on March 31, 2024. The entity has been unable to conclude re-negotiations or obtain replacement financing and is considering filing for bankruptcy. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statements do not adequately disclose this fact.

- (c) As per section 143(12) of the Companies Act, 2013 read with Rule 13 of the Companies (Audit and Auditors) Rules, 2014, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as prescribed.

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In the given case, CA Guru has reason to believe that a fraud involving ₹ 75 lakhs has been committed in the company by its employees. Therefore, he is under no statutory obligation to report this matter to Central Government by filing prescribed Form (ADT-4) on MCA portal.

In case of a fraud involving lesser than the specified amount [i.e. less than ₹ 1 crore], the auditor shall report the matter to the audit committee constituted under section 177 or to the Board in other cases within such time and in such manner as prescribed. Besides, auditor has obligation to report matters pertaining to fraud under clause (xi) of paragraph 3 of CARO, 2020.

2. (a) As per SA 701, 'Communicating Key Audit Matters in the Independent Auditor's Report', the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:
- (i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.
 - (ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
 - (iii) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the aforesaid matters considered were of most significance in the audit of the financial statements of the current period and therefore are the key audit matters.

These aforesaid considerations focus on the nature of matters communicated with those charged with governance. Such matters are often linked to matters disclosed in the financial statements and are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users.

The fact that these considerations are required is not intended to imply that matters related to them are always key audit matters; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit.

In addition to matters that relate to the specific required considerations, there may be other matters communicated with those charged with governance that required significant auditor attention and that therefore may be determined to be key audit matters. Such matters may include, for example, matters relevant to the audit that was performed that may not be required to be disclosed in the financial statements. For example, the implementation of a new IT system (or significant changes to an

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existing IT system) during the period may be an area of significant auditor attention, in particular if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (e.g., changes to a system affecting revenue recognition).

In the given case, there was implementation of ERP system in the company due to which some of its business processes got automated and which had a significant effect on the auditor's overall audit strategy during the period.

As per Mr. Arjun, Engagement Partner, above mentioned matter can be considered as a key audit matter and should be reported in the audit report since it requires significant attention that had affected his overall audit strategy. Mr. Krishna, EQCR, considered the significance of said matter, however, he was of the opinion that ERP implementation did not appear to link with the matters disclosed in the financial statements, therefore, no need to disclose such matter as a key audit matter.

In view of the above, the contention of Mr. Krishna is not appropriate as matters that do not link with the matters disclosed in the financial statements can also be considered as a key audit matter, if it requires significant attention.

- (b)** Clause 11 of Part I of First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he engages in any business or occupation other than the profession of Chartered Accountants unless permitted by the Council so to engage.

Provided that nothing contained herein shall disentitle a Chartered accountant from being a director of a Company, (not being a managing director or a whole-time director), unless he or any of his partners is interested in such company as an auditor.

Ethical Standards Board of ICAI has announced that it is permissible for a member in practice to engage in derivative transactions in his personal capacity but not in professional capacity i.e. for clients. Such engagements in derivatives are not violative of provisions of Clause 11 of Part I of First Schedule to the Chartered Accountants Act, 1949. Further, members are allowed to transact in equity and currency derivatives. There is no requirement to take permission of Council in this matter.

Therefore, there is no difference if CA. Kapila had earned income from currency derivatives. However, in accordance with announcement of Ethical Standards Board of ICAI, it is not permissible for members in practice to transact in commodity derivative transactions. In such a case, CA. Kapila would be held guilty of professional misconduct for engaging in business other than profession of Chartered Accountancy.

(c) Advantages and Disadvantages of Remote Audit:

ADVANTAGES	DISADVANTAGES
Cost and time effective: No travel time and travel costs involved.	Due to network issues, interviews and meetings can be interrupted.
Comfort and flexibility to the audit team as they would be working from home environment,	Limited or no ability to visualize facility culture of the organization, and the body language of the auditees. Time zone issues could also affect the efficiency of remote audit session.
Time required to gather evidence can spread over several weeks, instead of concentrated into a small period that takes personnel from their daily activities.	The opportunity to present doctored documents and to omit relevant information is increased. This may call for additional planning, some additional/different audit procedures, Security and confidentiality violation.
Auditor can get first-hand evidence directly from the IT system as direct access may be provided.	Remote access to sensitive IT systems may not be allowed. Security aspects related to remote access and privacy needs to be assessed
Widens the selection of auditors from global network of experts.	Cultural challenges for the auditor. Lack of knowledge for local laws and regulations could impact audit. Audit procedures like physical verification of assets and stock taking cannot be performed.

3. (a) **Responsibility and Co-ordination among Joint Auditors:** As per SA 299, "Joint Audit of Financial Statements", where joint auditors are appointed, they should, by mutual discussion, divide the audit work among themselves. The division of the work would usually be in terms of audit identifiable units or specified area. In some cases, due to the nature of the business entity under audit, such a division of the work may not be possible. In such situations, the division of the work may be with reference to items of assets or liabilities or income or expenditure or with reference to period of time. The division of the work among joint auditors as well as the areas of work to be covered by all of them should be adequately documented and preferably communicated to the entity.

In respect of the audit work divided among the joint auditors, each joint auditor is responsible only for the work allocated to him, whether or not he has prepared a separate audit of the work performed by him. On the other hand all the joint auditors are jointly and severally responsible –

- (i) The audit work which is not divided among the joint auditors and is carried out by all joint auditors;

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- (ii) Decisions taken by all the joint auditors under audit planning phase concerning the nature, timing and extent of the audit procedure to be performed by each of the auditor;
- (iii) Matters which are brought to the notice of the joint auditors by any one of them and on which there is an agreement among the joint auditors;
- (iv) Examining that the financial statements of the entity comply with the requirements of the relevant statute;
- (v) Presentation and disclosure of financial statements as required by the applicable financial reporting framework;
- (vi) Ensuring that the audit report complies with the requirements of the relevant statutes, the applicable Standards on Auditing and the other relevant pronouncements issued by ICAI;

The joint auditors shall also discuss and document the nature, timing, and the extent of the audit procedures for common and specific allotted areas of audit to be performed by each of the joint auditors and the same shall be communicated to those charged with governance. After identification and allocation of work among the joint auditors, the work allocation document shall be signed by all the joint auditors and the same shall be communicated to those charged with governance of the entity.

Hence, in respect of audit work divided among the joint auditors, each joint auditor shall be responsible only for the work allocated to such joint auditor including proper execution of the audit procedures.

In the instant case, Studio Ltd. appointed two CA Firms AB & Associates and CD & Co. as joint auditors for conducting audit. As observed during the course of audit that there is a significant understatement in the value of trade receivable and valuation of trade receivable work was looked after by AB & Associates.

In view of SA 299, AB & Associate will be held responsible for the same as trade receivable valuation work was looked after by AB & Associates only. Further, there is violation of SA 299 as the division of work has not been documented.

- (b) As per Clause (xvi) of Paragraph 3 of CARO 2020, the auditor is required to report that “whether the company is required to be registered under section 45-IA of the Reserve Bank of India Act, 1934 and if so, whether the registration has been obtained.”

The auditor is required to examine whether the company is engaged in the business which attracts the requirement of the registration. The registration is required where the financing activity is a principal business of the company. The RBI restrict companies from carrying on the business of a non-banking financial institution without obtaining the certificate of registration.

Audit Procedures and Reporting:

- (i) The auditor should examine the transactions of the company with relation to the activities covered under the RBI Act and directions related to the Non-Banking Financial Companies.
- (ii) The financial statements should be examined to ascertain whether company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.
- (iii) Whether the company has net owned funds as required for the registration as NBFC.
- (iv) Whether the company has obtained the registration as NBFC, if not, the reasons should be sought from the management and documented.
- (v) The auditor should report incorporating the following:-
 - (1) Whether the registration is required under section 45-IA of the RBI Act, 1934.
 - (2) If so, whether it has obtained the registration.
 - (3) If the registration not obtained, reasons thereof.

In the given case, Manu Finance Ltd. is a Non-Banking Finance Company and was in the business of accepting public deposits and giving loans since 2019. The company was having net owned funds of ₹ 1,75,00,000/-(one crore seventy five lakhs) which is less in comparison to the prescribed limit i.e. 2 crore rupees and was also not having registration certificate from RBI (though applied for it on 29th March 2024). The auditor is required to report on the same as per Clause (xvi) of Paragraph 3 of CARO 2020.

- (c) According to Clause (7) of Part I of Second Schedule to the 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 usually 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.

In the instant case, DIGI & Associate did not exercise due diligence and is grossly negligent in the conduct of his professional duties since it did not visit the site where the stock was lying and instead the firm relied on the MIS report along with inspection reports and photographs of stock taken by the employees of PQR Ltd, which is incorrect.

To conduct stock audit, ascertainment of existence and physical condition of stocks, cross tallying the stock with Stock statement submitted by bank borrower, correct classification of stocks for valuation

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purpose etc. is essential. Further submitting stock audit report without physically verifying the stock amounts to gross negligence.

From the above, it can be concluded that DIGI & Associate is guilty of professional misconduct under Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

4. (a) **Consolidation of Financial Statement:** As per Ind AS 110, there is no such exemption for 'temporary control', or "for operation under severe long-term funds transfer restrictions" and consolidation is mandatory for Ind AS compliant financial statement in this case. Paragraph 20 of Ind AS 110 states that "Consolidation of an investee shall begin from the date the investor obtains control of the investee and cease when the investor loses control of the investee".

However, as per Section 129(3) of the Companies Act, 2013 read with rule 6 of the Companies (Accounts) Rules, 2014, where a company having subsidiary, which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with the provisions on consolidated financial statements provided in Schedule III to the Act.

In the given case, Girdhar Ltd.'s intention is disposal of the shares in the near future as shares are being held as stock in trade and it is quite clear that the control is temporary, Therefore, Girdhar Ltd. is required to prepare Consolidated Financial Statements in accordance with Ind AS 110 as exemption for 'temporary control' is not available in the same.

- (b) Section 2(45) of the Companies Act, 2013, defines a "Government Company" as a company in which not less than 51% of the paid-up share capital is held by the Central Government or by any State Government or Governments or partly by the Central Government and partly by one or more State Governments, and includes a company which is a subsidiary company of such a Government company.

The auditors of these government companies are firms of Chartered Accountants, appointed by the Comptroller & Auditor General, who gives the auditor directions on the manner in which the audit should be conducted by them.

In the given situation, Abhinandan Ltd. is a company wholly owned by Delhi Government was disinvested during the previous year, resulting in 38% of the shares being held by public. The shares were also listed on the NSE. The listing of company's shares on a stock exchange is irrelevant for this purpose and hence, opinion of finance manager Paras is not correct.

- (c) Under Section 2(2)(iv) of the Chartered Accountants Act, 1949, a member of the Institute shall be deemed "to be in practice" when individually or in partnership with Chartered Accountants in practice, he, in consideration of remuneration received or to be received renders such other services as, in the opinion of the Council, are or may be rendered by a Chartered Accountant in practice.

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Pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949, read with Regulation 191 of Chartered Accountants Regulations, 1988 a member shall be deemed to be in practice if he, in his professional capacity and neither in his personal capacity nor in his capacity as an employee, acts as representative for taxation matters.

In the given situation, CA Ram, a practicing Chartered Accountant, provides non-assurance services. He is approached by DEF Limited, a non-audit client, to file an appeal in GST Tribunal against GST Demand of ₹ 6 crore, which was imposed by the Commissioner (Appeals) and to plead on behalf of DEF Limited in the matter. CA Ram offers to accept the case and agrees to charge fees of ₹ 3,50,000.

Therefore, CA Ram is not guilty of professional misconduct.

5. (a) In the instant case, Quality Ltd. is engaged in the business of manufacturing and distribution of various ready-to-cook products like vegetables, noodles etc. Further, management was looking for some financial investor to fund some part of the proposed expansion. Aman is interested in funding; therefore, he initiated investigation of audited financial statements to ensure the appropriateness of the valuation of the shares. For initiating the same it may be considered that if the investigation has been launched because of some doubt in the audited statement of account, no question of reliance on the audited statement of account arises. However, if the investigator has been requested to establish value of a business or a share or the amount of goodwill payable by an incoming partner, ordinarily the investigator would be entitled to put reliance on audited materials made available to him unless, in the course of his test verification, he finds the audit to have been carried on very casually or unless his terms of appointment clearly require to test everything afresh.
- If the statements of account produced before the investigator were not audited by a qualified accountant, then of course there arises a natural duty to get the figures in the accounts properly checked and verified.
 - However, when the accounts produced to the investigator have been specially prepared by a professional accountant, who knows or ought to have known that these were prepared for purposes of the investigation, he could accept them as correct relying on the principle of liability to third parties.
 - It would be prudent to see first that such accounts were prepared with objectivity and that no bias has crept in to give advantage to the person on whose behalf these were prepared.
- (b) As per SA 450, "Evaluation of Misstatements Identified during the Audit", the auditor is required to reassess materiality, in accordance with SA 320 "Materiality in Planning and Performing an Audit", before evaluating the impact of uncorrected misstatements. This reassessment is crucial to

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confirm the ongoing appropriateness of materiality in light of the entity's actual financial results.

The determination of materiality under SA 320 often relies on estimates of the entity's financial results, given that the actual results may not be known during the early stages of the audit. Therefore, before the auditor proceeds to assess the effect of uncorrected misstatements, it becomes necessary to adjust the materiality calculated under SA 320 based on the now available actual financial results.

SA 320 outlines that, as the audit progresses, materiality may be revised for the financial statements as a whole or for specific classes of transactions, account balances, or disclosures. This revision is prompted by the auditor's awareness of information that would have led to a different initial determination. Typically, significant revisions occur before the evaluation of uncorrected misstatements. However, if the reassessment of materiality under SA 320 results in a lower amount, the auditor must reconsider performance materiality and the appropriateness of the audit procedures' nature, timing, and extent. This is crucial for obtaining sufficient and appropriate audit evidence on which to base the audit opinion.

In the present case involving MINI Builders Private Limited, it has been identified that the materiality calculated at the beginning of the audit for revenue was based on estimates provided by the management. The management extrapolated sales for the full year using the actual amount of 11 months, but since the company experiences significant monthly variations in sales, the actual sales for the last month were only 30% of the estimated figure. This discrepancy arose due to an unexpected slowdown in project completions.

In this audit scenario, Mr. Gautam, the auditor, must review and re-assess the materiality initially determined under SA 320 to ensure its continued validity in light of the actual financial results. If the re-assessed materiality is lower than the previously calculated amount, Mr. Gautam must reconsider performance materiality and the appropriateness of the nature, timing, and extent of further audit procedures. This meticulous approach is essential to gather sufficient and appropriate audit evidence, enabling Mr. Gautam to form an independent and objective opinion on the financial statements of MINI Builders Private Limited.

- (c) The information given in situation [i] states that company has secured a loan to expand its operations and invests the funds in purchasing raw materials and machinery. The loan, along with revenue generated from existing sales, contributes to the pool of resources available for production. Therefore, it involves pool of funds that is available to the organization for use in the production of goods or provision of services. Further, it is obtained through financing, such as debt, equity, or grants, or generated through operations or investments. The capital referred to at [i] is **“Finance Capital”**.

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Further, situation [ii] describes increase in number of beneficiaries under flagship CSR programmes providing value for communities and sustainable livelihood is an example of relationships established within and between each community, group of stakeholders and other networks to enhance individual and collective well-being. The capital referred to as [ii] is “**Social and Relationship Capital.**”

6. (a) As per SA 500 “Audit Evidence”, when information to be used as audit evidence has been prepared using the work of a management’s expert, the auditor shall, to the extent necessary, have regard to the significance of that expert’s work for the auditor’s purposes evaluate the competence, capabilities and objectivity of that expert.

A broad range of circumstances may threaten objectivity, for example, self-interest threats, advocacy threats, familiarity threats, self-review threats and intimidation threats. Safeguards may reduce such threats and may be created either by external structures (for example, the management’s expert’s profession, legislation or regulation), or by the management’s expert’s work environment (for example, quality control policies and procedures). Although safeguards cannot eliminate all threats to a management expert’s objectivity, threats such as intimidation threats may be of less significance to an expert engaged by the entity than to an expert employed by the entity, and the effectiveness of safeguards such as quality control policies and procedures may be greater. Because the threat to objectivity created by being an employee of the entity will always be present, an expert employed by the entity cannot ordinarily be regarded as being more likely to be objective than other employees of the entity.

When evaluating the objectivity of an expert engaged by the entity, it may be relevant to discuss with management and that expert any interests and relationships that may create threats to the expert’s objectivity and any applicable safeguards, including any professional requirements that apply to the expert; and to evaluate whether the safeguards are adequate. Interests and relationships creating threats may include:

- Financial interests.
- Business and personal relationships.
- Provision of other services.

In the current case, Black Mountain Mining Ltd. re-appointed Mr. Aman for this engagement as an independent expert. The audit team was of the view that the objectivity of the independent expert cannot be questioned just because he was appointed by management as their expert. However, the audit partner had a contrary view.

Hence, the audit team should evaluate the objectivity of an expert engaged by the entity as the threat to objectivity, created by being an employee of the entity, will always be present. An expert appointed by the entity cannot ordinarily be regarded as being more likely to be

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objective than other employees of the entity. As a result, audit partner Atharva is correct in his view.

- (b) **Delegation of Authority to the Employee:** 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”.

In this case CA Jay proprietor of M/s Adhya & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Vijay, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants of India.

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 and such delegation will not attract provisions of this clause.

In the given case, Mr. Vijay, a Chartered Accountant being employee of M/s Adhya & Co. has asked for information or issued questionnaire. He has also proceeded for initiating and stamping of vouchers and of schedules prepared for the purpose of audit. Apart from the same, he acknowledged and carried out routine correspondence with clients. Here Vijay is right in doing the same, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First Schedule to the Act.

- (c) The practitioner shall not accept the compilation engagement unless the practitioner has agreed the terms of engagement with management, and the engaging party if different. In accordance with SRS 4410, “Compilation Engagement”, the responsibilities of the management to be agreed on for the compilation engagement are that:
- (i) The financial information, and for the preparation and presentation thereof, in accordance with a financial reporting framework that is acceptable in view of the intended use of the financial information and the intended users
 - (ii) Design, implementation and maintenance of such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error
 - (iii) The accuracy and completeness of the records, documents, explanations and other information provided by management for the compilation engagement and
 - (iv) Judgments needed in the preparation and presentation of the financial information, including those for which the practitioner may provide assistance in the course of the compilation engagement

OR

- (c) As per SRE 2400, "Engagements to Review Historical Financial Statements", a review of financial statements includes consideration of the entity's ability to continue as a going concern. If, during the performance of the review, the practitioner becomes aware of events or conditions that may cast significant doubt about the entity's ability to continue as a going concern, the practitioner shall:
- (i) Inquire of management about plans for future actions affecting the entity's ability to continue as a going concern and about the feasibility of those plans, and also whether management believes that the outcome of those plans will improve the situation regarding the entity's ability to continue as a going concern.
 - (ii) Evaluate the results of those inquiries, to consider whether management's responses provide a sufficient basis to: -
 - (1) Continue to present the financial statements on the going concern basis if the applicable financial reporting framework includes the assumption of an entity's continuance as a going concern or
 - (2) Conclude whether the financial statements are materially misstated or are otherwise misleading regarding the entity's ability to continue as a going concern.
 - (iii) Consider management's responses in light of all relevant information of which the practitioner is aware as a result of the review.