

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

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### **Part I – Multiple Choice Questions**

#### **Integrated Case Scenario - I**

*AT Solutions Ltd. (ATS) is a rapidly growing, unlisted tech company specializing in providing cloud-based software services. The company was founded five years ago by two visionary co-founders, Mr. RV (CEO) and Mr. AG (CTO), who also serve as the key members of Those Charged with Governance (TCWG).*

*CA RM is the Engagement Partner for the audit of ATS for the financial year ending March 31, 2025. Your firm, RM & Associates, has been the statutory auditors for the last three years.*

*During the audit, your team encounters the following key issues and observations:*

- *ATS earns revenue primarily through subscription services. A new policy was implemented in the current year, effective from April 1<sup>st</sup>, 2024, to recognize revenue from multi-year contracts on an accelerated basis in the initial year, deviating from the previous practice of straight-line recognition over the contract period. This change was not communicated to your firm beforehand and resulted in a significant overstatement of current year revenue by ₹ 4 crores, which is both material and pervasive amount to the financial statements. The company's previous policy was in line with applicable accounting standards. When you raise this matter with the management, they insist that the new policy better reflects the value derived from the initial customer onboarding efforts. The management refuses to revert to the previous policy.*
- *ATS holds a small amount of physical inventory, consisting of specialized server components. The physical verification was conducted by the company's internal team on March 31, 2025. However, the auditor was not able to observe the stock count due to a last-minute travel restriction on the audit team. Upon inquiry, the management provides a signed stock count sheet and a video recording of the count. Your team performs alternative*

procedures, including inspecting subsequent sales invoices and conducting a review of the inventory movement records. The inventory balance is ₹24 lakhs, which is not material to the financial statements.

- Your team identified a significant transaction where ATS provided a loan of ₹20 crores to a subsidiary company, "ABC Solutions Pvt. Ltd.", which is a related party. The transaction was approved by the board but was not adequately disclosed in the draft financial statements. When confronted, the management explained that since both the companies have common ownership and control, they did not deem it necessary to disclose the transaction, believing it was an internal matter.
- A former employee has filed a significant lawsuit against ATS, claiming intellectual property theft. The claim amount is ₹6 crores, and the legal counsel has advised the company that the outcome is highly uncertain, but a potential liability cannot be ruled out. The management has provided a contingent liability note in the draft financial statements, but it only mentions the lawsuit without quantifying the potential financial impact or detailing the nature of the claim, stating that they do not want to alarm potential investors.

Your firm recently hired a new articled assistant, Mr. A, who is a close relative of the CFO of ATS. Mr. A was initially assigned to the audit engagement. This relationship was not disclosed by the audit firm, and the firm's quality control procedures failed to identify this potential threat to independence. The engagement partner, CA RM, only became aware of this fact during the final review meeting. The audit fieldwork is complete. However, CA RM has applied the appropriate safeguards.

Based on the above facts, answer the following Q. Nos. 1 to 6 by choosing the most appropriate option:

1. Based on the auditor's observation regarding the new revenue recognition policy, what type of audit opinion should CA RM issue on the financial statements of ATS?
  - (A) Unmodified opinion, as the change is management's discretion.
  - (B) Qualified opinion, because the financial statements are materially misstated due to the non-adherence to the previous accounting policy.

- (C) *Adverse opinion, because the material misstatement from the change in revenue recognition policy is pervasive.*
- (D) *Disclaimer of opinion, due to the management's refusal to correct the misstatement. (2 Marks)*
2. *Considering the issue with the physical verification of inventory, what is the most appropriate course of action for the auditor?*
- (A) *Issue a Qualified opinion as the inventory balance is not material, and alternative procedures were performed.*
- (B) *Issue a Disclaimer of opinion since the auditor could not observe the physical count.*
- (C) *Include the matter relating to inventory in Emphasis of Matter paragraph.*
- (D) *Since the inventory is not material, the auditor should consider the audit to be complete without any modification to the opinion. (2 Marks)*
3. *In the context of the related party loan transaction with ABC Solutions Ltd., what is the auditor's primary responsibility?*
- (A) *To issue a Qualified opinion with respect to related party transaction.*
- (B) *To report the matter to the Serious Fraud Investigation Office (SFIO) under Section 143(12) of the Companies Act, 2013.*
- (C) *To assess if the non-disclosure constitutes a material misstatement and, if so, to request management to disclose it.*
- (D) *To issue an Unmodified opinion with an Emphasis of Matter paragraph to draw users' attention to the non-disclosure. (2 Marks)*
4. *What should be the auditor's conclusion if the management refuses to disclose the pending litigation?*
- (A) *The auditor should include in Other Matter Paragraph regarding the uncertainty of the pending litigation.*
- (B) *The auditor should issue a Disclaimer of opinion since the outcome is uncertain.*

- (C) *The auditor should include an Emphasis of Matter paragraph in the audit report to highlight the uncertainty regarding the pending litigation.*
- (D) *The auditor should express an Unmodified opinion as the management has provided a note on the contingent liability. (2 Marks)*
5. *What is the most appropriate safeguard that CA RM should apply upon discovering the relationship between the articled assistant and the CFO?*
- (A) *The audit report should be qualified due to a lack of auditor independence.*
- (B) *The articled assistant should be immediately removed from the audit team, and the work performed by him should be re-evaluated and re-performed if necessary.*
- (C) *The firm must resign from the engagement immediately as the independence is impaired.*
- (D) *The firm should inform TCWG of the situation, and an Unmodified opinion can be issued if the work performed by the articled assistant is not material. (2 Marks)*
6. *Which out of the following is not the auditor's responsibility concerning the internal control system of ATS in respect of related party transaction?*
- (A) *The auditor is required to report on the internal financial controls over financial reporting (ICFR) as per the Companies Act, 2013.*
- (B) *The auditor should report a material weakness in internal control related to revenue recognition and related party transactions.*
- (C) *The auditor should communicate the significant deficiencies in the internal control system, to TCWG in writing.*
- (D) *The auditor should report under clause (xiii) of CARO 2020. (2 Marks)*

**Integrated Case Scenario - II**

*LMN & Associates, Chartered Accountants, a leading firm in providing assurance services, is in the course of finalizing various audit assignments. The audit team has 5 audit assistants in addition to the engagement partners.*

*They are appointed as statutory auditors of DEF Finance Limited for the F.Y. 2024-25. This is an Investment and Credit Company (ICC) incorporated in*

March 2020. The company has total assets of ₹ 1,200 crores as on 31<sup>st</sup> March, 2024, with financial assets constituting 65% of total assets (netted off by intangible assets). The company's income from financial assets is 58% of its gross income. The company applied for RBI registration in April 2024 and currently has Net Owned Funds (NOF) of ₹ 8 crores. The company has been operating without RBI registration since inception.

LMN & Associates are also the statutory auditor for the F.Y. 2024-25 of SH Finance Limited; a Non-Banking Finance company registered with RBI under the Middle Layer category. The company is primarily engaged in providing loans and advances to small and medium enterprises (SMEs) and individuals. During the course of audit CA L, the engagement partner observed that the company has classified a demand loan of ₹ 3.8 crores to RR Traders as NPA. This loan became NPA on 1<sup>st</sup> September, 2023. The estimated realizable value of security is ₹ 2.2 crores and the company has made a provision of ₹ 1.6 crores (₹ 1.6 crores = 100% of unsecured portion). He also observed that the company has invested in approved liquid assets worth ₹ 45 crores and held them in safe custody at its own premises.

During the audit process of the above companies, the engagement partners have assigned the responsibility of various areas to the audit assistants including signing of documents on behalf of the firm where need arises keeping in view the clarifications issued by the Council as envisaged in the provisions of the Chartered Accountants Act 1949. One of the audit assistants has signed the following documents and conducted under mentioned jobs during audit of DEF Finance Ltd.:

- (i) Issued the notes to accounts and cash flow statement ultimately finalized for onward submission.
- (ii) Asking for information or issue of questionnaire.
- (iii) Acknowledging and carrying routine correspondence with clients.
- (iv) Issued non-financial report expressing professional authentication.

CA N, the engagement partner of MT Industries Limited, while conducting a comprehensive review of the audit trail functionality and related controls, observed that multiple employees use common User IDs for processing routine transactions to improve efficiency. Changes made to the audit trail configurations in the past are not formally documented or authorized through a defined approval process.

*During the course of audit of Global Reach Ltd., an Indian parent company, CA L prepares the consolidated financial statements for the year ended 31<sup>st</sup> March, 2025. In his opinion the following informations given in the notes to the separate financial statement need not be included in the consolidated financial statement under IND*

- (i) Source from which bonus shares are issued (e.g., capitalization of profits or reserves or from securities premium account).*
- (ii) Disclosure required under Micro, Small and Medium Enterprises Development Act, 2006*
- (iii) Disclosure of all utilized monies out of the issue indicating the form in which utilized funds have been invested.*
- (iv) Earnings in foreign exchange classified as export of goods not calculated on F.O.B. basis.*

*Based on the above facts, answer the following Q. Nos 7 to 12 by choosing the right option:*

7. *What is the minimum NOF requirement that DEF Finance Limited must achieve by 31<sup>st</sup> March, 2027?*
- (A) 2 crores*
  - (B) 7 crores*
  - (C) 10 crores*
  - (D) 8 crores*
- (2 Marks)**
8. *For the loan of ₹ 3.8 crores to RR Traders, what should be the correct asset classification and minimum total provisioning required for F.Y. 2024-25?*
- (A) Sub-standard Asset with provision of ₹ 1.98 crores*
  - (B) Doubtful Asset with provision of ₹ 2.26 crores.*
  - (C) Doubtful Asset with provision of ₹ 2.04 crores*
  - (D) Loss Asset with provision of ₹ 3.8 crores*
- (2Marks)**

9. *During the audit of DEF Finance Ltd., which actions of the audit assistant regarding signing of documents and conducting of jobs should be approved by the engagement partner as correct?*

- (A) (i) & (ii)
- (B) (ii) & (iii)
- (C) (iii) & (iv)
- (D) (i) & (iv)

**(2 Marks)**

10. *Which of the following are most specific IT controls for MT Industries Limited to implement and operate to demonstrate that the audit trail feature is functional, operated and not disabled?*

- (i) *Controls to ensure that User IDs are assigned to each individual employee and that User IDs are not shared among multiple users.*
- (ii) *Controls to ensure that the audit trail data is encrypted using advanced cryptographic algorithms.*
- (iii) *Controls to ensure that changes to the configurations of the audit trail are authorized and logs of such changes are maintained.*
- (iv) *Controls to ensure that all audit trail reports are printed and physically stored in fire-proof cabinets.*

*Choose the correct option from below:*

- (A) (i) & (ii)
- (B) (ii) & (iii)
- (C) (i) & (iii)
- (D) (iii) & (iv)

**(2 Marks)**

11. *Which of the following information given in the notes to the separate financial statement need not be included in Global Reach Ltd.'s consolidated financial statements under IND AS 110?*

- (A) (i) & (ii)
- (B) (ii) & (iii)

(C) (iii) & (iv)

(D) (i) & (iv)

**(2 Marks)**

12. What should be CA L's observation regarding the custody arrangement of investment made in approved liquid assets held by SH Finance Limited?

(A) The arrangement is acceptable as approved liquid assets can be held in company's own custody.

(B) The company should lodge in safe custody these liquid assets with a designated scheduled commercial bank as required by the NBFC Acceptance of Public Deposits Directions and also should obtain certificate from RBI to that effect.

(C) Safe custody arrangement is not relevant for audit purposes.

(D) Approved liquid assets need not be lodged with banks as they are risk-free assets.

**(2 Marks)**

13. Mr. Verma, the CTO of a mid-sized technology firm, has received an urgent alert from his network monitoring dashboard: the company's customer portal is responding extremely slowly and, within minutes, becomes completely inaccessible. The alert appears to originate from the firm's own IT systems and even displays familiar company branding and language in the notification. Concerned about a potential server malfunction, Mr. Verma contacts the operations team but they report no hardware failures or software errors. Meanwhile, customers flood the support line, complaining that they cannot log in or place orders. Real-time charts on the dashboard show an enormous surge of traffic far beyond normal usage patterns.

Based on the above scenario, which type of cyber-attack is faced by the firm?

(A) IoT-Based Attack

(B) Spoofing Attack

(C) Denial-of-Service Attack

(D) Identity-Based Attack

**(2 Marks)**

14. ABC Manufacturing Ltd. operates a large factory employing 1,200 workers. Over the past year, management has introduced new shift schedules to meet rising demand. However, production targets have pushed some line

*supervisors to require employees to work extended hours, routinely exceeding 12-hour shifts with only 15-minute breaks. Several workers have complained of chronic fatigue, frequent musculoskeletal injuries and lack of time for rest or family commitments. A small group attempted to form a workers' committee to discuss these issues, but were told by management that any "collective gathering" would hamper productivity and could lead to disciplinary action.*

*ABC Manufacturing Ltd.'s board of directors has engaged you, to conduct the social impact assessment and whether the company policies are aligned with Corporate Social Responsibility (CSR) guidelines.*

*Based on the above scenario, which principle is not being adhered to by the Company?*

- (A) Principle 5-Respect and Promote Human Rights*
- (B) Principle 8-Promote inclusive growth and equitable development*
- (C) Principle 3-Promote well-being of all Employees including those in the Value Chain.*
- (D) Principle 4-Respect for stakeholders' Interests and Responsiveness.*

**(2 Marks)**

15. *CA H, with an experience of 3 years in practice, has recently joined as a partner with JP & Associates, Chartered Accountants. He is making efforts to increase his professional income by taking up various assignments. Some of the areas where he has engaged himself are as under:*
- (i) He is a part time faculty for the Live Virtual Classes run under the aegis of the Institute for CA Students.*
  - (ii) He is also a lecturer of Management Accounting in one Private University in his locality.*
  - (iii) He is providing tutorship to Class XII Commerce students of Good Edu Public School run by G H Educational Society.*
  - (iv) He is providing consultation for recovery of loans and advances portfolio of MM Bank Limited.*

The senior partner of his firm is of the view that all these assignments which CA H has taken up require specific and prior approval of the Council and that CA H will be deemed to be guilty of professional misconduct as he has not taken such approval.

Based on the above, which amongst the four activities require specific and prior approval of the Council?

- (A) (i) & (ii)
- (B) (ii) & (iii)
- (C) (iii) & (iv)
- (D) (ii) & (iv)

(2 Marks)

**Answer Key**

MCQ No.	Correct Option
1.	(C)
2.	(D)
3.	(A/C)
4.	(C)
5.	(B)
6.	(D)
7.	(C)
8.	(C)
9.	(B)
10.	(C)
11.	(A)
12.	(B)
13.	(C)
14.	(C)
15.	(B)

**Part II – Descriptive Questions**

Question No.1 is compulsory.

Candidates are required to answer any **four** questions from the remaining **five** questions.

Working notes should form part of the answer.

**Question 1**

(a) DEF Apparels Ltd. is a manufacturing company with its business having a global outreach. The company appoints CA Y as the statutory auditor for the F.Y. 2024-25. During the audit, CA Y encountered the following issues:

- (1) The company has a large manufacturing facility with Fixed Assets of the value of ₹ 250 crores, which constitutes 60% of the total assets. The facility was significantly damaged in flash floods during the year. Management refused to allow an independent valuer to assess the damage, claiming internal estimates are sufficient. The company has not made any provision for impairment despite visible damage to machinery and buildings. Insurance claims are pending with disputes regarding coverage.
- (2) The company has entered into multiple transactions with related parties totalling ₹ 120 crores during the year. However, the management has refused to provide complete documentation regarding these transactions, citing confidentiality agreements. The audit team was denied access to board meeting minutes discussing these transactions and could not verify the commercial rationale or arm's length nature of these deals.

In view of the observations made, what kind of opinion should CA Y give in the Audit Report? Justify your answer citing the above scenarios. On the basis of opinion decided by CA Y, you are required to draft the Opinion and Basis of Opinion paragraph to be given in the Independent Auditor's Report.

**(5 Marks)**

(b) AXO Automobiles Limited, a leading manufacturer of electric vehicles, appoints WYZ & Co. Chartered Accountants as the statutory auditors for the financial year ended March 31, 2025. CA W, the engagement partner, during the course of audit identifies the following misstatements:

- An amount of ₹ 4 lakhs of rent income has not been recorded due to oversight.
- An expense of ₹ 6 lakhs pertaining to F.Y. 2023-24 has been charged to Profit and Loss Account in F.Y. 2024-25.
- In a sample testing of warranty provisions, projected misstatement in the population is ₹ 10 lakhs.

CA W is of the opinion that the above misstatements need to be rectified to portray the correct financial results of the company. The management of AXO Automobiles Ltd. refused to make the necessary corrections on the contention that these amounts were not material in relation to the company's turnover of ₹ 250 crores.

With reference to the relevant Standards on Auditing analyze the circumstances faced by CA W and guide him how he should evaluate the effect of these misstatements which are not corrected by the management. What communication requirements are applicable for the auditor in this situation? **(5 Marks)**

- (c) XYZ & Co., a mid-sized audit firm, has recently expanded its operations and taken on several large clients. To manage the growing workload, the firm's CEO has delegated operational responsibilities for the firm's quality control system to two senior partners. However, certain concerns have been raised:
- (1) One of the partners, though commercially successful in bringing in new clients, has limited experience in audit quality oversight.
  - (2) The firm's new incentive system heavily rewards partners and staff based on revenue generation and client acquisition, with little emphasis on audit quality or compliance with professional standards.
  - (3) Due to rapid expansion, the firm has allocated most of its resources towards marketing and client development.

The aforesaid concerns reflect on which element of quality control within the firm as per SQC1? What are the considerations one should exercise to achieve quality in all the engagements that the firm performs? **(4 Marks)**

**Answer**

(a) In the present case, CA Y, the statutory auditor of DEF Apparels Ltd. for the financial year 2024–25, is unable to obtain sufficient and appropriate audit evidence in respect of following matters that are material and pervasive to the financial statements:

1. The company's fixed assets amounting to ₹ 250 crores constitute about 60% of the total assets and were significantly damaged due to flash floods during the year. However, management refused to permit an independent valuation of the damaged assets and relied solely on internal estimates. Despite visible damage to machinery and buildings and pending insurance claims with disputes regarding coverage, the company has not made any provision for impairment loss. Due to this management-imposed limitation, *the* auditor is unable to assess the impairment, if any, and consequently cannot ascertain the carrying value of fixed assets.
2. The company entered into related party transactions aggregating to ₹ 120 crores during the year. Management refused to provide complete documentation relating to these transactions and denied access to board meeting minutes citing confidentiality agreements. As a result, the audit team was unable to verify the commercial rationale, arm's length nature, completeness, and adequacy of disclosure of such related party transactions. The auditor was therefore unable to obtain sufficient appropriate audit evidence in respect of these transactions.

In the above two circumstances the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive as per SA 705.

Thus, CA Y should give a *Disclaimer of Opinion*.

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

**Disclaimer of Opinion**

We were engaged to audit the financial statements of DEF Apparels Ltd. ("the entity"), which comprise the balance sheet as at

March 31, 2025, the statement of Profit and Loss, [the statement of changes in equity (where applicable)] and statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies.

We do not express an opinion on the accompanying financial statements of DEF Apparels Ltd. because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

**Basis for Disclaimer of Opinion**

The Company's manufacturing facility, carrying a value of ₹ 250 crores (representing 60% of total assets), sustained significant physical damage due to flash floods during the year. The management has neither allowed an independent valuation nor recorded any impairment provision. In the absence of a formal assessment and given the pending insurance disputes, we were unable to determine the extent of the required write-down and its consequential impact on the financial statements.

We were unable to verify the completeness, commercial rationale, and arm's length nature of related party transactions totalling ₹ 120 crores. Management refused to provide supporting documentation and denied us access to the minutes of the meetings of the Board of Directors citing confidentiality agreements. Consequently, we were unable to verify the commercial rationale, arm's length nature, and completeness of disclosures of these related party transactions.

- (b) SA 450 "Evaluation of Misstatements Identified During the Audit", deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements.

In the given situation, the auditor CA W should categorize the identified misstatements to evaluate their nature and impact in case of rent income of 4 lakhs not recorded due to oversight, expenses of 6 lakhs pertaining to F.Y. 2023-24 charged to Profit & Loss Account in F.Y. 2024-25, and for projected misstatement in the population sample test of warranty

provisions of 10 lakhs. However, after insisting for rectification to reflect the correct financial results of the company, Management of AXO Automobiles Ltd. refused to make necessary corrections. Therefore, CA W shall evaluate the effect of these misstatements which are not corrected by management in following manner:

Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320 to confirm whether it remains appropriate in the context of the entity's actual financial results.

The auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider:

- The size and nature of the misstatements, both in relation to particular classes of transactions, account balances or disclosures and the financial statements as a whole, and the particular circumstances of their occurrence; and
- The effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

**Communication:** The auditor shall communicate with those charged with governance, in accordance with SA 260, uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditor's report, unless prohibited by law or regulation. The auditor's communication shall identify material uncorrected misstatements individually. The auditor shall request that uncorrected misstatements be corrected.

Further, the auditor shall also communicate with those charged with governance the effect of uncorrected misstatements related to prior periods on the relevant classes of transactions, account balances or disclosures, and the financial statements as a whole.

- (c) SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," requires firms to establish policies and procedures designed to promote an internal culture based on the recognition that

quality is essential in performing engagements. Such policies and procedures should require the firm's chief executive officer or the firm's managing partners to assume ultimate responsibility for the firm's system of quality control. The example set by firm's leadership encourages an inner culture that recognizes high quality audit work.

It has been laid down clearly that the firm's business strategy is subject to the overriding requirement for the firm to achieve quality in all the engagements that the firm performs. Essentially, it implies that audit quality is paramount in all engagements. It is non-negotiable.

In the given situation, XYZ & Co., a mid-sized audit firm, has recently undergone rapid expansion and taken several large clients. In order to manage the increased workload, the firm's CEO has delegated operational responsibilities for the firm's system of quality control to two senior partners. However, concerns have emerged regarding the competence of the personnel entrusted with quality oversight, the firm's incentive structure being heavily revenue-oriented, and the disproportionate allocation of resources towards marketing activities. These issues raise questions about the firm's commitment to audit quality and compliance with professional standards and primarily reflect weaknesses in the "Leadership responsibilities for quality within the firm" element of quality control as per SQC 1.

Overall, such a situation reflects lack of proper establishment of quality control framework at top of the firm. Following considerations should be taken into account while upholding quality of firm: -

- (i) The firm assigns its management responsibilities so that commercial considerations do not override the quality of work performed.
- (ii) The firm's policies and procedures addressing performance evaluation, compensation, and promotion (including incentive systems) with regard to its personnel are designed to demonstrate the firm's overriding commitment to quality and
- (iii) The firm devotes sufficient resources for the development, documentation and support of its quality control policies and procedures.

**Question 2**

- (a) *MNP Manufacturing Ltd., a listed company with a turnover of ₹2,500 crores, appointed three joint auditors: CA Anil & Associates, CA Raman & Co. and CA Reena & Associates to undertake the statutory audit of the company. The joint auditors divided the work amongst themselves in accordance with SA 299. CA Anil & Associates were responsible for fixed assets and related depreciation, CA Raman & Co. took the area of cash, bank and investments and CA Reena & Associates handled inventory and receivables.*

*At the Annual General Meeting held on 30<sup>th</sup> September 2025, the company decided not to reappoint CA Reena & Associates due to disagreements over certain audit observations regarding valuation of inventory. The shareholders passed a special resolution appointing CA Neha & Associates in place of CA Reena & Associates, while retaining the other two joint auditors CA Anil & Associates and CA Raman & Co.*

*CA Neha accepted the appointment immediately upon receiving the company's appointment letter and a certificate regarding compliance of provisions of the Companies Act, 2013. However, she later discovered that the company had not sent any special notice to the shareholders regarding her appointment as required under the Companies Act, 2013. She also found that CA Reena & Associates had not been given an opportunity to make representations to the shareholders regarding her non-reappointment.*

*Analyze the professional conduct of CA Neha in light of the provisions of the Chartered Accountants Act, 1949 and Schedules thereto. **(5 Marks)***

- (b) *You have been appointed as internal auditor of a Company manufacturing and trading in Chemicals. You have asked your team to review the internal controls and get the first hand information of each department and their heads and note their respective roles in the company's procurement and inventory processes.*

*Your team has observed that-*

- (i) *The Head of Purchase department, a relative of the promoter, has for several years been in-charge of purchasing and sanctioning payments, without allowing anybody to question him.*

(ii) *There has been no rotation of duties for several years of most of the employees, in particular, the Chief Accountant who has a good rapport with majority customers.*

(iii) *The Storekeeper also has not kept adequate stock records since he joined the company without carrying out physical verification of the assets.*

*Analyse the specific violations of the principles of an adequate internal check system. Evaluate how these control deficiencies, individually and collectively, increase the inherent and control risk for the entity. (5 Marks)*

(c) *M/s RSP & Associates, a firm of Chartered Accountants, has been engaged to conduct a review of the financial statements of AR Pvt. Ltd. for the quarter ended 30<sup>th</sup> September 2025.*

*During the review, the engagement partner, CA R, explained to the audit team that unlike a full-scope audit, a review primarily relies on inquiries and analytical procedures to obtain limited assurance about whether the financial statements are prepared in accordance with the applicable financial reporting framework.*

*Explain how performing analytical procedures assists the practitioner in a review of financial statements. (4 Marks)*

**Answer**

(a) As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, a CA in practice is deemed to be guilty of professional misconduct if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

Further, as per Clause (9) of Part I of First Schedule to the Chartered Accountants Act, 1949, a CA in practice is deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956 (1 of 1956), or sections 139 to 141 of the Companies Act, 2013 or any other law pertaining to appointment of auditors for the time being in force, in respect of such appointment have been duly complied with.

Under this clause it is obligatory on the incoming auditor to ascertain from the Company that the appropriate procedure in the matter of his appointment has been duly complied with so that no shareholder or retiring auditor may, at a later date, challenge the validity of such appointment.

For the purpose of ascertaining whether the Company has complied with the provisions of Section 140 of the Companies Act the incoming auditor should verify the records of the Company that whether a member of the Company has given special notice of the resolution as required under Section 140 (4) of the Companies Act, 2013 and to ensure that whether this special notice has been sent to all the members, of the Company as required under the Companies Act, 2013.

In the given case, CA Neha accepted the audit appointment immediately on receipt of the company's appointment letter and certificate of compliance, without first ensuring that proper professional communication had been made with the outgoing auditor, CA Reena & Associates, who was not reappointed due to disagreements over certain audit observations.

Therefore, CA Neha will be held guilty of professional misconduct under the Clause (8) and Clause (9) of Part I of First Schedule to the Chartered Accountants Act, 1949, if she accepts the appointment without communicating with previous auditor as well as for not verifying the compliance of statutory requirements.

- (b)** Based on the observations made by the internal audit team, the following violations of the principles of an adequate internal check system are identified:
- (i) The Head of the Purchase Department, being a relative of the promoter, has been entrusted with both purchasing and sanctioning of payments for several years without allowing anybody to question him. This violates the fundamental principle that no single person should have complete control over any important aspect of business operations and that every employee's actions should come under the review of another person. It also breaches the principle relating to distribution of financial and administrative powers and their periodic review.

- (ii) There has been no rotation of duties for several years of most of the employees, in particular, the Chief Accountant, who has a good rapport with major customers. This violates the principle that staff duties should be rotated from time to time so that employees do not perform the same function for a considerable length of time.
- (iii) The Storekeeper has failed to maintain proper stock records and no physical verification of assets has been carried out since his appointment. This violates the principle that those with physical custody of assets should not have access to accounting records. It also violates the principle that there should exist an accounting control in respect of each class of assets, in addition there should be periodical inspection so as to establish their physical condition.

**Impact of Control Deficiencies on Inherent and Control Risk:**

**Increased Inherent Risk:** The nature of the procurement and inventory functions makes them inherently susceptible to fraud such as fictitious purchases, overbilling, or theft of stock. The lack of proper controls means that these inherent risks are not mitigated.

**Increased Control Risk:** Non-rotation of accounting staff increases the risk of collusion and manipulation of receivables, while absence of stock records and physical verification exposes the company to theft, pilferage, and incorrect inventory valuation. The identified deficiencies demonstrate that the company's internal control system is not operating effectively. This leads to a high control risk in the procurement and inventory cycles.

**(c) As per SRE 2400, "Engagements to Review Historical Financial Statements", In a review of financial statements, performing analytical procedures assists the practitioner in:**

- (i) Obtaining or updating the practitioner's understanding of the entity and its environment, including to be able to identify areas where material misstatements are likely to arise in the financial statements.
- (ii) Identifying inconsistencies or variances from expected trends, values or norms in the financial statements such as the level of congruence of the financial statements with key data, including key performance indicators.

- (iii) Providing corroborative evidence in relation to other inquiries or analytical procedures already performed.
- (iv) Serving as additional procedures when the practitioner becomes aware of matters that cause the practitioner to believe that the financial statements may be materially misstated.

**Question 3**

- (a) *The Comptroller and Auditor General of India (C&AG) appointed M/s. VR & Associates, a firm of Chartered Accountants, to conduct the audit of Sunshine Ltd., a Public Sector Undertaking (PSU) under the Government of India and intimated to the auditors about the following concerns in respect of the PSU.*

*Sunshine Ltd. proposed to set up a solar panel manufacturing project in North Gujarat with an estimated cost of ₹ 5,750 crores, which included ₹ 2,000 crores earmarked for Research and Development (R&D). While all approvals, documentation, and statutory requirements were duly complied with, the C&AG expressed concern that the proposed R&D expenditure appeared wasteful and lacking justification on the tests of public interest, as several established companies were already engaged in similar activities in that region.*

*Identify the type of audit that the C&AG expects M/s. VR & Associates to conduct in this context. Also, explain the principles of this audit. (5 Marks)*

- (b) *CA Amit, the auditor of KRT Pvt. Ltd, also undertakes statutory compliances related to Income Tax, GST and MCA for the client. For carrying out the compliances within the time limits KRT Pvt. Ltd. transfers ₹ 3,00,000 to CA Amit with an email that clearly earmarks the utilization of the said amount:*

- (1) *₹ 1,20,000 is paid as an advance towards professional fees for ongoing audit and taxation work.*
- (2) *₹ 1,80,000 is to be utilized to make statutory payments of TDS, GST, MCA filings and DIN renewals falling due within 1 month.*

*CA Amit receives the above amount of ₹ 3,00,000 in his regular savings account.*

*From the amount of ₹ 1,80,000, he deposits ₹ 50,000 towards TDS payable and ₹ 60,000 against GST liability on the due dates that fall within 1 month from the date of receiving the money from the client.*

*The balance ₹ 70,000 pertaining to MCA filings and DIN renewals was deposited after 3 months due to portal issues. In between, CA Amit paid his office rent of ₹ 40,000 from this amount and deposited it back in that account within 2 weeks.*

*Analyse the actions of CA Amit and comment with reference to the Chartered Accountants Act, 1949 and Schedules thereto. (5 Marks)*

- (c) *Everfresh Beverages Limited has recently implemented Robotic Process Automation (RPA) across various business processes to enhance operational efficiency and reduce manual errors. The company has deployed RPA bots in key areas, namely, invoice processing, payroll generation and purchase order processing. This has resulted in significant time saving and improved accuracy in routine processes.*

*As the statutory auditor of Everfresh Beverages Limited, discuss the key audit implications and the common risks associated with RPA. (4 Marks)*

**Answer**

- (a) The type of audit that the Comptroller and Auditor General of India (C&AG) expect M/s. VR & Associates to conduct in this context is Propriety Audit since C&AG expressed concern that the proposed R&D expenditure of ₹2,000 crores appeared wasteful and lacking justification on the test of public interest. Propriety audit stands for verification of transactions on the tests of public interest, commonly accepted customs and standards of conduct.

Propriety requires transactions, and more particularly expenditure, to conform to certain general principles. The following principles should be applied by M/s. VR & Associates:

- (i) that the expenditure is not *prima facie* more than the occasion demands and that every official exercises the same degree of vigilance in respect of expenditure as a person of ordinary prudence would exercise in respect of his own money;
- (ii) that the authority exercises its power of sanctioning expenditure to pass an order which will not directly or indirectly accrue to its own advantage;
- (iii) that funds are not utilised for the benefit of a particular person or group of persons and

(iv) that, apart from the agreed remuneration or reward, no other avenue is kept open to indirectly benefit the management personnel, employees and others.

- (b)** As per Clause (10) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he fails to keep moneys of his client other than fees or remuneration or money meant to be expended in a separate banking account or to use such moneys for purposes for which they are intended within a reasonable time.

In the course of his engagement as a professional accountant, a member may be entrusted with money belonging to his client. If he should receive such funds, it would be his duty to deposit them in a separate banking account, and to utilize such funds only in accordance with the instructions of the client or for the purposes intended by the client.

In this connection the Council has considered some practical difficulties of the members and the following suggestions have been made to remove these difficulties:

- (i) An advance received by a Chartered Accountant against services to be rendered does not fall under Clause (10) of Part I of the Second Schedule.
- (ii) Moneys received for expenses to be incurred, for example, payment of prescribed statutory fees, purchase of stamp paper etc., which are intended to be spent within a reasonably short time need not be put in a separate bank account. For this purpose, the expression; "reasonably short time", would depend upon the circumstances of each case.
- (iii) Moneys received for expenses to be incurred which are not intended to be spent within a reasonably short time as aforesaid, should be put in a separate bank account immediately.

In the given situation, CA Amit receives ₹ 3,00,000 from KRT Pvt. Ltd. in his regular savings account. An analysis of CA Amit's actions with reference to the above provisions are as under: -

- ₹ 1,20,000 received as advance towards professional fees is correctly kept in savings account by CA Amit.
- ₹ 70,000 which was not paid within one month for MCA filings and DIN renewals should have been transferred to a separate bank account as the payment was delayed for more than a reasonably short time.
- ₹ 40,000 which was utilized for payment of office rent of CA Amit and later on replaced, is against the instructions of the client.

In view of above, CA Amit is guilty of professional misconduct under Clause (10) of Part I of the Second Schedule to the Chartered Accountants Act for not keeping the amount of ₹ 70,000 in a separate bank account and for utilizing an amount of ₹ 40,000 which was not in accordance with the instructions of the client.

**(c) RPA - Key Audit Implications:**

- It is of utmost importance for auditors to understand RPA processes, which include data extraction, aggregation, sanitization and cleansing. Unless auditors understand these processes, they will not be in a position to initiate an audit.
- A comprehensive assurance process might demand review of the source code.
- To perform substantive testing, auditors must have an understanding of the tools used to develop and maintain RPA. This will be helpful when auditors review logs, configuration controls, privileged access controls and the like. General IT controls are applicable as always.

**Common Risks of RPA:**

**Operational and execution risks:** Robots are deployed without proper operating model. Buying the wrong tool, making wrong assumptions, taking shortcuts, and jeopardizing security and compliance. Assigning proper responsibilities, training and clearly stating about changing roles also can help you reduce operational risk to a great extent.

**Change management risks:** Not following the change management implementation lifecycle, improper and incomplete testing (not covering all scenarios) leads to inaccurate results.

**RPA Strategy Risk:** Setting wrong expectations, improper KPIs, and unrealistic business goals creates an environment of uncertainty. Management should discuss, and analyze the complete working characteristics, potential, and limitations of RPA before drafting a robotic process automation.

**Question 4**

- (a) CA Rohan is the engagement partner for the audit of Horizon Ltd.'s complete set of financial statements for the year ended March 31, 2025. During the audit, he identified a material misstatement concerning the valuation of a specific class of inventory. As a result, CA Rohan concluded that it was necessary to express a qualified opinion on the complete set of financial statements.

Subsequently, Horizon Ltd. prepared summary financial statements derived from these audited financial statements and requested CA Rohan to issue a report on them. After performing the required procedures, CA Rohan is satisfied that the summary financial statements are consistent, in all material respects, with the audited financial statements, in accordance with the applied criteria.

- (i) Based on the requirements of relevant SA, advise CA Rohan on the specific additional disclosures he must include in auditor's report on the summary financial statements, considering the qualified opinion on the audited financial statements.
- (ii) In the above case, if the auditor's report on the audited financial statements contains an adverse report, then which additional elements are required to be disclosed in the auditor's report on the summary financial statement? **(5 Marks)**
- (b) M/s. Arora & Taneja, a firm of Chartered Accountants with four partners, has recently been recognized for its strong commitment to professional development and community service. During the F.Y. 2024-25, the following instances came to light during a peer review:

- (1) Support to ICAI Programme Organizing Unit (PoU):

The firm contributed funds to the "Financial Reporting Update Seminar" organized by one Program Organising Unit of the ICAI. The event had

*prior approval from the CPE Directorate, and the firm's name was included among the sponsors in the official ICAI circular and event signage.*

(2) *CSR Activity by Partner:*

*One of the partners, CA Anjali Taneja, personally financed a Clean Water Drive under her company's CSR initiative. The posters and banners displayed the following:*

*"An initiative supported by CA Anjali Taneja (Partner, Arora & Taneja)"  
[Firm's logo was displayed at the bottom corner of the banner]*

*Analyse the professional and ethical implications of the above situations in light of the ICAI Code of Ethics. **(5 Marks)***

(c) *Global Techno Systems Limited is among the top 1000 listed companies in the country. The company is preparing and presenting its Integrated Report in line with the internationally recognized Integrated Reporting Framework. The company continues to align its BRSR disclosures with its Integrated Report to demonstrate how it creates value over the short, medium, and long term through effective use of the six capitals.*

*Following further information is provided in respect of the above company:*

(i) *The company has implemented a structured leadership development programme for its employees across all divisions. This initiative focuses on enhancing professional skills, innovation capabilities, and ethical decision-making, resulting in improved employee engagement and alignment with the organization's long-term strategy.*

(ii) *The company has commissioned a new, fully automated production line equipped with modern machinery and smart control systems. This has significantly improved production efficiency, reduced wastage, and enhanced product quality, leading to overall improvement in operational performance.*

*Discussing the above information, identify and explain which of the capitals of Integrated Reporting are being referred to at (i) and (ii) respectively. **(4 Marks)***

**Answer**

**(a) (i)** As per SA 810 "Engagements to Report on Summary Financial Statements", if the auditor is satisfied that the summary financial statements are consistent, in all material respects, with or are a fair summary of the audited financial statements, in accordance with the applied criteria, the auditor's report on the summary financial statements shall

- State that the auditor's report on the audited financial statements includes a qualified opinion.
- Describe the basis for the qualified opinion on the audited financial statements and the effect thereof, if any, on the summary financial statements

**(ii)** If the auditor's report on the audited financial statements contains an adverse opinion, the auditor's report on the summary financial statements shall, in addition to the elements:

- State that the auditor's report on the audited financial statements contains an adverse opinion or disclaimer of opinion;
- Describe the basis for that adverse opinion; and
- State that, as a result of the adverse opinion on the audited financial statements, it is inappropriate to express an opinion on the summary financial statements.

**(b)** Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 refers to professional misconduct of a member in practice if he solicits client or professional work either directly or indirectly, by circular, advertisement, or personal communication or interview or by any other means.

There are some forms of soliciting work which the council has prohibited, which includes Sponsoring Activities:

- Member in practice or a Firm of Chartered Accountants is not permitted to sponsor an event. However, such member or Firm may sponsor an event conducted by a Programme Organizing Unit (PoU) of the ICAI, provided such event has the prior approval of Continuing Professional Education (CPE) Directorate of the ICAI.

- Members sponsoring activities relating to Corporate Social Responsibility may mention their individual name with the prefix "CA". However, the mention of Firm name or CA Logo is not permitted.
- (1) In the given situation, M/s. Arora & Taneja, a firm of Chartered Accountants, contributed funds to the "Financial Reporting Update Seminar" organized by one Program Organising Unit of the ICAI with prior approval from the CPE Directorate. Therefore, M/s Arora & Taneja shall not be held guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 since member or firm may sponsor an event conducted by a Programme Organizing Unit (PoU) of the ICAI with the prior approval of Continuing Professional Education (CPE) Directorate.
- (2) In the given situation, CA Anjali Taneja, a partner of firm who personally financed a clean water drive under her company's CSR initiative, displayed the name, designation and Firm Logo in the posters and banners at the bottom corner of the banner. Therefore, she will be held guilty of professional misconduct under Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 as members sponsoring activities relating to CSR may mention their individual name with the prefix "CA" but mention of Firm name or CA Logo is not permitted.

**(c) Capitals of Integrated Reporting**

- (i) The capital referred to here is **Human Capital**.  
People's skills and experience, their capacity, and motivations to innovate, including their:
  - Alignment with and support of the organization's governance framework & ethical values such as its recognition of human rights.
  - Ability to understand and implement an organization's strategy.
  - Loyalties and motivations for improving processes, goods, and services, including their ability to lead and to collaborate.
- (ii) The capital referred to here is **Manufactured Capital**.
  - Seen as human-created, production-oriented equipment and tools.

- Available to the organization for use in the production of goods or the provision of services, including buildings, equipment, infrastructure (such as roads, ports, bridges & waste, and water treatment plants).

**Question 5**

(a) You have been appointed as the statutory auditor of KYM Pvt. Ltd. for the F.Y. 2024-25. The company has a Paid-up capital and Reserves & Surplus of ₹ 2 Cr; total borrowings of ₹ 9 Cr; total revenue ₹ 9 Cr. (excluding revenue of ₹ 2 Cr. from discontinuing operations) during F.Y. 2024-25.

You are required to state additional matters specified, as may be applicable, besides the report u/s 143 of the Companies Act, 2013 with regard to the following aspects:

- The company has incurred cash losses of ₹ 50 Lakh during F.Y. 2024-25 and ₹ 75 Lakh during F.Y. 2023-24 with negative working capital. The suppliers have reduced credit period while some customers have delayed payments beyond the credit period. A few customers have been declared insolvent.
- The company has been continuously in profits since inception. Because of the losses incurred during the last two F.Y.s, the management suspected certain financial irregularities. Subsequently, a fraud was discovered through proper mechanism and was being addressed by the management on certain complaints filed with them. You have been informed of such a case.
- The company has been awarded certain projects during F.Y. 2023-24 of Metrolines, Monorail and Coastal Roads for which the company had borrowed funds ₹ 4 Cr. from Bank. Metrolines and Monorail were ongoing projects but the Coastal Road project was yet to commence to-date and the amount unspent is ₹ 4 Cr. sanctioned for this project.
- In the case of ongoing projects of Metrolines and Monorail, there was an unspent amount of ₹ 2 Cr. as on 31-03-2025.

Is there any reporting responsibility cast on you regarding the above matters of KYM Pvt. Ltd. under CARO 2020 for F.Y. 2024-25? If no, where and how the above matters would be dealt with in your audit report for F.Y. 2024-25?

**(5 Marks)**

(b) *As the senior audit manager for "Alpha Tech Ltd.", a listed technology company with significant debt financing, you are planning the audit for the financial year ending March 31, 2025. Your previous two audits resulted in an unmodified opinion. However, the company has recently been in the media spotlight due to allegations of manipulating share prices and not disclosing all related party transactions. The company is under intense pressure from external stakeholders to meet aggressive earnings targets.*

*During your preliminary risk assessment, you identify that:*

- *A significant portion of the senior management's compensation is tied to achieving unrealistic profitability targets.*
- *The company's financial results show rapid, unusual profitability compared to its competitors.*
- *A number of significant, complex, and unusual transactions occurred very close to the year-end.*
- *You also notice that there has been a high turnover of senior management and legal counsel in the past year.*

*Based on the above facts and with reference to relevant SA, you are required to identify and explain the specific fraud risk factors present in the scenario that suggest a heightened risk of material misstatement due to fraudulent financial reporting.* **(5 Marks)**

(c) *A practicing Chartered Accountant, Mr. P, is approached by a prominent retail chain to conduct "Mystery Audits" at their stores. The goal of the audit is to evaluate compliance with internal policies and service standards. Mr. P accepts the assignment and structures his professional fees to be contingent upon the number of operational lapses and non-compliances he identifies, with a higher fee for more significant findings.*

*Discuss whether Mr. P is guilty of professional misconduct under the Chartered Accountants Act, 1949, with specific reference to the relevant schedules.* **(4 Marks)**

**Answer**

(a) CARO 2020 is an additional reporting requirement applicable to all companies unless specifically exempted. In the given case, KYM Pvt. Ltd. is a private limited company and is not a banking company, insurance

company, Section 8 company, One Person Company or a small company. Further, although its paid-up capital and reserves are 2 crore, its total borrowings are ₹ 9 crore, which exceeds the exemption limit of ₹ 1 crore prescribed for private companies. Accordingly, KYM Pvt. Ltd. does not fall under the exempted category, and therefore, CARO 2020 is applicable to the company for the F.Y. 2024-25.

- (i) In the given situation, Company has incurred cash losses of ₹ 50 lakh during F.Y. 2024-25 AND ₹ 75 lakh with negative working capital. The auditor is required to report under Clause (xvii) of Paragraph 3 of CARO, 2020, that whether the company has incurred cash losses in the financial year and in the immediately preceding financial year, if so, state the amount of cash losses.
- (ii) In respect of the fraud discovered by the management, the auditor is required to report under Clause (xi) (c) of Paragraph 3 of CARO, 2020, which requires the auditor to state whether the auditor has considered whistle-blower complaints, if any, received during the year by the company;
- (iii) KYM Pvt Ltd has obtained term loans of ₹ 4 crores for the Metrolines, Monorail and Coastal Roads from the Bank in the year 2023-24. Coastal Road project has not commenced as on 31-03-2025 and hence the loan remains unutilised. Under Clause 3(ix)(c) of CARO, 2020, the auditor is required to report on the application of term loans which requires the auditor to state whether term loans were applied for the purpose for which the loans were obtained; if not, the amount of loan so diverted and the purpose for which it is used may be reported; Mere non-utilisation due to non-commencement of the project does not constitute diversion or misuse of funds. Accordingly, no adverse reporting or qualification is required, though an explanatory statement is to be included in the CARO report indicating non-utilisation of the term loan. Subject to adequate disclosure in the notes, the audit opinion remains unmodified.
- (iv) With regard to the Metrolines and Monorail projects, which are ongoing in nature, the existence of an unspent amount of ₹ 2 crores as on 31-03-2025 represents normal timing differences in the execution of long-term infrastructure projects. Under Clause 3(ix)(c) of

CARO, 2020, the auditor is required to report on the application of term loans for their intended purposes. Where term loans are not fully utilised due to the stage of execution of the project, an explanatory remark is required in the CARO report. Since the funds are intended to be applied for the stated purpose and there is no diversion, misuse or default, no adverse reporting under CARO, 2020 is warranted.

The auditor is also required to evaluate the entity's ability to continue as a going concern as per SA 570 and express the opinion in his report accordingly.

- (b) As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud risk factors are events or conditions that indicate an incentive or pressure to commit fraud or provide an opportunity to commit fraud.

Specific Fraud Risk Factors Present in Alpha Tech Ltd.:

**Incentives/Pressures:**

- **A significant portion of the senior management's compensation is tied to achieving unrealistic profitability targets:** Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as rapid growth or unusual profitability especially compared to that of other companies in the same industry.
- **The company's financial results show rapid, unusual profitability compared to its competitors:** Financial stability or profitability is threatened by economic, industry, or entity operating conditions, such as high degree of competition or market saturation, accompanied by declining margins.

**Opportunities:**

- **A number of significant, complex, and unusual transactions occurred very close to the year-end:** The nature of the industry or the entity's operations provides opportunities to engage in fraudulent financial reporting that can arise from the Significant, unusual, or highly complex transactions, especially those close to period end that pose difficult "substance over form" questions.

- **High turnover of senior management and legal counsel in the past year:** High turnover of senior management and legal counsel creates low morale among senior management.
- (c) 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.

Further, as per Recent Decisions of Ethical Standards Board, it is permissible for a member in practice to accept the assignment of Mystery Audit.

In the given case, Mr. P, a practicing Chartered Accountant, has accepted the assignment of Mystery Audit and structured his professional fees to be contingent upon the number of operational lapses and non-compliance he identifies, with higher fee for more significant findings. While acceptance of the Mystery Audit assignment per se is permissible, the fee arrangement being contingent upon the findings is not allowed.

Accordingly, Mr. P would be held guilty of professional misconduct under Clause (10) of Part I of the First Schedule to the Chartered Accountants Act, 1949 for charging fees which are contingent upon the findings.

#### Question 6

- (a) *M/s. AKP & Co., Chartered Accountants, have been engaged by Tech Systems Ltd. (TSL), a listed company engaged in cloud computing solutions and enterprise software services, to conduct a Due Diligence Review in connection with its proposed acquisition of a 70% stake in Code Technologies Pvt. Ltd. (CTPL), a fast-growing start-up specializing in artificial intelligence (AI) and data analytics.*

*The management of TSL believes that CTPL's proprietary AI models and client portfolio could provide significant strategic advantage, but its finance and legal teams have expressed concerns regarding revenue projections, compliance with data protection laws, cybersecurity regulations, and corporate filings.*

*You are the senior audit manager at M/s. AKP & Co. and are responsible for planning and conducting the due diligence engagement. The audit staff is new to this kind of work. You are required to explain the steps involved in conducting due diligence to the audit team.* **(5 Marks)**

- (b) *SDI Bank Ltd. is finalizing its financial statements for the year ended 31<sup>st</sup> March, 2025. PAM & Associates, Chartered Accountants are appointed statutory auditors of SDI Bank Ltd. for the financial year 2024-25. CA M is the engagement partner for conducting the audit.*

*During the course of audit, the audit team seeks guidance of CA M, the engagement partner for the following observations made while conducting the audit of investments:*

- (i) *The bank holds ₹ 450 crores in government securities, ₹ 250 crores in debentures, ₹ 95 crores in shares and ₹ 75 crores in bonds. During the audit, it is noticed that the investment team comprising of 4 staff members, is responsible for all investment functions.*
- (ii) *There are 5 Bank Receipts (BRs) with other banks totalling ₹ 35 crores at the year end. Out of these 3 BRs have been outstanding for more than 8 months.*
- (iii) *The audit team observes during the course of audit that during the year the Bank has re-classified ₹ 80 crores of investments from AFS (available for sale) to HTM (held to maturity) on the basis of a resolution passed by Asset Liability Committee, but without explicit approval from the Board of Directors.*

*Outline the audit procedures that CA M, the engagement partner will advise the audit team to be undertaken to address each of these observations.*

**(5 Marks)**

- (c) *RBR Infrastructure Pvt. Ltd. is bidding for a long-term government project involving construction of smart highways. As part of the bidding documents, the company is required to present Prospective Financial Information (PFI) for the next five years to demonstrate its financial viability. CA J has been engaged to examine the Prospective Financial Information. While examining the PFI, CA J observes that the Management has assumed zero increase in construction material costs over five years, even though industry reports predict a steady 6-8% annual increase due to inflation. Further, the company*

*has based its revenue projections on the assumption that it will win two additional large contracts, even though bids are yet to be submitted. Elaborate on the duties of CA J while examining the Prospective Financial Information. (4 Marks)*

**OR**

(c) *PMP Industries Ltd. is a listed manufacturing company. CA F is the statutory auditor for the F.Y. 2024-25. During the course of audit CA F and his audit team made the following observations:*

- *Fictitious sales of ₹ 20 crores through fake invoices*
- *Missing inventory worth ₹ 8 crores with forged records*

*On communicating the observations with the Management and those charged with governance they refused to take corrective action. Instead of making the corrections, the Managing Director threatened legal action if disclosures are made in the Audit Report. The Board of Directors is divided, with promoter directors supporting the Managing Director and others agreeing to the auditor's contention.*

*Since the fraud is material to the financial statements, CA F finds it difficult to continue the audit engagement due to these exceptional circumstances. State with reference to the relevant Standard on Auditing the course of action CA F will take. (4 Marks)*

**Answer**

**(a) Steps involved in conducting the due diligence:**

- (i) Start with an open mind. Do not assume that anything wrong will be found and look for it. What needs to be done is to identify trouble spots and ask for explanations.
- (ii) Get the best team of people. If you do not have a group of people inside your firm that can do the task (e.g. lack of staff, lack of people who know the new business because you are acquiring a business in an unrelated area, etc.), there are due diligence experts that you can hire. When hiring such professionals, look for their experience record in the industry.

- (iii) Get help in all areas like finance, tax accounting, legal, marketing, technology, and any others relevant to the assignment so that you get a 360-degree view of the acquisition candidate.
  - (iv) Talk to customers, suppliers, business partners, and employees are great resources.
  - (v) Take a risk management approach. So, while you want to do your research, you also want to make sure that you do not antagonise the team of people of the target company by bogging them down with loads of questions.
  - (vi) Prepare a comprehensive report detailing the compliances and substantive risks/issues.
- (b)** CA M, the engagement partner, will advise the audit team to undertake the following audit procedures to address the given observations:
- (i) Concentration of Investment Functions with Four Staff Members**
    - Review the investment policy of the bank to ascertain that the policy conforms, in all material respects, to the RBI's guidelines as well as to any statutory provisions applicable to the bank.
    - Check the segregation of duties within the bank staff in terms of executing trades, settlement and monitoring of such trades, and accounting of the same (generally termed as front office, middle office and back-office functions' segregation).
    - Assess whether the concentration of all investment functions with a limited number of staff members indicates a weakness in internal controls, necessitating increased audit attention.
  - (ii) Outstanding Bank Receipts (BRs) for More Than Eight Months:**
    - In respect of BRs issued by other banks and on hand with the bank at the year-end, the auditor should examine confirmations of counterparty banks about such BRs.
    - Where any BRs have been outstanding for an unduly extended period, the auditor should obtain written explanation from the management for the reasons thereof.

- The auditor should examine the reconciliation of BRs issued by the bank.
- BRs should not be issued in respect of transactions in government securities for which SGL facility is available.

**(iii) Re-classification of Investments from AFS to HTM without explicit approval from the Board of Directors.**

- Examine that entire investment portfolio of bank is classified under three categories i.e. HTM, HFT and AFS and shifting of securities is as per regulatory norms and laid down policy.
- Examine whether the shifting of the investments from 'available for sale' to 'held to maturity' is duly approved by the Board of Directors of the bank.
- Examine whether the investments have been properly classified into the three categories at the time of acquisition based on such intention as evidenced by the decision of the competent authority such as the Board of directors, Asset Liability Committee (ALCO) or Investment Committee.

**(c)** As per SAE 3400 "The Examination of Prospective Financial Information", in an engagement to examine prospective financial information, CA J, the auditor should obtain sufficient appropriate evidence as to whether:

- (i) management's best-estimate assumptions on which the prospective financial information is based are not unreasonable and, in the case of hypothetical assumptions, such assumptions are consistent with the purpose of the information;
- (ii) the prospective financial information is properly prepared on the basis of the assumptions;
- (iii) the prospective financial information is properly presented and all material assumptions are adequately disclosed, including a clear indication as to whether they are best-estimate assumptions or hypothetical assumptions; and
- (iv) the prospective financial information is prepared on a consistent basis with historical financial statements, using appropriate accounting principles.

While examining prospective financial information, principles laid down in other Standards on Auditing should be applied to the extent practicable.

**OR**

(c) As per SA 240 "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" if, as a result of a misstatement resulting from fraud or suspected fraud, the auditor encounters exceptional circumstances that bring into question the auditor's ability to continue performing the audit, the auditor shall:

- (I) Determine the professional and legal responsibilities applicable in the circumstances, including whether there is a requirement for the auditor to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities;
- (II) Consider whether it is appropriate to withdraw from the engagement, where withdrawal from the engagement is legally permitted; and
- (III) If the auditor withdraws:
  - (i) Discuss with the appropriate level of management and those charged with governance, the auditor's withdrawal from the engagement and the reasons for the withdrawal and
  - (ii) Determine whether there is a professional or legal requirement to report to the person or persons who made the audit appointment or, in some cases, to regulatory authorities, the auditor's withdrawal from the engagement and the reasons for the withdrawal.

In the given case, CA F has identified material misstatements arising from fraud, namely fictitious sales of ₹ 20 crores and missing inventory of ₹ 8 crores supported by forged records. Despite due communication, both management and those charged with governance have refused to take corrective action, and the Managing Director has further attempted to intimidate the auditor by threatening legal action. These circumstances clearly constitute exceptional circumstances that cast serious doubt on the auditor's ability to continue the audit engagement with integrity and independence. Accordingly, CA F should take the abovementioned actions in compliance with SA 240 under the given circumstances.