

Mock Test Paper - Series I: July, 2025

Date of Paper: 23rd July, 2025

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

FINAL COURSE: GROUP – I

PAPER – 3: ADVANCED AUDITING, ASSURANCE AND PROFESSIONAL ETHICS

ANSWERS

Part I: MULTIPLE CHOICE QUESTION

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

Part II - DESCRIPTIVE QUESTION

1. (a) As per SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", the auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error.

As per SA 580, "Written Representations", if management modifies or does not provide the requested written representations, it may alert the auditor to the possibility that one or more significant issues may exist.

In the instant case, the auditor observed that there was an investigation conducted at the instance of the management on a possible suspicion of fraud. Therefore, the auditor requested for investigation report which was not provided by the management despite of many reminders. The auditor also insisted for written representation in respect of fraud on/by the company. For this request also management remained silent.

It may be noted that, if management does not provide one or more of the requested written representations, the auditor shall discuss the matter with management; re-evaluate the integrity of management and evaluate the effect that this may have on the reliability of representations (oral or written) and audit evidence in general; and take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

Further, as per section 143(12) of the Companies Act, 2013, if an auditor of a company, in the course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall immediately report the matter to the Central Government (in case amount of fraud is ₹ 1 crore or above) or Audit Committee or Board in other cases (in case the amount of fraud involved is less than ₹ 1 crore) within such time and in such manner as may be prescribed.

The auditor is also required to report as per Clause (xi) of Paragraph 3 of CARO, 2020, (a) whether any fraud by the company or any fraud on the company has been noticed or reported during the year, if yes, the nature and the amount involved is to be indicated; (b) whether any report under sub-section (12) of section 143 of the Companies Act has been filed by the auditors in Form ADT-4 as prescribed under rule 13 of Companies (Audit and Auditors) Rules, 2014 with the Central Government;

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:
 - (1) 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
 - (2) 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.

- (b) As per SA 620, "Using the work of an Auditor's Expert", if the auditor concludes that the work of the auditor's expert is not adequate for the auditor's purposes and the auditor cannot resolve the matter through the additional audit procedures, which may involve further work being performed by both the expert and the auditor, or include employing or engaging another expert, it may be necessary to express a modified opinion in the auditor's report in accordance with SA 705 because the auditor has not obtained sufficient appropriate audit evidence.

In addition, the auditor shall not refer to the work of an auditor's expert in an auditor's report containing an unmodified opinion unless required by law or regulation to do so. If such reference is required by law or regulation, the auditor shall indicate in the auditor's report that the reference does not reduce the auditor's responsibility for the audit opinion.

If the auditor makes reference to the work of an auditor's expert in the auditor's report because such reference is relevant to an understanding of a modification to the auditor's opinion, the auditor shall indicate in the auditor's report that such reference does not reduce the auditor's responsibility for that opinion. In such circumstances, the auditor may need the permission of the auditor's expert before making such a reference.

In the given case, the auditor cannot reduce his responsibility by referring the name of auditor's expert and thereby issuing a unmodified report. The auditor should have issued a modified report and could have given reference to the work of an auditor's expert in that report if such reference was relevant to understanding of a modification to the auditor's opinion but even in that case the auditor should have indicated in his report that such reference of an auditor's expert does not reduce his responsibility for that opinion.

- (c) (i) **Audit Procedures to be followed in case of initial audit engagement:**
As per SA 510, "Initial Audit Engagements – Opening Balances", the auditor shall obtain sufficient appropriate audit evidence about whether the

opening balances contain misstatements that materially affect the current period's financial statements by:

- Determining whether the prior period's closing balances have been correctly brought forward to the current period or, when appropriate, any adjustments have been disclosed as prior period items in the current year's Statement of Profit and Loss;
- Determining whether the opening balances reflect the application of appropriate accounting policies; and
- Performing one or more of the following:
 - Where the prior year financial statements were audited, perusing the copies of the audited financial statements including the other relevant documents relating to the prior period financial statements;
 - Evaluating whether audit procedures performed in the current period provide evidence relevant to the opening balances; or
- Performing specific audit procedures to obtain evidence regarding the opening balances.

(ii) **Approach to be followed if he is either unable to obtain adequate evidence about the Opening Balances or finds material misstatements therein:** If the auditor is unable to obtain sufficient appropriate audit evidence regarding the opening balances, the auditor shall express a qualified opinion or a disclaimer of opinion, as appropriate. Further, If the auditor concludes that the opening balances contain a misstatement that materially affects the current period's financial statements, and the effect of the misstatement is not properly accounted for or not adequately presented or disclosed, the auditor shall express a qualified opinion or an adverse opinion.

2. (a) As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," the firm should establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and, where applicable, others subject to independence requirements (including experts contracted by the firm and network firm personnel), maintain independence where required by the Code. Such policies and procedures should enable the firm to:

- (i) Communicate its independence requirements to its personnel and, where applicable, to others subject to them; and
- (ii) Identify and evaluate circumstances and relationships that create threats to independence, and to take appropriate action to eliminate those threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the engagement.

Further, as per SA 220, "Quality Control for an Audit of Financial Statements", the engagement partner shall form a conclusion on compliance with independence requirements that apply to the audit engagement.

In doing so, the engagement partner shall:

- (i) Obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence;
 - (ii) Evaluate information on identified breaches, if any, of the firm's independence policies and procedures to determine whether they create a threat to independence for the audit engagement; and
 - (iii) Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.
- (b)** Important steps involved in conducting the investigation by Mr. Ankit on behalf of Mr. Jain, the incoming partner are the following:
- (i) Ascertainment of the history of the inception and growth of the firm.
 - (ii) Study of the provisions of the deed of partnership, particularly for composition of partners, their capital contribution, drawing rights, retirement benefits, job allocation, financial management, goodwill, etc.
 - (iii) Scrutiny of the record of profitability of the firm's business over a suitable number of years, with usual adjustments that are necessary in ascertaining the true record of business profits. Particular attention should, however, be paid to the nature of partners' remuneration, which may be excessive or inadequate in relation to the nature and profitability of the business, qualification and expertise of the partners and such other factors as may be relevant.

- (iv) Examination of the asset and liability position to determine the tangible asset backing for the partner's investment, appraisal of the value of intangibles like goodwill, know how, patents, etc. impending liabilities including contingent liabilities and those pending for tax assessment. In case of firms rendering services, the question of tangible asset backing usually is not important, provided the firm's profit record, business coverage and standing of the partners are of the acceptable order.
- (v) Position of orders at hand and the range and quality of clientele should be thoroughly examined, which the firm is presently operating.
- (vi) Position and terms of loan finance would call for careful scrutiny to assess its usefulness and implication for the overall financial position; reason for its absence or negative impact should be studied.
- (vii) It would be interesting to study the composition and quality of key personnel employed by the firm and any likelihood of their leaving the organisation in the near future.
- (viii) Various important contractual and legal obligations should be ascertained and their nature studied. It may be the case that the firm has standing agreement with the employees as regards salary and wages, bonus, gratuity and other incidental benefits. Full impact of such standing agreements would be gauged before a final decision is reached.
- (ix) Reasons for the offer of admission to a new partner should be ascertained and it should be determined whether the same synchronises with the retirement of any senior partner whose association may have had considerable bearing on the firm's success.
- (x) Appraisal of the record of capital employed and the rate of return. It is necessary to have a comparison with alternative business avenues for investments and evaluation of possible results on a changed capital and organisation structure, if any, envisaged along with the admission of the partner.
- (xi) It would be useful to have a firsthand knowledge about the specialisation, if any, attained by the firm in any of its activities.
- (xii) Manner of computation of goodwill on admission as also on retirement, if any, should be ascertained.

- (xiii) Whether any special clause exists in the deed of partnership to allow admission in future of a new partner, who may be specified, on concessional terms.
 - (xiv) Whether the incomplete contracts which will be transferred to the reconstituted firm will be a liability or a loss.
- (c) As per the recent decisions taken by the Ethical Standards Board of ICAI, a member in practice cannot act as Trademark or Patent Attorney. However, Professional advice in relation to Intellectual Property Rights (IPR) is a routine professional work for a Chartered Accountants in practice and same is permissible under the provisions of the Chartered Accountants Act, 1949.

In the given case, CA. Rohan agrees to support the client by filing applications and representing him as a Trademark Attorney before the Registrar of Trademarks. However, one of his senior partners reminds him that such activities may be restricted under the Chartered Accountants Act, 1949.

Thus, it can be concluded that the senior partner of CA. Rohan is correct as CA. Rohan's action of agreeing to act as a Trademark Attorney before the Registrar of Trademarks would amount to professional misconduct under the Chartered Accountants Act, 1949.

3. (a) As per Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he advertises his professional attainments or services, or uses any designation or expressions other than the Chartered Accountant on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a University established by law in India or recognized by the Central Government or a title indicating membership of the Institute of Chartered Accountants or of any other institution that has been recognized by the Central Government or may be recognized by the Council.

Further, Chapter XVI for Logo of Council General Guidelines, 2008 prescribes the following guidelines for CA members:

- There should be no alteration of the font (colour, bold/unbold, size). Moreover, there should be no change in spacing and dimensions.
- Do not change the design and colours including the white background.
- Refrain from rotating or tilting the logo clockwise and anti-clockwise.
- The logo should not be shrunk or distorted changing the original proportion.

In the given case, CA. Ramesh made changes in the CA India logo to make the cards attractive. He changed the background colour from white to grey to match the firm's theme, reduced the size of the logo to fit into a smaller space on the top-right corner of his cards, replaced the word "India" in the logo with his firm's initials, and added a gradient effect to the blue colour in the letters "CA".

Hence, CA. Ramesh will be held guilty of professional misconduct due to violation of the Council General Guidelines and Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949.

(b) Projected Financial Statements: As per SAE 3400, "The Examination of Prospective Financial Information", before accepting an engagement to examine prospective financial information, the auditor would consider, amongst other things:

- the intended use of the information;
- whether the information will be for general or limited distribution;
- the nature of the assumptions, that is, whether they are best-estimates or hypothetical assumptions;
- the elements to be included in the information; and
- the period covered by the information.

Further, the auditor should not accept, or should withdraw from, an engagement when the assumptions are clearly unrealistic or when the auditor believes that the prospective financial information will be inappropriate for its intended use. The auditor should consider the extent to which reliance on the entity's historical financial information is justified. Like in other engagements, it is necessary that terms of engagements should be agreed with client by sending an engagement letter.

(c) Steps that the auditor should take to evaluate the impact of technology-driven changes on the company's internal controls and financial reporting include the following:

- Maintain sufficient professional skepticism when reviewing management's risk assessment for new systems.
- Understand the direct and indirect effects of new technology and determine how its use by the entity impacts the auditor's overall risk assessment.

- Understand how the technologies impact the flow of transactions, assess the completeness of the in-scope ICFR systems, and design a sufficient and appropriate audit response.
- Assess the appropriateness of management's processes to select, develop, operate, and maintain controls related to the organization's technology based on the extent the technology is used.

4. (a) Clause (1) of Part I of the 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 allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice and is in partnership with or employed by him.

The above clause is intended to safeguard the public against unqualified accountant practicing under the cover of qualified accountants. It ensures that the work of the accountant will be carried out by a Chartered Accountant who may be his partner, or his employee and would work under his control and supervision.

In the instant case, CA. Suraj allowed CA. Sudeep (who is a newly qualified CA. professional with COP) to sit in his office for 6 months and allowed him to provide tax consultancy independently to his firm's clients, filing of some IT and GST Returns. He also allowed him to appear before various tax authorities on behalf of his firm. CA. Sudeep was only reimbursed with his usual expenses and was not paid any salary or share of profit for the same. However, after the end of agreed period he was given a lump-sums of ₹ 4,00,000 for his association out of gratitude.

Thus, in the present case CA. Suraj will be held guilty of professional misconduct as per Clause (1) of Part I of the First Schedule to the Chartered Accountants Act, 1949 as he allowed CA. Sudeep to practice in his name as Chartered accountant and CA. Sudeep is neither in partnership nor in employment with CA. Suraj.

- (b) **Sections of BRSR covered by XYZ Ltd.:** In the given case, XYZ Ltd., a listed entity, has made disclosures that fall under the following sections of the BRSR framework:

- (i) **Section A – General Disclosures:** This section contains the details of the listed companies, its products, services, operations, employee related details, its holding, subsidiary, associate companies etc.
- (ii) **Section B – Management Process and disclosures:** It contains questions related to policy and management processes, governance, leadership, and oversight.

(iii) **Section C – Principle-wise performance disclosures:** Companies are required to report upon Key performance indicators (KPIs) in alignment with the nine principles of the NGRBC. The section classifies KPIs into two categories that companies are required to report upon:

- Essential indicators (Mandatory disclosures): This would include data on training programs conducted, environmental data on energy, emissions, water, waste management etc.
- Leadership indicators (Optional disclosures): It would include life cycle assessments, details of conflict management policy, additional data on biodiversity, energy consumption, supply chain managements etc.

In the given situation, XYZ Ltd. has disclosed information related to its workforce strength, gender diversity, and number of subsidiaries, which aligns with Section A - General Disclosures about employee details and corporate structure. Further, disclosure of policies on ethics, diversity, human rights, and environmental sustainability initiatives indicates coverage of Governance and Policy are in compliance with Section B - Management Process and disclosures. Furthermore, XYZ Ltd. has disclosed data on energy consumption, carbon emissions, and sustainability-related training for employees, which are part of the Mandatory Essential Indicators under Section C - Principle-wise performance disclosures.

Compliance with Minimum Mandatory Disclosures: XYZ Ltd. has disclosed essential indicators such as environmental data (energy, emissions), employee training, and policy-related disclosures, which are the core components of mandatory requirements. However, XYZ Ltd., has not disclosed life cycle assessments, details of its biodiversity conservation initiative which are leadership indicators. Since, disclosure of Leadership indications is optional, therefore, their exclusion does not violate compliance with mandatory BRSR requirements.

Thus, it can be concluded that XYZ Ltd. appears to have complied with the minimum mandatory disclosures required under BRSR.

(c) **Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement:** As per SA 705, "Modification to the Opinion in the Independent Auditor's Report", if, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to

disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

If management refuses to remove the prescribed limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

- (i) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (ii) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:
 - 1. Withdraw from the audit, where practicable and possible under applicable law or regulation; or
 - 2. If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

If the auditor withdraws as discussed above, before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

In the given case, management imposed limitation on audit opinion. Thus, CA. Kabir should take above mentioned actions in response to such limitations.

5. (a) Evaluation of the Internal Control System in the area of credit card operations of the bank:

- There should be effective screening of applications with reasonably good credit assessments.
- There should be strict control over storage and issue of cards.

- There should be a system whereby a merchant confirms the status of unutilised limit of a credit-card holder from the bank before accepting the settlement, in case the amount to be settled exceeds a specified percentage of the total limit of the card holder.
- There should be a system of prompt reporting by the merchants of all settlements accepted by them through credit cards.
- Reimbursement to merchants should be made only after verification of the validity of merchant's acceptance of cards.
- All the reimbursement (gross of commission) should be immediately charged to the customer's account.
- There should be a system to ensure that statements are sent regularly and promptly to the customer.
- There should be a system to monitor and follow-up customers' payments.
- Payments overdue beyond a reasonable period should be identified and attended to carefully. For defaulting customers, credit should be stopped by informing the merchants through periodic bulletins, as early as possible, to avoid increased losses.
- There should be a system of periodic review of credit card holders' accounts. On this basis, the limits of customers may be revised, if necessary. The review should also include determination of doubtful amounts and the provisioning in respect thereof.

- (b) As per SA 560, "Subsequent Events", the auditor shall perform audit procedures designed to obtain sufficient appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require adjustment of, or disclosure in, the financial statements have been identified. The auditor is not, however, expected to perform additional audit procedures on matters to which previously applied audit procedures have provided satisfactory conclusions.

The auditor shall perform the procedures required in the above paragraph so that they cover the period from the date of the financial statements to the date of the auditor's report, or as near as practicable thereto.

In the given case, the nationwide strike and suspension of domestic flight operations in April 2025, though occurring after the balance sheet date, constitutes a significant subsequent event that may impact the recoverability of receivables and valuation of inventory. Being the auditor of SAFE Ltd., to ensure

that all subsequent events are considered so that financial statements for the year ending 31.03.2025 represent a true and fair view, the auditor shall take into account the auditor's risk assessment in determining the nature and extent of such audit procedures, which shall include the following:

- (a) Obtaining an understanding of any procedures management has established to ensure that subsequent events are identified.
- (b) Inquiring of management and, where appropriate, those charged with governance as to whether any subsequent events have occurred which might affect the financial statements.
- (c) Reading minutes, if any, of the meetings, of the entity's owners, management and those charged with governance, that have been held after the date of the financial statements and inquiring about matters discussed at any such meetings for which minutes are not yet available.
- (d) Reading the entity's latest subsequent interim financial statements, if any.

When, as a result of the procedures performed as required above, the auditor identifies events that require adjustment of, or disclosure in, the financial statements, the auditor shall determine whether each such event is appropriately reflected in those financial statements.

- (c) According to Clause (2) of Part II of First Schedule of the Chartered Accountant Act, 1949, a member of the Institute (other than a member in practice) shall be guilty of professional misconduct, if he being an employee of any company, firm or person accepts or agrees to accept any part of fee, profits or gains from a lawyer, a chartered accountant or broker engaged by such company, firm or person or agent or customer of such company, firm or person by way of commission or gratification.

The objective is that when a member is in employment, he must maintain high level of ethics and should not accept any other amount from anyone for which he is not entitled from employer under contractual agreement of service.

In the present case, CA. Rudra is the Chief Financial Officer of DGT General Insurance Limited. He releases the commission payments on the condition that he gets 25% of the commission amount from the agent as majority of the clients are through their agency only.

Therefore, CA. Rudra is guilty of professional misconduct by virtue of Clause (2) of Part II of First Schedule of the Chartered Accountant Act, 1949.

6. (a) As per Standard on Internal Audit (SIA) 210, "Managing the Internal Audit Function", the Internal Audit Function performs a number of activities to achieve its objectives as outlined in its Charter (or Terms of Engagement). A few of the critical activities are as follows:

- (i) Define the overall plan, scope and methodology of the Internal Audit Function on a periodic basis.
- (ii) Oversee and monitor various audit assignments, their proper planning, execution, reporting of findings and subsequent closure of reported observations.
- (iii) Plan, acquire, engage and review the performance, training and development of professional staff, talent and other resources to achieve its objectives.
- (iv) Identify, source, engage and manage external experts and technical solutions, if required.
- (v) Communicate and engage with all key stakeholders regarding progress and achievement of objectives.
- (vi) Develop and maintain a quality evaluation and improvement program.

Therefore, planning, acquiring and review of performance, training and development of professional staff is one of the critical activities for achievement of internal audit objectives. Without performance of this critical activity, it would be difficult to achieve objectives of internal audit function as outlined in internal audit charter. Hence, it falls within purview of critical activities to be performed by Chief Internal auditor to achieve objectives as outlined in internal audit charter.

- (b) **Opinion Paragraph:** In the given situation, the auditor of Megh and Sons was unable to obtain sufficient appropriate audit evidence regarding accounts receivable and inventories, of which impact can be material and pervasive to the financial statements as a whole. Thus, a disclaimer of opinion will be given for the same.

Disclaimer of Opinion

We were engaged to audit the financial statements of Megh & Sons ("the entity"), which comprise the balance sheet as at March 31, 2025, the statement of Profit and Loss, (the statement of changes in equity) and the 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 the entity. 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

We were not appointed as auditors of the Company until after March 31, 2025, and thus did not observe the counting of physical inventories at the beginning and end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at March 31, 2024, and 2025, which are stated in the Balance Sheets at ₹ xxx and ₹ xxx, respectively. In addition, the introduction of a new computerised accounts receivable system in November 2024 resulted in numerous errors in accounts receivable. As of the date of our report, management was still in the process of rectifying the system deficiencies and correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of ₹ xxx as at March 31, 2025. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories and accounts receivable, and the elements making up the statement of Profit and Loss (and statement of cash flows).

- (c) According to SA 200, “Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing”, the Audit Risk is a risk that Auditor will issue an inappropriate opinion while Financial Statements are materially misstated.

Audit Risk has two components: Risk of material Misstatement and Detection Risk. The relationship can be defined as follows.

Audit Risk = Risk of Material Misstatement X Detection Risk

Risk of Material Misstatement: - Risk of Material Misstatement is anticipated risk that a material Misstatement may exist in Financial Statement before start of the Audit. It has two components Inherent risk and Control risk. The relationship can be defined as

Risk of Material Misstatement = Inherent risk X Control risk

Inherent risk: It is a susceptibility of an assertion about account balance; class of transaction, disclosure towards misstatements which may be either individually or collectively with other Misstatement becomes material before considering any related internal control which is 30% in the given case.

Control risk: It is a risk that there may be chances of material Misstatement even if there is a control applied by the management and it has prevented defalcation to 60%.

Hence, Control risk is 40% (100%-60%)

Risk of Material Misstatement: Inherent risk X Control risk i.e., $30\% \times 40\% = 12\%$

Chances of Material Misstatement are reduced to 12% by the internal control applied by management.

Detection risk: It is a risk that a material misstatement remained undetected even if all audit procedures applied, Detection Risk is $100\% - 75\% = 25\%$

In the given case, overall Audit Risk can be reduced up to 3% as follows:

Audit Risk: Risk of Material Misstatement X Detection Risk = $12\% \times 25\% = 3\%$

OR

- (c) As per Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice will be deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.

Provided that nothing herein contained shall be construed as preventing or prohibiting -

- (i) Any Chartered Accountant from applying or requesting for or inviting or securing professional work from another chartered accountant in practice; or
- (ii) A member from responding to tenders or enquiries issued by various users of professional services or organisations from time to time and securing professional work as a consequence.

However, as per the guideline issued by the Council of the Institute of Chartered Accountants of India, a member of the Institute in practice shall not respond to any tender issued by an organisation or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit and attestation services. However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

In the given case, JDB Cooperative Bank circulated a list of branches to audit firms, specifying the maximum fee per branch. In response, CDR & Associates submitted their quotation. As per Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949, and the Guidelines issued by the Council of ICAI, such a response is not permitted, since the assignment relates to audit services exclusively reserved for Chartered Accountants, and only a maximum fee (not minimum) was prescribed. Accordingly, the concerned responsible partner of CDR & Associates, being a Chartered Accountant in practice, shall be held guilty of professional misconduct for responding to such a quotation.