

Suggested Answers and Marking Scheme

MTP 1 (Ch. 1 – Quality Control & Ch. 2 – General Auditing Principles)

Marks: 40

Time: 1 hr. 15 Minutes

Instructions: Part A comprises of MCQ.

Part B Comprises of descriptive questions.

Part – A (Multiple Choice Questions)

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| Q.1 | (b) | <p>Raise a concern internally and consider involving external experts or specialists.</p> <p>Reason:</p> <p>As per SQC 1, the firm shall accept or continue an engagement only when it has the competence, capabilities, and resources to perform the engagement. Where the engagement team lacks experience in specialized areas such as pharmaceutical R&D accounting and regulatory compliance, the engagement partner is required to address deficiency by involving appropriately qualified experts to ensure compliance with professional standards and audit quality.</p> | 2 |
| Q.2 | (b) | <p>Proceed after understanding the nature of scope limitations and documenting the evaluation.</p> <p>Reason:</p> <p>In accordance with SA 510 and SA 220, the auditor is required to evaluate matters leading to the predecessor auditor's resignation, including scope limitations, to assess their relevance and impact on the current audit. Such evaluation must be appropriately documented to identify potential risks and determine necessary audit responses.</p> | 2 |
| Q.3 | (b) | <p>To ensure appropriate direction, supervision, and review of the audit work.</p> <p>Reason:</p> <p>As per SA 220, "Quality Control for an Audit of Financial Statements", engagement partner has the responsibility for direction, supervision and performance of audit engagement in accordance with professional standards and regulatory and legal requirements.</p> | 2 |
| Q.4 | (b) | <p>Observing inventory counts at certain locations after prior intimation.</p> <p>Reason:</p> <p>Due to fraud, observing inventory counts at certain locations after prior intimation is not likely to be an appropriate response to assessed risk of material misstatement.</p> | 2 |
| Q.5 | (c) | <p>Only inquiry of company management personnel and review of correspondence with regulatory authorities are suffice to verify compliance.</p> | 2 |

Reason:

In accordance with requirements of SA 250, the auditor shall perform following audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements:

- (a) Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and
- (b) Inspecting correspondence, if any with the relevant licensing or regulatory authorities.

- Q.6** (c) He should obtain further information to evaluate the possible effect on financial statements. Besides, he should evaluate implications of non-compliance for audit risk assessment. **2**

Reason:

The auditor has observed non-compliance of laws prohibiting employment of child labour. In accordance with SA 250, if the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain:

- (a) An understanding of the nature of the act and the circumstances in which it has occurred; and
- (b) Further information to evaluate the possible effect on the financial statements. The auditor shall evaluate the implications of non-compliance in relation to other aspects of the audit, including the auditor's risk assessment and the reliability of written representations, and take appropriate action.

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Part B (Descriptive Questions)

Q. No. 1 is Compulsory. Attempt ANY TWO from the rest.

- Q.1** (a) **Consultation in difficult or contentious matters:**

- 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 must establish policies to ensure that appropriate consultation takes place on difficult or contentious matters.

(1 Mark)

- Consultation includes discussion, at the appropriate professional level, with individuals within or outside the firm who have specialized expertise, to resolve a difficult or contentious matter. It helps to promote quality and improves the application of professional judgment. Consultation procedures require consultation with those having appropriate knowledge, seniority and experience within the firm (or outside the firm) on significant technical, ethical and other matters and appropriate documentation and implementation of conclusions resulting from consultations.

(1.5 Marks)

- A firm needing to consult externally, for example, a firm without appropriate internal resources, may take advantage of advisory services provided by other firms or professional and regulatory bodies. Complete and proper documentation should be maintained on issues involved and results of consultation. **(1.5 Marks)**
- In the given case, CA Varun's approach of avoiding consultation on a complex and contentious matter to save time or protect the firm's image is inappropriate and violates the principles of quality control.

Conclusion: CA Varun must seek consultation since the matter of government grants involves significant technical complexity and falls under "difficult or contentious matters". By not consulting, the firm fails to implement a rigorous audit process. The firm should either consult a larger firm or use the advisory services of professional bodies like ICAI, and must ensure that the issue and the resulting conclusions are thoroughly documented to support the audit quality. **(1 Mark)**

(b) Auditor's duties in case of suspected fraud:

- SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements," emphasize that fraud can be perpetrated by management override of controls, such as the creation of fictitious journal entries, particularly towards the end of an accounting period, to manipulate operating results or achieve specific objectives. **(1 Mark)**
- In the case of Supreme Ltd., where purchases of ₹ 1.50 crore were recorded at year-end without supporting evidence, it became apparent during the investigation that the company had entered fictitious journal entries to manipulate the operating results.
- Given this situation, the auditor would align their approach based on the impact of the misstatement resulting from such fictitious journal entries. If, due to fraud or suspected fraud, the auditor encounters exceptional circumstances that cast doubt on their ability to continue the audit, they must assess the professional and legal responsibilities applicable.
- This includes considering reporting obligations to those who appointed the auditor or, in some cases, to regulatory authorities. The appropriateness of withdrawal from the engagement is also a consideration, where legally permitted. **(1 Mark)**
- Furthermore, the auditor is mandated to report in accordance with Sec. 143(12) of the Companies Act, 2013. According to Sec. 143(12) read with Rule 13 of Companies (Audit & Auditor's) Rules, 2014, if the auditor, during the performance of their duties, has reason to believe that an offence of fraud involving an amount of ₹ 1 crore or more has been committed by the company's officers or employees, reporting to the Central Government is required in the prescribed manner. **(1.5 Marks)**
- Additionally, reporting obligations extend to Clause (xi) of Para 3 of CARO, 2020. The auditor is obligated to disclose whether any fraud by the company or against the company by its officers or employees has been observed or reported during the year. If affirmative, the nature and amount involved are to be indicated. This comprehensive reporting framework ensures transparency, adherence to legal requirements, and protection of stakeholders' interests in the face of potential fraudulent activities. **(1.5 Marks)**

(c) Reporting by the User Auditor:

- As per SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation", the user auditor shall modify the opinion in the user auditor's report in accordance with SA 705, "Modifications to the Opinion in the Independent Auditor's Report", if he is unable to obtain sufficient appropriate audit evidence regarding the services provided by the service organisation relevant to the audit of the user entity's financial statements. **(1 Mark)**
- User Auditor shall not refer to the work of a Service auditor in the user 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 user auditor's report shall indicate that the reference does not diminish the user auditor's responsibility for the audit opinion. **(2 Marks)**
- In the given case, CA Raman while reviewing the unmodified audit report drafted by his assistant found that, a reference has been made to the work done by the service auditor. CA Raman hence asked his assistant to remove such reference and modify report accordingly.

Conclusion: Contention of CA Raman in removing reference of work done by service auditor is in order as in case of unmodified report, user auditor cannot refer to work done by service auditor.

(1 Mark)

Q.2 (a) Documentation requirements:

As per SA 220, "Quality Control for an Audit of Financial Statements", documentation is essential to provide evidence of the implementation of quality control procedures at the engagement level.

Documentation by the Engagement Partner:

The engagement partner should document the following matters pertaining to an audit engagement:

- Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
- Conclusions on compliance with independence requirements that apply to the audit engagement, and any relevant discussions with the firm that support these conclusions.
- Conclusions reached regarding the acceptance and continuance of client relationships and audit engagements.
- The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit engagement.

(3 Marks – Any 3 Points)

Documentation by the Engagement Quality Control Reviewer (EQCR):

The engagement quality control reviewer shall document, for the audit engagement reviewed, that:

- The procedures required by the firm's policies on engagement quality control review have been performed.
- The engagement quality control review has been completed on or before the date of the auditor's report.
- The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the engagement team made and the conclusions they reached were not appropriate.

(2 Marks – Any 2 Points)

Proper documentation serves as the primary evidence that the audit was performed in accordance with professional standards and the firm's quality control policies.

CA Aman must ensure his review is finalized and documented before or on the date of the audit report, while the engagement partner must ensure all ethical and consultation matters are meticulously recorded to support the audit's integrity.

(b) Audit Procedures When Non-Compliance is Identified or Suspected:

- When the auditor becomes aware of the existence of or has information about investigations by government departments and regulatory organizations, it may be an indication of non-compliance with laws and regulations. **(1 Mark)**
- In the instant case, notice has been served upon the company by DGGI for allegedly creating fictitious invoices in guise of providing “marketing and sales services” for ₹ 50 crores. Issuing an invoice without supply of services is a serious offence under GST laws and it could involve penalties and imprisonment. Such suspected non-compliance may have a direct effect on financial statements. The matter has also been informed to regulator i.e. IRDAI. Violation of IRDAI regulations may result in fines, litigation or other consequences for the entity that may have a material effect on the financial statements.
- If the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the auditor shall obtain:
 - (a) An understanding of the nature of the act;
 - (b) Circumstances in which it has occurred; and
 - (c) Further information to evaluate the possible effect on the financial statements. **(2 Marks)**
- If auditor suspects there may be non-compliance, he shall discuss the matter with management and, where appropriate, TCWG. If management or TCWG do not provide sufficient information that supports that the entity is in compliance with laws and regulations and in the auditor's judgment, the effect of the suspected non-compliance may be material to the financial statements, the auditor shall consider the need to obtain legal advice. **(1 Mark)**
- If sufficient information about suspected non-compliance cannot be obtained, the auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the auditor's opinion. **(1 Mark)**

(c) Considerations regarding the nature and extent of activities undertaken by service organisation:

As per SA 402 “Audit Considerations relating to an Entity using a Service Organisation”, when obtaining an understanding of the user entity in accordance with SA 315, the user auditor shall obtain an understanding of how a user entity uses the services of a service organisation in the user entity's operations, including:

- (i) The nature of the services provided by the service organisation and the significance of those services to the user entity, including the effect thereof on the user entity's internal control;
- (ii) The nature and materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;
- (iii) The degree of interaction between activities of service organisation and those of user entity; and
- (iv) The nature of the relationship between the user entity and the service organisation, including the relevant contractual terms for the activities undertaken by the service organisation.

Based on above, the auditor will assess the effect on the audit risk and take necessary steps while conducting the audit.

(1 Mark for each correct point – 4 Marks)

Q.3 (a) Matters to be communicated with TCWG:

SA 260 “Communication with Those Charged with Governance” deals with auditor’s responsibility to communicate with TCWG in relation to an audit of financial statements. Among various matters as included in the list, one of the matters that is not mentioned in the list is Significant findings from the audit. With respect to such matter, the auditor shall communicate with TCWG:

- (a) Auditor’s views about significant qualitative aspects of entity’s accounting practices, including accounting policies, accounting estimates and financial statement disclosures. When applicable, the auditor shall explain to TCWG why the auditor considers a significant accounting practice, that is acceptable under the applicable FRF, not to be most appropriate to the particular circumstances of the entity;
- (b) Significant difficulties, if any, encountered during the audit;
- (c) Unless all of TCWG are involved in managing the entity:
 - (i) Significant matters arising during the audit that were discussed, or subject to correspondence, with management;
 - (ii) Written representations the auditor is requesting
- (d) Circumstances that affect the form and content of the auditor’s report, if any and
- (e) Any other significant matters arising during the audit that, in the auditor’s professional judgment, are relevant to the oversight of the financial reporting process. **(4 Marks)**

The communication of findings from the audit may include requesting further information from TCGW in order to complete the audit evidence obtained. For example, the auditor may confirm that TCWG have the same understanding of the facts and circumstances relevant to specific transactions or events. **(1 Mark)**

(b) Reporting in case of Joint Auditors:

- SA 299 “Joint Audit of Financial Statements” lays down the principles for effective conduct of joint audit to achieve the overall objectives of the auditor as laid down in SA 200.
- SA 299 requires the Joint auditors to issue common audit report. However, in case of any disagreement among joint auditors with regard to the opinion or any matters to be covered by the audit report, they shall express their opinion in a separate audit report.
- A joint auditor is not bound by the views of the majority of the joint auditors regarding the opinion or matters to be covered in the audit report and shall express opinion formed by the said joint auditor in separate audit report in case of disagreement.
- In case of separate reports, the audit report(s) issued by the joint auditor(s) shall make a reference to the separate audit report(s) issued by the other joint auditor(s). Such reference shall be made under the heading “Other Matter Paragraph” as per SA 706. **(3 Marks)**

Review of work by other joint auditor:

- Each joint auditor is entitled to assume that the other joint auditors have carried out their part of the audit work and the work has actually been performed in accordance with the SAs.
- It is not necessary for a joint auditor to review the work performed by other joint auditors or perform any tests in order to ascertain whether the work has actually been performed in such a manner.
- Each joint auditor is entitled to assume that the other joint auditors have brought to said joint auditor’s notice any departure from applicable FRF or significant observations that are relevant to their responsibilities noticed in the course of the audit.

- Before finalizing audit report, the joint auditors shall discuss and communicate with each other their respective conclusions that would form the content of the audit report. **(2 Marks)**

(c) Aspects to be considered while performing EQCR for audit of F.S.:

As per SA 220, “Quality Control for an Audit of Financial Statements”, for audits of financial statements of listed entities, CA. Giri, the engagement quality control reviewer, on performing an engagement quality control review, shall also consider the following:

- Engagement team’s evaluation of the firm’s independence in relation to the audit engagement;
- Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, and the conclusions arising from those consultations;
- Whether audit documentation selected for review reflects the work performed in relation to the significant judgments made and supports the conclusions reached. **(2 Marks)**

As per SQC 1, “Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements”, there might be difference of opinion within ET, with those consulted and between EP and EQC reviewer. The report should only be issued after resolution of such differences. In case, recommendations of engagement quality control reviewer are not accepted by engagement partner and matter is not resolved to reviewer’s satisfaction, the matter should be resolved by following established procedures of firm like by consulting with another practitioner or firm, or a professional or regulatory body. **(1 Mark)**

Conclusion: In the given situation, under completion of review, CA. Giri, Engagement Quality Control Reviewer has identified certain issues. However, the view of CA Giri, the EQCR are not accepted by the Engagement Partner. This difference of opinion among the CA Giri and Engagement Partner should be resolved with abovementioned manner as per SQC 1. **(1 Mark)**

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Link for Resources (Revision Videos, MTPs, Amendments, Charts, etc.) and Inquiries

1	Youtube Channel	https://www.youtube.com/@altclassesca9193	
2	Telegram Channel	https://t.me/altclasses	
3	Whatsapp Group for Doubts	https://chat.whatsapp.com/LSDM362gij2ErmRgTi7ceA	
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