

Section A Multiple Choice Questions

MCQs 1-6 carry 1 mark each and MCQs 7-8 carry 2 marks each. (Total 10 marks)

1. Professional scepticism requires that the auditor should be _____ indicating _____.
(a) Ignorant; Possible mis-statements
(b) Alert; Possible mis-statements
(c) Alert; Management bias
(d) Ignorant; Possible mis-statements

2. Which of the following is not necessary to establish preconditions for an audit?
(a) Acceptability of financial reporting framework.
(b) Acknowledgment of cooperation from management in designing audit procedures.
(c) Acknowledgment from management of providing access to persons within company.
(d) Acknowledgment of management in understanding its responsibility for preparation of financial statements.

3. CA. Jayesh has been appointed as auditor of XYZ Limited a tyre manufacturing company. He is curious to know as to which of the following action may result in a self-interest threat
(a) The client offering a very high amount of audit fees to him as compared to the other clients in same industry
(b) The client is offering him an appointment as to represent him in a court of law wherein he will be acting in a capacity as advocate
(c) A partner of CA Jayesh is a director in the holding company of XYZ Limited
(d) All of these give rise to self-interest threat

CAREFULLY READ THE FOLLOWING CASE AND ANSWER THE MCQs 4-8

Ravish and Co, a chartered accountancy firm, has been auditing the books of PQ groups of banks, from the past 6 years. Ravish and Co. has a good standing reputation as auditor and there are regular quality control activities performed by the firm's engagement partner. The recent weekly meeting of the firm's staff included discussions on each of the element of the firm's system of quality control as per SQC 1 and code of ethics as per SA 200. During the 7th year of audit, there have been some changes in the bank due to which the firm is considering revision of audit terms as per SA 210. Also, new laws and updates in the field of accounting makes the auditor feel that the financial reporting framework used by the bank is not acceptable as per law and is considering the impact of this on his audit report. Owing to the changes, Mr. Ravish instructs his articles to go through the audit programme once again and make necessary changes to it. He also reviews the audit plan developed for the bank. After the above exercise of re-planning and revision in terms of the engagement as per SA 210, Mr. Ravish and Co. carries on the audit of the 7th year,

4. Which among the following is NOT an element of firm's system of quality control?
(a) Ethical Requirements
(b) Acceptance and continuance of client relationships and specific engagements
(c) Engagement review
(d) Monitoring

5. When conducting an audit of financial statement, which of the following is NOT a fundamental principle of professional ethics?
(a) Integrity
(b) Professional Skepticism
(c) Confidentiality
(d) Objectivity

6. Standard on Quality Control (SQC) 1 provides that,
- (a) unless otherwise specified by law or regulation, audit documentation is the property of the management.
 - (b) unless otherwise specified by law or regulation, audit documentation is the property of those charged with governance.
 - (c) unless otherwise specified by law or regulation, audit documentation is the property of the management or those charged with governance.
 - (d) unless otherwise specified by law or regulation, audit documentation is the property of the auditor.
7. Which of the following statement is incorrect considering the context of revision in audit terms as per SA 210?
- (a) Indication that the entity has misunderstood the objective and scope of the audit
 - (b) A significant change in ownership of the client
 - (c) A change in legal or regulatory requirements
 - (d) Significant change in the audit team
8. The engagement partner as per SA-220 means ____ in the firm who is responsible for ____.
- (a) Partner; engagement and report
 - (b) other person; engagement and report
 - (c) Partner / other person; engagement and report
 - (d) Partner; engagement

Section B: Descriptive Questions

Question 1: SQC 1 requires that the firm should establish a system of quality control designed to provide it with reasonable assurance that the firm and its personnel comply with professional standards and regulatory and legal requirements and that reports issued by the firm or engagement partners are appropriate in the circumstances. State the elements of quality control (4 marks)

Answer 1:

Elements of System of Quality Control

The firm's system of quality control should include policies and procedures addressing each of the following elements: -

- (A) Leadership responsibilities for quality within the firm
- (B) Ethical requirements
- (C) Acceptance and continuance of client relationships and specific engagements
- (D) Human resources
- (E) Engagement performance
- (F) Monitoring

Quality control policies and procedures should be documented and communicated to the firm's personnel. Therefore, the firm encourages its personnel to communicate their views or concerns on quality control matters.

Question 2: An engagement partner takes overall responsibility for maintaining audit quality in an audit engagement in accordance with SA 220. What are his objectives in taking and emphasizing such responsibility? (4 marks)

Answer 2:

Leadership responsibility of an engagement partner is to take **responsibility for the overall quality** on each audit engagement. The actions of the engagement partner and appropriate messages to the other members of the engagement team, in taking responsibility for the overall quality on each audit engagement, emphasise

- (a) The importance to audit quality of: -

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- (i) Performing work that complies with professional standards and regulatory and legal requirements;
 - (ii) Complying with the firm's quality control policies and procedures as applicable;
 - (iii) Issuing auditor's reports that are appropriate in the circumstances; and
 - (iv) The engagement team's ability to raise concerns without fear of reprisals.
- (b) The fact that quality is essential in performing audit engagements.

Question 3: Briefly outline how principles-based approach differs from rules-based approach to ethics. (3 marks)

Answer 3:

- Ethical guidance may follow principles-based approach or rules-based approach.
- The essence of principles-based approach to ethics is that it requires compliance with spirit of ethics. It requires accountants to exercise professional judgment in every situation based upon their professional knowledge, skill and expertise.
- However, rules-based approach to ethics strictly follows clearly established rules. It may lead to a narrow outlook and spirit of ethics may be overlooked while strictly adhering to rules.
- Further, rules-based approach is somewhat rigid as it may not be possible to deal with every practical situation relying upon rules.

Question 4: R & Co, a firm of Chartered Accountants have not revised the terms of engagements and obtained confirmation from the clients, for last 5 years despite changes in business and professional environment. Please elucidate the circumstances that may warrant the revision in terms of engagement. (4 marks)

Answer 4:

If the engagement letter had been issued at the time of taking initial engagement, then it is not necessary to issue audit engagement letter each year for repetitive audit. However, the auditor may think of issuing a new engagement letter in the circumstances as mentioned below:

- (i) In case it appears that the client has misunderstood the objective and scope of audit.
- (ii) In case any revision by way of addition, deletion, or modifications is required in the original engagement letter.
- (iii) If there has been change in TCWG or owners, then there may be need to explain the terms to them.
- (iv) If the scope and terms of engagement need to be altered because changes had occurred in nature, volume of the business of the client.
- (v) If it is necessary to modify audit approach to be in line with the latest pronouncements of ICAI or changes in various laws etc.

Question 5: X, a Chartered Accountant was engaged by PQR, & Co. Ltd. auditing their accounts. He sent his letter of engagement to the Board of Directors, which was accepted by the Company. In the course of audit of the company, the auditor was unable to obtain appropriate sufficient audit evidence regarding receivables. The client requested for a change in the terms of engagement. Offer your comments in the regard. (6 marks)

Answer 5:

1. An auditor who, before the completion of the engagement, is requested to change the engagement to one which provides a lower level of assurance, should consider the appropriateness of doing so.
2. A request from the client for the auditor to change the engagement may be due to-
 - (a) a change in circumstances affecting the need for the service,
 - (b) a misunderstanding as to the nature of an audit originally requested.a restriction on the scope of the engagement, whether imposed by management or caused by circumstances.
3. The auditor would consider carefully the reason given for the request, particularly the implications of a restriction on the scope of the engagement.
4. The auditor shall not agree to a change in the terms of the audit engagement where there is no reasonable justification for doing so.

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5. If, prior to completing the audit engagement, the auditor is requested to change the audit engagement to an engagement that conveys a lower level of assurance, the auditor shall determine whether there is reasonable justification for doing so.
6. If the terms of the audit engagement are changed, the auditor and management shall agree on and record the new terms of the engagement in an engagement letter or other suitable form of written agreement.
7. If the auditor is unable to agree to a change of the terms of the audit engagement and is not permitted by management to continue the original audit engagement, the auditor shall:
 - (a) Withdraw from the audit engagement where possible under applicable law or regulation; and
 - (b) Determine whether there is any obligation, either contractual or otherwise, to report the circumstances to other parties, such as those charged with governance, owners or regulators.

Question 6: ABC and company is offered appointed as an auditor of APJ School. Mr. A, a partner of said firm is father of the founder cum administrator of APJ school. The firm is in dilemma if the proposed appointment would give rise to any threat. Can you guide them and explain the reason to back your advice? (4 marks)

Answer 6:

- As per the facts given, Mr. A, a partner of proposed auditor is father of the founder cum administrator of APJ school. This relationship between proposed auditor and the client management gives rise to the familiarity threat and thus the firm should not accept auditor ship of such concern.
- Familiarity threats are self-evident, and occur when **auditors form relationships with the client** where they end up being too **sympathetic** to the client's interests.
- This can occur in many ways including:
 - ✓ close relative of the audit team working in a senior position in the client company
 - ✓ former partner of the audit firm being a director or senior employee of the client
 - ✓ long association between specific auditors and their specific client counterparts and
 - ✓ acceptance of **significant gifts or hospitality** from the client company, its directors or employees.

Question 7. CA. Amar is offered appointment as auditor of a company engaged in providing tourism services. While making due diligence of the proposed client, he comes to know that there have been raids on premises of the company and residences of its directors by National Investigation Agency (NIA) on suspicion of links with terror outfits. It has been followed up with searches by Enforcement Directorate hunting for illicit money trail. There is a strong suspicion of tourism services provided by company being façade of terror funds. Should proposed offer be accepted by him? (5 marks)

Answer 7:

- Integrity of principal owners has to be considered before accepting an audit engagement in accordance with SA 220. In this regard, SA 220 states requirements on lines of SQC 1 and states that a firm **before accepting an engagement** should acquire vital information about the client. Such an information should help firm to decide about: -
 - ✓ Integrity of Client
 - ✓ Competence (including capabilities, time and resources) to perform engagement
 - ✓ Compliance with ethical requirements
- Thus, in cases where there are indications that the client might be involved in fraudulent activities raising question on his integrity such as money laundering or other criminal activities, appointment should not be accepted.
- In the instant case, there have been raids of NIA on suspected links with terror outfits which is a criminal activity.
- Further, raids by Enforcement Directorate also point towards money laundering.
- Therefore, proposed offer should not be accepted.