

MOCK TEST PAPER 1
FINAL (OLD) COURSE: GROUP – I
PAPER – 3: ADVANCED AUDITING AND PROFESSIONAL ETHICS
SUGGESTED ANSWERS/HINTS

DIVISION A - MCQs (30 Marks)

Questions no. (1-10) carry 1 Mark each and Questions no. 11-20 carry 2 Marks each.

1. (b)
2. (c)
3. (c)
4. (c)
5. (a)
6. (b)
7. (c)
8. (b)
9. (a)
10. (c)

Questions (11-20) carry 2 Marks each

11. (a)
12. (d)
13. (b)
14. (d)
15. (d)
16. (d)
17. (c)
18. (b)
19. (a)
20. (b)

DIVISION B - DESCRIPTIVE QUESTIONS (70 Marks)

1. (a) **Reporting of Fraud Committed by Management/Directors of the Company:** As per SA 240 on "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements", fraud can be committed by management overriding controls using such techniques as recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.

In the given case, Phony Ltd. has made purchases amounting Rs. 1.02 crores, at year-end. It also debited the sum in the books of account, however, no documentary or other evidence of such purchases was found, on investigation. It is clear that company has passed fictitious journal entries, near year-end, to manipulate the operating results.

Accordingly, the auditor would adopt the approach which will be based on the result of misstatement on the basis of such fictitious journal entry, i.e. 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 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; or the auditor may consider for appropriateness of withdrawal from such engagement, where withdrawal from the engagement is legally permitted.

In addition, the auditor is required to report according to section 143(12) of the Companies Act, 2013. As per section 143(12), if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an offence of fraud, which involves or is expected to involve individually an amount of ₹ 1 crore or above is being or has been committed in the company by its officers or employees, he shall report the matter to the Central Government in prescribed manner.

The auditor is also required to report under clause (x) of paragraph 3 of Companies (Auditor's Report) Order, 2016, whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year. If yes, the nature and the amount involved is to be indicated.

- (b) **Verification of Accounts Receivable:** As per SA 510 "Initial Audit Engagements – Opening Balances", while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether-
- (i) Opening balances contain misstatements that materially affect the current period's financial statements; and
 - (ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

When the financial statements for the preceding period were audited by another auditor, the current auditor may be able to obtain sufficient appropriate audit evidence regarding opening balances by perusing the copies of the audited financial statements.

Ordinarily, the current auditor can place reliance on the closing balances contained in the financial statements for the preceding period, except when during the performance of audit procedures for the current period the possibility of misstatements in opening balances is indicated.

For current assets and liabilities, some audit evidence about opening balances may be obtained as part of the current period's audit procedures, say, the collection of opening accounts receivable during the current period will provide some audit evidence of their existence, rights and obligations, completeness and valuation at the beginning of the period.

In addition, according to SA 580 "Written Representations", the auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements; in particular, to support an understanding that the auditor has obtained from other audit evidence of management's judgment or intent in relation to, or the completeness of, a specific assertion. Although such written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own for that assertion.

In the given case, the management of Natural (P) Ltd. has restrained CA. Jill, its auditor, from obtaining appropriate audit evidence for balances of Accounts Receivable outstanding as it is from the preceding year. CA. Jill, on believing that the preceding year balances have already

been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Thus, CA. Jill should have requested the management to provide written representation for their views and expressions; and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme. Consequently, CA. Jill shall also be held guilty for professional misconduct for not exercising due diligence, or grossly negligence in the conduct of his professional duties as per the Code of Ethics.

- (c) **Compliance with Other Laws:** As per SA 250, “Consideration of Laws and Regulations in an Audit of Financial Statements”, the auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements including tax and labour laws.

Further, non-compliance with other laws and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be provided for in the financial statements, but are not considered to have a direct effect on the financial statements.

In the instant case, major portion of the labour employed in the company was child labour. While questioning by auditor, reply of the management that it was outside his scope of financial audit to look into the compliance with other laws is not acceptable as it may have a material effect on financial statements.

Thus, auditor should ensure the disclosure of above fact and provision for the cost of fines, litigation or other consequences for the entity. In case if the auditor concludes that non-compliance has a material effect on the financial statements and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statement as per SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”.

2. (a) **Closure of Business:** As per SA 570 “Going Concern”, management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity’s ability to continue as going concern.

As per SA 570, if events or conditions have been identified that may cast significant doubt on the entity’s ability to continue as a going concern but, based on the audit evidence obtained the auditor concludes that no material uncertainty exists, the auditor shall evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosures about these events or conditions.

Even when no material uncertainty exists, it requires the auditor to evaluate whether, in view of the requirements of the applicable financial reporting framework, the financial statements provide adequate disclosure about events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern.

Further, as per SA 701 “Communicating Key Audit Matters in the Independent Auditor’s Report”, when matters relating to going concern may be determined to be key audit matters, and explains that a material uncertainty related to events or conditions that may cast significant doubt on the entity’s ability to continue as a going concern is, by its nature, a key audit matter. SA 701 also emphasis on auditor’s responsibility to communicate key audit matters in the auditor’s report.

As per the facts given in the case, intention of the Choti Limited had definite plan of its business being closed down within short period from 31st March, 2019. However, financial statements for the year ended 31.03.2019 had been prepared on the same basis as it had been in earlier periods with an additional note.

Thus, management intentions to liquidate the entity or to cease operations is one of the event or condition that may cast significant doubt on the entity's ability to continue as going concern is a key audit matter. Therefore, the auditor is required to Communicate the Key Audit Matters in accordance with SA 570 in above stated manner. Simple reference as to a possible cessation of business and making of adjustments, if any, he made at the time of cessation only by the auditor in his report is not sufficient.

- (b) Disclosure in Audit Report:** The auditor is required to specifically include certain matters as per CARO, 2016 under section 143 of the Companies Act, 2013.

According to clause (i) (a) of CARO, 2016 the auditor has to comment whether the company is maintaining proper records showing full particulars, including quantitative details and situation of fixed assets; and as per clause (i) (b) whether these fixed assets have been physically verified by the management at reasonable intervals; whether any material discrepancies were noticed on such verification and if so, whether the same have been properly dealt with in the books of account;

In the given case, Nasir Ltd. has intention to sale its earth removing machines of outdated technology which had been retired from active use and had been kept for disposal after knock down and these assets are appearing at residual value. Further, inspection of such machines (though it is a retired machine, however value is 23.49crores which is material amount) was done seven years back, is not in compliance with CARO, 2016.

Hence, this fact needs to be disclosed in the Audit Report as per clause (i) (a) and (b) of Paragraph 3 of CARO 2016.

- (c) Grossly Negligent and Bringing Disrepute to the Institute:** Clause (7) of Part I of the Second 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 does not exercise due diligence, or is grossly negligent in the conduct of his professional duties.

Furthermore, Clause (2) of Part IV of the First Schedule to the said Act states that a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he, in the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action whether or not related to his professional work.

In the given case, Mr. Yuvi, a Chartered Accountant in practice, is grossly negligence in conduct of his professional duties by issuing clean reports on the balance sheet without examining the accounts. Further, he has also brought disrepute to the profession by advising unethical practice to the managing director of the company. Therefore, Mr. Yuvi will be held guilty for professional and other misconduct under abovementioned Clauses to the Chartered Accountants Act, 1949.

- 3. (a) Role of C&AG in the Audit of a Government company:** Role of C&AG is prescribed under sub section (5), (6) and (7) of section 143 of the Companies Act, 2013.

In the case of a Government company, the comptroller and Auditor-General of India shall appoint the auditor under sub-section (5) or sub-section (7) of section 139 i.e. appointment of First Auditor or Subsequent Auditor and direct such auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

The Comptroller and Auditor-General of India shall within sixty days from the date of receipt of the audit report have a right to:

- (i) conduct a supplementary audit of the financial statement of the company by such person or

persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and

- (ii) comment upon or supplement such audit report.

It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

Test Audit: Further, without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of section 19A of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

- (b) (i) As per Sec 35(5) read with Rule 80(3), the total turnover calculation must be PAN-based, which means that once the turnover under the PAN is more than Rs. 2 crores, all business entities registered under GST for that PAN will be liable for GST audit for a financial year.

In the instant case, SSM & Co. is a leading electronics company having multiple branches registered under GST in different states and the total aggregate turnover of all its branches exceed Rs. 2 crores. Therefore, instead of Delhi branch is having turnover of 75 lakh, GST audit is applicable on Delhi branch. Thus, Contention of Mr. Pankaj, Finance Officer, is incorrect that GST audit is not applicable on Delhi branch as the turnover for that branch does not surpass the threshold.

- (ii) The auditor should advise the company to file all the GSTR-3B, GSTR-1 and annual returns before conducting GST audit so that auditor can validate and verify the returns filed by the company, verification of ITC claimed, verification of output GST liability discharged by the company and for collation of return workings and reconciliations. Auditor needs to have a comprehensive picture of -

- (i) Understanding of the back-up of monthly returns as well as annual return and understanding of reports generated by the GSTN portal as well as internal records of the company.
- (ii) Understanding of the eligibility of Input Tax Credit (ITC) availed i.e. whether ITC availed by the company is creditable or not and understanding of reversal of ITC undertaken or applicable (if any).
- (iii) Understanding of the taxability of outward supplies and transactions covered under Reverse Charge Mechanism and other miscellaneous/ specific transactions and understanding of the positions taken on various transactions by the company.

- (c) **Chartered Accountant in Practice Acting as Liquidator:** 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.

However, CA Regulation allow the Chartered Accountant in practice to charge the fees in respect of any professional work which are based on a percentage of profits, or which are contingent upon the findings or results of such work, in the case of a receiver or a liquidator, and the fees may be based on a percentage of the realization or disbursement of the assets.

In the given case, Mr. Vinod, a practicing Chartered Accountant, has acted as liquidator of XYZ & Co. and charged his professional fees on percentage of the realisation of assets.

Therefore, Mr. Vinod shall not be held guilty of professional misconduct as he is allowed to charge fees on percentage of the realisation of assets being a liquidator.

4. (a) Obligation of auditor to submit an exception report to the RBI

- (I) Where, in the case of a non-banking financial company, the statement regarding any of the items referred to in paragraph 3 above, is unfavorable or qualified, or in the opinion of the auditor the company has not complied with:
- (i) the provisions of Chapter III B of RBI Act (Act 2 of 1934); or
 - (ii) Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016; or
 - (iii) Non-Banking Financial Company – Non-Systemically Important Non-Deposit taking Company (Reserve Bank) Directions, 2016 and Non-Banking Financial Company - Systemically Important Non-Deposit taking Company and Deposit taking Company (Reserve Bank) Directions, 2016.

It shall be the obligation of the auditor to make a report containing the details of such unfavourable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Non-Banking Supervision of the RBI under whose jurisdiction the registered office of the company is located as per first Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 2016.

- (II) The duty of the Auditor under sub-paragraph (I) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions.

(b) The factors to be considered to analyse causes for high employee attrition rate are as under:

- (i) Job Stress & work life imbalance.
- (ii) Wrong policies of the Management.
- (iii) Unbearable behaviour of Senior Staff.
- (iv) Safety factors.
- (v) Limited opportunities for promotion.
- (vi) Low monetary benefits.
- (vii) Lack of labour welfare schemes.
- (viii) Whether the organization has properly qualified and experienced personnel for the various levels of works?
- (ix) Is the number of people employed at various work centres excessive or inadequate?
- (x) Does the organization provide facilities for staff training so that employees and workers keep themselves abreast of current techniques and practices?

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

However, nothing herein contained shall be construed as preventing or prohibiting, any chartered accountant from applying or requesting for or inviting or securing professional work from another chartered accountants in practice.

In the instant case, CA. Nikhil has written email to all the CA for securing professional work from them and has not approached any other person or professional or communicated with any client,

Thus, as per exception to the Clause (6), CA. Nikhil is well within the regulation of the act and has not committed any professional misconduct.

5. (a) **Balances in Account of a Bank situated in a Foreign Country:** The following procedure may be followed while verifying balances in account of a bank situated in a foreign country-

- (i) Verify the ledger balances in each account with reference to the bank confirmation certificates and reconciliation statements as at the year-end.
- (ii) Review the reconciliation statements and pay particular attention to the following.
 - (1) Examine that no debit for charges or credit for interest is outstanding and all the items which ought to have been taken to revenue for the year have been so taken. This should be particularly observed when the bills collected, etc., are credited with net amount and entries for commission, etc. are not made separately in the statement of account.
 - (2) Examine that no cheque sent or received in clearing is outstanding. As per the practice prevalent among banks, any cheques returned unpaid are accounted for on the same day on which they were sent in clearing or on the following day.
 - (3) Examine that all bills or outstanding cheques sent for collection and outstanding as on the closing date have been credited subsequently.
- (iii) Examine the large transactions in inter-bank accounts, particularly towards the year-end, to ensure that no transactions have been put through for window-dressing.
- (iv) Check original deposit receipts in respect of balances in deposit accounts in addition to confirmation certificates obtained from banks in respect of outstanding deposits.
- (v) Check whether these balances are converted into the Indian currency at the exchange rates prevailing on the balance sheet date and ensure compliance with relevant Accounting Standard.

- (b) **Control Procedure While Applying Computer Assisted Auditing Techniques (CAATs):** Computer Assisted Auditing Techniques (CAATs) involve performing audit procedures while conducting audit through the computer. Audit software and Test Data are two common types of CAATs. Using CAATs involves taking various measures including monitoring so that the use of CAATs by the auditor provides reasonable assurance that the audit objectives and detailed specifications of CAATs have been met. It is to be seen that CAATs are not manipulated by staff of the entity. The specific procedures necessary to control the use of CAATs will depend on the particular application.

Procedures carried out by the auditor to control CAATs applications may include:

- (i) participating in the design and testing of CAAT;
- (ii) checking, if applicable, the coding of the program to ensure that it conforms with the detailed program specifications;

- (iii) asking the entity's staff to review the operating system instructions to ensure that the software will run in the entity's computer installation;
- (iv) running the audit software on small test files before running it on the main data files;
- (v) checking whether the correct files were used, for example, by checking external evidence, such as control totals maintained by the user, and that those files were complete;
- (vi) obtaining evidence that the audit software functioned as planned, for example, by reviewing output and control information; and
- (vii) establishing appropriate security measures to safeguard the integrity and confidentiality of the data.

When using a CAAT, the auditor may require the cooperation of the entity's staff who have extensive knowledge of the computer installation. In such circumstances, the auditor should have reasonable assurance that the entity's staff did not improperly influence the results of the CAATs.

- (c) (i) A contingent liability in respect of guarantees arises when a company issues guarantees to another person on behalf of a third party e.g. when it undertakes to guarantee the loan given to a subsidiary or to another company or gives a guarantee that another company will perform its contractual obligations.

However, where a company undertakes to perform its own obligations, and for this purpose issues, what is called a "guarantee", it does not represent a contingent liability and it is misleading to show such items as contingent liabilities in the Balance sheet. For various reasons, it is customary for guarantees to be issued by Bankers e.g. for payment of insurance premia, deferred payments to foreign suppliers, letters of credit, etc. For this purpose, the company issues a "counter-guarantee" to its Bankers. Such "counter-guarantee" is not really a guarantee at all, but is an undertaking to perform what is in any event the obligation of the company, namely, to pay the insurance premia when demanded or to make deferred payments when due. Hence, such performance guarantees and counter-guarantees should not be disclosed as contingent liabilities.

- (ii) All other expenses not classified under other heads will be classified under "Other Expenses". For this purpose, any item of expenditure which exceeds one percent of the revenue from operations or Rs. 1,00,000 whichever is higher, needs to be disclosed separately. The given treatment in the scenario is not in order.
- (iii) Deferred Tax Liability should be shown under Non-Current Liabilities. Deferred Tax Asset shall be shown under Non-Current Asset. But Deferred tax assets and deferred tax liabilities, both, cannot be shown in balance sheet because only the net balance of Deferred Tax Liability or Asset is to be shown. Thus, DTA and DTL shown separately in the balance sheet by the company is not correct.

6. (a) **Steps involved while conducting investigation on behalf of an incoming partner:** The general approach of the investigating accountant in this type of investigation would be more or less similar, irrespective of the nature of business of the firm-manufacturing, trading or rendering a service.

Primarily, an incoming partner would be interested to know whether the terms offered to him are reasonable having regard to the nature of the business, profit records, capital distribution, personal capability of the existing partners, socio-economic setting, etc., and whether he would be capable of deriving continuing benefit in the shape of return on capital to be contributed and remuneration for services to be rendered, which can be justified by the overall economic conditions prevailing and other considerations considering his own personality and achievements. In addition, he would be interested to ascertain whether the capital to be contributed by him would be safe and applied usefully.

Broadly, the steps involved 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 for pending 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 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 import 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 first hand 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.

It would always be worthwhile to remember that, in a partnership, personal considerations count predominantly over other considerations and assessment of standing of the firm, standing and reliability of other partners, their personal reputation and the goodwill enjoyed by the products/services are important.

On the basis of the broad frame of considerations as given above, the investigating accountant should devise his own considerations in each case which may be quite diverse. Additional considerations may come up in the case of service-rendering firms where profit and business record, goodwill of the firm and of individual partners would assume greater significance.

Again, in the case of industrial firms, the network of customers, their scatter, size, etc., would be relevant for consideration.

- (b) (i) **When the Parent's Auditor is also the Auditor of all its Components:** While drafting the audit report, the auditor should report whether principles and procedures for preparation and presentation of consolidated financial statements as laid down in the relevant accounting standards have been followed. In case of any departure or deviation, the auditor should make adequate disclosure in the audit report so that users of the consolidated financial statements are aware of such deviation. Auditor should issue an audit report expressing opinion whether the consolidated financial statements give a true and fair view of the state of affairs of the Group as on balance sheet date and as to whether consolidated profit and loss statement gives true and fair view of the results of consolidated profit or losses of the Group for the period under audit. Where the consolidated financial statements also include a cash flow statement, the auditor should also give his opinion on the true and fair view of the cash flows presented by the consolidated cash flow statements.
- (ii) **When the Parent's Auditor is not the Auditor of all its Components:** In a case where the parent's auditor is not the auditor of all the components included in the consolidated financial statements, the auditor of the consolidated financial statements should also consider the requirement of SA 600 "Using the Work of Another Auditor".

As prescribed in SA 706 "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report", if the auditor considers it necessary to make reference to the audit of the other auditors, the auditor's report on the consolidated financial statements should disclose clearly the magnitude of the portion of the financial statements audited by the other auditor(s). This may be done by stating aggregate rupee amounts or percentages of total assets, revenues and cash flows of components included in the consolidated financial statements not audited by the parent's auditor. Total assets, revenues and cash flows not audited by the parent's auditor should be presented before giving effect to permanent and current period consolidation adjustments. Reference in the report of the auditor on the consolidated financial statements to the fact that part of the audit of the group was made by other auditor(s) is not to be construed as a qualification of the opinion but rather as an indication of the divided responsibility between the auditors of the parent and its subsidiaries.

- (c) **Important Points to be kept in Mind While Drafting Letter of Weakness:** As per SA 265, "Communicating Deficiencies in Internal Control to Those who Charged with Governance and Management", the auditor shall include in the written communication of significant deficiencies in internal control -
- (i) A description of the deficiencies and an explanation of their potential effects; and
 - (ii) Sufficient information to enable those charged with governance and management to understand the context of the communication.

In other words, the auditor should communicate material weaknesses to the management or the audit committee, if any, on a timely basis. This communication should be, preferably, in writing through a letter of weakness or management letter. Important points with regard to such a letter are as follows-

- (1) The letter lists down the area of weaknesses in the system and offers suggestions for improvement.

- (2) It should clearly indicate that it discusses only weaknesses which have come to the attention of the auditor as a result of his audit and that his examination has not been designed to determine the adequacy of internal control for management.
- (3) This letter serves as a valuable reference document for management for the purpose of revising the system and insisting on its strict implementation.
- (4) The letter may also serve to minimize legal liability in the event of a major defalcation or other loss resulting from a weakness in internal control.

OR

(c) As per the Peer Review Statement, Technical, Professional and Ethical Standards - means

- (i) Accounting Standards issued by ICAI and/or prescribed and notified by the Central Government of India;
- (ii) Standards;

Standards issued by the Institute of Chartered Accountants of India including -	
(a) Engagement standards (b) Statements (c) Guidance notes	(d) Standards on Internal Audit. (e) Statements on Quality Control. (f) Notifications/Directions/Announcements/ Guidelines/Pronouncements/Professional standards issued from time to time by the Council or any of its committees.

- (iii) Framework for the Preparation and presentation of financial statements, Framework of Statements and Standard on Auditing, Standard on Assurance Engagements, Standards on Quality Control and Guidance Notes on related services issued, from time to time, by the Institute of Chartered Accountants of India and Framework for Assurance Engagements;
- (iv) Provisions of the various relevant statutes and / or regulations which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.