

ANSWERS OF MODEL TEST PAPER 6
FINAL COURSE: GROUP I
PAPER-3: ADVANCED AUDITING, ASSURANCE AND
PROFESSIONAL ETHICS
Part I: MULTIPLE CHOICE QUESTION

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

Part II - DESCRIPTIVE QUESTION

1. (a) **Acceptance and Continuance of Client Relationships:** As per SQC 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements," 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, promoters, and key managerial personnel.
 - Competence (including capabilities, time, and resources) to perform engagement.

- Compliance with ethical requirements.

The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client. Where issues have been identified, and the firm decides to accept or continue the client relationship or a specific engagement, it should document how the issues were resolved.

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 obtain relevant information from the firm and, where applicable, network firms, to identify and evaluate circumstances and relationships that create threats to independence.

In view of the above, PQR Associates should:

- ✓ follow their firm's policies and procedures for client acceptance and continuance. This includes evaluating the integrity of the client, assessing potential risks associated with the engagement, and ensuring the firm has the necessary resources and expertise to perform the engagement effectively. The engagement team, should assess, whether the company is involved in any funding activities, to the political parties, and if so enquire and assess the risks related to such transactions.
- ✓ communicate clearly with the client regarding the scope of the engagement, the responsibilities of both parties, and any limitations on the services to be provided. This helps manage expectations and ensures alignment between the firm and the client.
- ✓ independence and objectivity throughout the engagement. Any potential threats to independence, such as relationships with the client's affiliates or involvement in political activities by related parties, should be evaluated and mitigated appropriately. Since the senior manager who was on this engagement is providing certain accounting services, to one

of the group companies, the engagement partner, should assess, whether it would have any impact on the audit and examine the relevant ethical/independence requirements.

- ✓ continually monitor the client relationship for any changes or developments that may impact the firm's ability to provide services effectively. This includes staying informed about significant events such as the income-tax search, changes in client management, or potential conflicts of interest. Since there was an income-tax raid on the organisation, the engagement partner should evaluate the risks of material misstatements, and non-disclosure of tax disputes and liabilities.
- ✓ ensure that their engagement team possesses the necessary competence and capabilities to perform the audit effectively. The departure of a senior manager and the need to recruit a replacement with specific industry experience should be addressed promptly to maintain audit quality. Since one of the senior engagement team members has left PQR Associates, the engagement partner should assess, whether he would be in a position to devote adequate time on the engagement or whether to recruit another resource, before commencement of the audit.

(b) Drafting of Opinion Paragraph and basis thereof along with disclosure of Note XX:

INDEPENDENT AUDITOR'S REPORT

To the Members of Delhi Branch Office of Fancy Limited

Report on the Audit of the Standalone Financial Statements

Opinion

We have audited the standalone financial statements of Delhi Branch Office of Fancy Limited ("the Company"), which comprise the balance sheet as at March 31, 2024, and the statement of Profit & Loss, (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 and other explanatory information.

In our opinion, and to the best of our information and according to the explanations given to us the aforesaid financial statements, give a true and fair view, in conformity with the accounting principles generally accepted in India, of the state of affairs of the Delhi Branch Office of the Company as at March 31, 2024 and profit/loss, (*changes in equity*) and its cash flows for the year ended on that date.

Basis for Opinion

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements as per the ICAI's Code of Ethics and the provisions of the Companies Act, 2013, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Emphasis of Matter

We draw attention to Note XX regarding Delhi Branch Office management's intention to close the operations of the Branch Office subject to regulatory approvals. Accordingly, the financial statements have been prepared on the basis that the Delhi Branch Office does not continue to be a going concern and provisions have been made in the books of account for the losses arising or likely to arise on account of closure of operations including the losses on the realizability of current assets.

Our opinion is not modified in respect of this matter.

- (c) In the given situation, Mr. BK has been engaged by XYZ Ltd. to report on summary financial statements derived from the financial statements audited by him in accordance with SAs. Mr. BK, wants to determine whether the applied criteria are acceptable before accepting such assignment.

As per SA 810, "Engagements to Report on Summary Financial Statements", before accepting an engagement to report on

summary of financial statements, the auditor shall determine whether applied criteria are acceptable. 'Applied criteria' refers to the criteria applied by management in the preparation of the summary financial statements.

Factors affecting the auditor's determination of the acceptability of the applied criteria are:

- The nature of the entity;
- The purpose of the summary financial statements;
- The information needs of the intended users of the summary financial statements; and
- Whether the applied criteria will result in summary financial statements that are not misleading in the circumstances.

2. (a) In the given scenario, CA. Z, as the statutory auditor of Happy Hospital, is concerned about the effectiveness of controls at the service organization, specifically the system managed by CT Contractors. To address this concern, CT Contractors should provide a Type 2 assurance report from a practicing chartered accountant as per SA 402, "Audit Considerations Relating to an Entity Using a Service Organisation". This report will offer an opinion on the description of the system in use at Happy Hospital, as well as evaluate the effectiveness of the controls implemented by CT Contractors.

Using a Type 2 report as audit evidence that controls at the service organisation are operating effectively: If, the user auditor plans to use a Type 2 report as audit evidence that controls at the service organisation are operating effectively, the user auditor shall determine whether the service auditor's report provides sufficient appropriate audit evidence about the effectiveness of the controls to support the user auditor's risk assessment by:

- (a) Evaluating whether the description, design, and operating effectiveness of controls at the service organisation is at a date or for a period that is appropriate for the user auditor's purposes;
- (b) Determining whether complementary user entity controls identified by the service organisation are relevant to the user

entity and, if so, obtaining an understanding of whether the user entity has designed and implemented such controls and, if so, testing their operating effectiveness;

- (c) Evaluating the adequacy of the time period covered by the tests of controls and the time elapsed since the performance of the tests of controls; and
 - (d) Evaluating whether the tests of controls performed by the service auditor and the results thereof, as described in the service auditor's report, are relevant to the assertions in the user entity's financial statements and provide sufficient appropriate audit evidence to support the user auditor's risk assessment.
- (b) As per Clause (8) 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 accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

Although the mandatory requirement of communication with previous auditor being Chartered Accountant applies, in uniform manner, to audits of both government and Non-Government entities, yet in the case of audit of government Companies/ banks or their branches, if the appointment is made well in time to enable the obligation cast under this clause to be fulfilled, such obligation must be complied with before accepting the audit. However, in case the time schedule given for the assignment is such that there is no time to wait for the reply from the outgoing auditor, the incoming auditor may give a conditional acceptance of the appointment and commence the work which needs to be attended to immediately after he has sent the communication to the previous auditor in accordance with this clause. In his acceptance letter, he should make clear to the client that his acceptance of appointment is subject to professional objections, if any, from the previous auditors and that he will decide about his final acceptance after taking into account the information received from the previous auditor.

In the given case, PN and Associates are appointed as the Statutory Auditors of The Iron Company Ltd. which is a government company as Central Government holds 65% of the paid-up share capital of the company and CA N has given a conditional acceptance of the appointment and commenced the audit. In view of above, it can be concluded that CA N has complied with the provisions of the Chartered Accountants Act, 1949 and the Schedules thereunder.

(c) In order to demonstrate that the audit trail feature was functional, operated and was not disabled, a company would have to design and implement specific internal controls (predominantly IT controls) which in turn, would be evaluated by the auditors, as appropriate. An illustrative list of internal controls which may be required to be implemented and operated are given below:

- Controls to ensure that the audit trail feature has not been disabled or deactivated.
- Controls to ensure that User IDs are assigned to each individual and that User IDs are not shared.
- Controls to ensure that changes to the configurations of the audit trail are authorized and logs of such changes are maintained.
- Controls to ensure that access to the audit trail (and backups) is disabled or restricted and access logs, whenever the audit trails have been accessed, are maintained.
- Controls to ensure that periodic backups of the audit trails are taken and archived as per the statutory period specified under the provisions of the Act.

3. (a) To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the investigating accountant should take the under-mentioned steps:

- (1) Prepare a condensed income statement from the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid

annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.

- (2) Compute the under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:
 - (i) Sales to Average Inventories held.
 - (ii) Sales to Fixed Assets.
 - (iii) Equity to Fixed Assets.
 - (iv) Current Assets to Current Liabilities.
 - (v) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.
 - (vi) Equity to Long Term Loans.
 - (vii) Sales to Book Debts.
 - (viii) Return on Capital Employed.
- (3) Enter in a separate part of the statement the break-up of annual sales product-wise to show their trend.

- (b) In the given situation, CA N is carrying out an audit of restated financial statements of BQR Limited for past 3 financial years i.e., 2023-24, 2022-23 and 2021-22 so he requested Management Representation Letter from the management of the Company for this assignment before issuance of the report. The management of the Company provided the Management Representation Letter only for the financial year 2023-24 as they were not in place during that period.

As per SA 580, "Written Representations", as written representations are necessary audit evidence, the auditor's opinion cannot be expressed, and the auditor's report cannot be dated before the date of the written representations.

As per SA 560, "Subsequent Events", the auditor is concerned with events occurring up to the date of the auditor's report that may

require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor's report on the financial statements.

In some circumstances it may be appropriate for the auditor to obtain a written representation about a specific assertion in the financial statements during the course of the audit. Where this is the case, it may be necessary to request an updated written representation.

The written representations are for all periods referred to in the auditor's report because management needs to reaffirm that the written representations it previously made with respect to the prior periods remain appropriate. The auditor and management may agree to a form of written representation that updates written representations relating to the prior periods by addressing whether there are any changes to such written representations and, if so, what they are.

Situations may arise where current management were not present during all periods referred to in the auditor's report. Such persons may assert that they are not in a position to provide some or all the written representations because they were not in place during the period. This fact, however, does not diminish such persons' responsibilities for the financial statements as a whole.

Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies. Therefore, as per the above requirement of SA 580 CA. N should take written representation letter from management of BQR Limited for the financial year 2022-23 and 2021-22 also.

In case the management of BQR Limited does not provide written representation as requested, the auditor shall discuss with the management, re-evaluate the integrity of management, and take appropriate actions including the impact on the audit report as per SA 705.

- (c) As per Section 2(2)(iv) of the Chartered Accountant Act, 1949 as amended from time to time, a member of the Institute shall be deemed 'to be in practice' when individually or in partnership with

Chartered Accountants in practice, or in partnership with members of such other recognized professional as may be prescribed, he, in consideration of remuneration received or to be received, renders such other services as, in the opinion of the Council, are or may be rendered by a Chartered Accountant in practice.

As per Clause (11) of Part I of First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he engages in any business or occupation other than the profession of Chartered Accountant unless permitted by the Council so to engage.

However, the Council of the Institute is empowered to permit chartered accountants in practice to engage in any other business or occupation considered fit and proper. Accordingly, the Council formulated Regulations 191 to the Chartered Accountants Regulations, 1988 specifying the activities with which a member in practice can associate himself with or without the permission of the Council. As per Regulation 191 a Chartered Accountant in practice may take up an appointment that may be made by the Central Government or a State Government or a court of law or any other legal authority or may act as a secretary in his professional capacity, provided his employment is not on a salary-cum-full-time basis”.

In the instant case, CA Raj, a practicing chartered accountant has been appointed as a “Secretary” in his professional capacity by the Central Government for a metro project for a term of 2 years not on a salary-cum-full-time basis.

Conclusion: In view of above, in the given scenario, CA Raj will not be held liable for misconduct for acceptance of appointment as Secretary in terms of compliance of Regulations 191 read with Clause (11) of Part I of First Schedule of the Chartered Accountants Act, 1949.

4. (a) 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:
 - (i) The engagement team’s evaluation of the firm’s independence in relation to the audit engagement;

- (ii) 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;
- (iii) Whether audit documentation selected for review reflects the work performed in relation to the significant judgments made and supports the conclusions reached.

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 engagement team, with those consulted and between engagement partner and engagement quality control 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.

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.

- (b) As per SRS 4410, Compilation engagement is an engagement in which a practitioner applies accounting and financial reporting expertise to assist management in the preparation and presentation of financial information of an entity in accordance with an applicable financial reporting framework and issues a report.

Management may request a professional accountant in public practice to assist with the preparation and presentation of financial information of an entity. Financial information that is the subject of a compilation engagement may be required for various purposes including: -

- To comply with mandatory periodic financial reporting requirements established in law or regulation, if any or

- For purposes unrelated to mandatory financial reporting under relevant law or regulation, including for example: -
 - ✓ For management or those charged with governance, prepared on a basis appropriate for their particular purposes (such as preparation of financial information for internal use).
 - ✓ For periodic financial reporting undertaken for external parties under a contract or other form of agreement (such as financial information provided to a funding body to support provision or continuation of a grant).
 - ✓ For transactional purposes, for example to support a transaction involving changes to the entity's ownership or financing structure (such as for a merger or acquisition).

“Assurance engagement” means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. It means that the practitioner gives an opinion about specific information due to which users of information are able to make confident decisions knowing well that chance of information being incorrect is diminished.

A compilation engagement is not an assurance engagement. A compilation engagement does not require the practitioner to verify the accuracy or completeness of the information provided by management for the compilation, or otherwise to gather evidence to express an audit opinion or a review conclusion on the preparation of the financial information.

Further, SQC 1 is applicable to all Engagement and Quality Control Standards. Since SRS 4410 is also one of Engagement and Quality Control Standards, SQC 1 applies to firms in respect of firm's compilation engagements too which is covered in Related Services.

- (c) **Principle 1 – Ethics, Transparency and Accountability:** The first principle emphasizes that the business decisions in an organisation should be open to disclosure and accessible to the relevant interested parties.

The essence of the core elements associated with the first principle are:

- (i) The entities' governing structure should develop policies, procedures, and practices for their offices, factories, and work areas, ensuring that ethics is not compromised.
- (ii) The information relating to the policies, procedures, and practices along with the performance should be made available to the stakeholders.
- (iii) In case of adverse effects, more care has to be taken for transparent disclosures.
- (iv) The entities in the value chain should be encouraged to adopt these principles by the governance structure.
- (v) The entities should proactively respond to the outside entities that violate the nine principles of the BRSRs. This includes their suppliers, distributors, sub-contractors, or regulatory officers that may engage with the business concern.

5. (a) When assessing the presentation and disclosure of the prospective financial information and the underlying assumptions, in addition to the specific requirements of any relevant statutes, regulations as well as the relevant professional pronouncements, it needs to be considered whether: -

- (i) the presentation of prospective financial information is informative and not misleading
- (ii) the accounting policies are clearly disclosed in the notes to the prospective financial information
- (iii) the assumptions are adequately disclosed in the notes to the prospective financial information. It needs to be clear whether assumptions represent management's best-estimates or are hypothetical and, when assumptions are made in areas that are material and are subject to a high degree of uncertainty, this uncertainty and the resulting sensitivity of results needs to be adequately disclosed
- (iv) the date as of which the prospective financial information was prepared is disclosed. Management needs to confirm that the assumptions are appropriate as of this date, even though the

underlying information may have been accumulated over a period of time

- (v) the basis of establishing points in a range is clearly indicated and the range is not selected in a biased or misleading manner when results shown in the prospective financial information are expressed in terms of a range and
- (vi) if there is any change in the accounting policy of the entity from that disclosed in the most recent historical financial statements, whether reason for the change and the effect of such change on the prospective financial information has been adequately disclosed.

(b) For consolidation of subsidiaries in accordance with the Companies (Indian Accounting Standards) Rules, 2015:

- the financial statements of the parent and its subsidiaries are combined as per Ind AS 110, "Consolidated Financial Statements" on a line-by-line basis by adding together like items of assets, liabilities, income, expenses, and cash flows;
- related goodwill/ capital reserve (or gain on bargain purchase) and non-controlling interest is determined as per Ind AS 103;
- business combinations involving entities or businesses under common control shall be accounted for using the pooling of interest method in accordance with Ind AS 103;
- adjustments like elimination of intra-group transactions, balances, unrealised profits and deferred tax etc. are made in accordance with the requirements of Ind AS 110;
- investments in associates and joint ventures are accounted for using the Equity Method as prescribed in Indian Accounting Standard (Ind AS) 28, "Investments in Associates and Joint Ventures". Interests in assets, liabilities, revenues, and expenses in a joint operation are accounted for as part of separate financial statements of the entity in accordance with Indian Accounting Standard (Ind AS) 111, "Joint Arrangements";
- in a business combination achieved in stages, the acquirer shall remeasure its previously held equity interest in the

acquiree at its acquisition-date fair value and recognise the resulting gain or loss, if any, in profit or loss or other comprehensive income, as appropriate in accordance with Ind AS 103.

In the given situation, R Limited is, a listed company having investment in the (i) 2 Subsidiary Companies, (ii) 1 Joint Venture Company, (iii) 2 Associate Companies, (iv) 3 Business entities under common control, (v) Interest in assets, liabilities, revenues, and expenses in a joint operation with 1 Company. R Limited and all its components are required to present their accounts as per Ind AS. In view of above, R Limited consolidated its components on a line-by-line basis by adding together like items of assets, liabilities, income, expenses, and cash flows while preparing its consolidated financial statements which is correct for the subsidiaries, however the treatment is not correct for other components as per abovementioned Companies (Indian Accounting Standards) Rules, 2015.

- (c) In the given situation, CA R is looking after the audit of the TP Limited, a listed company. During audit, CA R observed that there are number of notices received from GST Department and Income-tax Department for various issues. Further during plant visit, CA R observed that few child labourers are engaged in some of the activity. In response to the observation made, CA R followed the procedure as envisaged in SA 250, "Consideration of Laws and Regulations in an Audit of Financial Statements". assuming the provisions of SA 250 and the provisions of NOCLAR (Non-Compliance with Laws and Regulations) under Revised Code of Ethics are one and the same. However, following points indicates that the provisions of SA 250 and NOCLAR (Non-Compliance with Laws and Regulations) under the Revised Code of Ethics are not one and same:
- (i) SA 250 is applicable only on Audit, and not on other Assurance engagements. However, NOCLAR is applicable on professional accountants in service, and in practice.
 - (ii) SA 250 talks of auditor's responsibilities for laws having direct effect on the determination of material amounts and disclosures in the financial statements (such as tax and labour

laws); and other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business. NOCLAR, while being alike to SA 250 till this point, is further ahead of it in that it takes into account non-compliance that causes substantial harm resulting in serious consequences in financial or non-financial terms.

- (iii) SA 250 does not define stakeholders. NOCLAR is related to affect of non-compliance on investors, creditors, employees as also the general public.
- (iv) As per NOCLAR, in exceptional circumstances, the professional accountant might become aware of an imminent breach of a law or regulation that would cause substantial harm to investors, creditors, employees or the general public. Having first considered whether it would be appropriate to discuss the matter with management or those charged with governance of the company, the accountant shall exercise professional judgment and determine whether to disclose the matter immediately to an appropriate authority in order to prevent or mitigate the consequences of such imminent breach. If disclosure is made, that disclosure is permitted. This provision is not existent in SA 250.

6. (a) **Reporting under Paragraph 3 of CARO, 2020:** Clause (viii) of Paragraph 3 of CARO, 2020 requires the auditor to report whether any transactions not recorded in the books of account have been surrendered or disclosed as income during the year in the tax assessments under the Income-tax Act, 1961 (43 of 1961), if so, whether the previously unrecorded income has been properly recorded in the books of account during the year.

In addition, Clause (xviii) of Paragraph 3 of CARO, 2020 requires the auditor to report whether there has been any resignation of the statutory auditors during the year, if so, whether the auditor has taken into consideration the issues, objections or concerns raised by the outgoing auditors.

In the given situation, during audit an order dated 01.05.2023 under section 148 of the Income-tax Act, 1961 was noticed wherein tax of

₹50 lakh were demanded owing to undisclosed cash sales of 150 lakh for the financial year 2020-21 which was accepted by the company and the applicable tax was paid by the company during the year 2023-24. The company has not recorded such undisclosed income in their books of account during the year 2023-24. The auditor would be required to report as per Clause (viii) of Paragraph 3 of CARO, 2020.

Further CA T, the auditor of SDA Limited resigned due to non-recording of such undisclosed income in their books of account. The auditor would be required to report the same in CARO, 2020 as per Clause (xviii) of Paragraph 3 of CARO, 2020.

Hence, the auditor would be required to report as per Clause (viii) and Clause (xviii) of Paragraph 3 of CARO 2020 for the year 2023-24.

(b) Key Areas for an Auditor to Understand IT Environment: Key Areas for an Auditor to Understand IT Environment are as follows:

- 1. Understand the flow of transaction:** The auditor's understanding of the IT environment may focus on identifying and understanding the nature and number of the specific IT applications and other aspects of the IT environment that are relevant to the flows of transactions and processing of information in the information system. Changes in the flow of transactions, or information within the information system may result from program changes to IT applications, or direct changes to data in databases involved in processing or storing those transactions or information.
- 2. Identification of Significant Systems:** The auditor may identify the IT applications and supporting IT infrastructure concurrently with the auditor's understanding of how information relating to significant classes of transactions, account balances and disclosures flows into, through and out the entity's information system.
- 3. Identification of Manual and Automated Controls:** An entity's system of internal control contains manual elements and automated elements (i.e., manual, and automated controls and other resources used in the entity's system of

internal control). An entity's mix of manual and automated elements varies with the nature and complexity of the entity's use of IT. The characteristics of manual or automated elements are relevant to the auditor's identification and assessment of the risks of material misstatement.

- 4. Identification of the technologies used:** The need to understand the emerging technologies implemented and the role they play in the entity's information processing or other financial reporting activities and consider whether there are risks arising from their use.

Given the potential complexities of these technologies, there is an increased likelihood that the engagement team may decide to engage specialists and/or auditor's experts to help understand whether and how their use impacts the entity's financial reporting processes and may give rise to risks from the use of IT.

- 5. Assessing the complexity of the IT environment:** Not all applications of the IT environment have the same level of complexity. The level of complexity for individual characteristics differs across applications. Complexity is based on the following factors – automation used in the organization, entity's reliance on system generated reports, customization in IT applications, business model of the entity, any significant changes done during the year and implementation of emerging technologies.

After considering the above factors for each application the over complexity is assessed of the IT environment.

- (c) Restriction on Fees based on a Percentage:** 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, Regulation 192 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 non-assurance services to non-audit clients, and the fees may be based on a percentage of Tax Demand Reduced.

In the given case, CA Kumar, a practicing Chartered Accountant, provides non-assurance services. He is approached by XYZ Limited, a non-audit client, to file an appeal in Tribunal against Income-tax Demand of ₹10 crore which was added by the CIT(A) and to plead on behalf of XYZ Limited in the matter. CA Kumar offers to accept the case and agrees to charge fees either ₹ 5,00,000 or 10% of Tax Demand reduced whichever is higher.

Conclusion: Therefore, Mr. Kumar will not be held guilty of professional misconduct since he is not providing any assurance services to non-audit client pursuant to Regulation 192 read with Clause 10 of Part I of First Schedule.

Or

- (c) In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets and income pattern as evidenced from the last audited balance sheet of the company to decide its principal business. The company will be treated as NBFC when a company's financial assets constitute more than 50 per cent of the total assets (netted off by intangible assets) and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfils both these criteria shall qualify as an NBFC and would require to be registered as NBFC by Reserve Bank of India.

In the given case, though Kushal Pvt. Ltd. is fulfilling the criteria on the asset side, but however is not fulfilling the criteria on the income side, the company cannot be classified as a deemed NBFC.