

CA Final Audit Q & A Compiler

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CA FINAL – ADVANCED AUDITING & PROFESSIONAL ETHICS**RTP – Nov 2022****QUESTIONS PART A: MULTIPLE CHOICE QUESTIONS****INTEGRATED CASE SCENARIO 1.**

Mr. K is a practicing-chartered accountant & also member of CPA Ireland. He handles only GST related work & tax audits for clients. Currently, he is having 19 companies for which he is handling the tax audit. At the beginning of the current Financial Year, he was approached by 40 new clients for tax audit assignments. He was reluctant to accept all the work as he feared breaching the permissible limit of handling clients. After consulting several friends of his, he finally decided to accept the work of just 2 big clients who approached him.

Mr. J, (K's friend) a chartered accountant in practice & a member empanelled as insolvency professional was acting as the statutory auditor for a listed entity. The audit for the current Financial Year was completed but there was some difference of opinion between auditor & the management. As a result of this, the company did not send the notice for AGM to Mr. J. When enquired, it was said that the company is not obliged to send notices to the auditor & it's the responsibility of the auditor to be aware of the AGM. Having heard this, Mr. J went to his friend to clarify the above matter. As a result of this incident, the management had not paid a part of the agreed audit fees to Mr. J. In retaliation, Mr. J took lien over few documents pertaining to the company. Having come to know about this, Mr. K immediately informed his friend that his act would lead to professional misconduct.

Mr. K & his friend Mr. J decided to start a partnership firm. They completed all formalities & went ahead & printed their visiting card as follows:

M/s KJ & Associates	M/s KJ & Associates
Mr. K, Chartered Accountant,	Mr. J, Chartered Accountant,
CPA Ireland	Insolvency Professional
Partner	Partner
No.3, MMM Street, Delhi	No.3, MMM Street, Delhi
Phone: 9xxxxxxx0	Phone: 9xxxxxxx0

The firm had also received the following assignments:

- (i) Concurrent audit for T Bank Ltd.
- (ii) Statutory audit for BBT Bank Ltd. (it is to be noted that the bank was not sponsored by T Bank)
- (iii) Offer to act as settlor of ZZ Charitable Trust.
- (iv) Internal audit of PF Trust of Government Company Ltd.
- (v) Statutory Auditor of Government Company Ltd.

On the basis of the abovementioned facts, you are required to choose the most appropriate answer for the following MCQs:

QUESTIONS :

1. In the given case scenario, has Mr. K breached the maximum limit of clients. If yes, can he be held guilty of professional misconduct?

- (a) Yes. The ceiling on number of tax audits which can be accepted by a chartered accountant is 20. In this given case, Mr. K is already having 19 clients & has now accepted 2 more (19+2=21). Also, he shall be held guilty of professional misconduct as per the CA Act, 1949.
- (b) Yes. The ceiling on number of tax audits which can be accepted by a chartered accountant is 20. In this given case, Mr. K is already having 19 clients & has now accepted 2 more (19+2=21).

However, this shall not be considered as guilty of professional misconduct as per the CA Act, 1949.

- (c) No. In the above case, the maximum ceiling is 25 in number (as per the latest decision taken by the ICAI council). The assignments (existing + new) handled by Mr. K is well below the prescribed limit & hence there is no breach.
- (d) No. In the above case, the maximum ceiling is 60 in number. The assignments (existing + new) handled by Mr. K is well below the prescribed limit & hence there is no breach.

2. Assuming yourself to be Mr. K, what would be your advice to Mr. J on the above matter?

- (a) The company has not followed the provisions of section 146 of Companies Act, 2013. All notices of, & other communications relating to, any general meeting shall be forwarded to the auditor of the company. Also, as per section 147, the company shall be punishable with fine which shall not be less than ₹ 25,000/- but which may extend to ₹ 5 lakh.
- (b) The company has not followed the provisions of section 146 of Companies Act, 2013. All notices of, & other communications relating to, any general meeting shall be forwarded to the auditor of the company. Also, as per section 147, the company shall be punishable with fine which shall not be less than ₹ 10,000/- but which may extend to ₹ 1 lakh.
- (c) The company has not followed the provisions of section 147 of Companies Act, 2013. All notices of, & other communications relating to, any general meeting shall be forwarded to the auditor of the company. However, the company shall not be punishable for this act.
- (d) The argument of the management is right. The Companies Act, 2013 does not mandate that the company shall send the notices for its general meetings to the auditor. It is the responsibility of the auditor (in this case Mr. J) to attend the AGM irrespective of getting the notice for it or not. The auditor shall be punishable under the provisions of the Act if he doesn't not attend the AGM.

3. Will the retaliating act of Mr. J against the company make him guilty of professional misconduct?

- (a) No. The above act will not lead to professional misconduct. However, u/s 147 of the Companies Act, 2013, Mr. J shall be punishable for exercising lien over the company's documents.
- (b) No. The CA Act, 1949 is silent about the above situation & hence it will not lead to professional misconduct.
- (c) Yes. As per the recent decision of Ethical Standards Board, a chartered accountant cannot exercise lien over client documents/ records for non-payment of his fees.
- (d) Yes. As per Clause 7 of Part I of Second Schedule of CA Act, 1949, the above act of Mr. J will make him guilty of professional misconduct.

4. In the given case scenario, visiting cards printed by Mr. K & Mr. J, is there anything which may lead to professional misconduct? If so, under what provisions?

- (a) Mentioning 'CPA Ireland' & the term 'Insolvency Professional' by Mr. K & Mr. J respectively violates the provisions of clause 7 of part I of First schedule of the CA Act, 1949. Hence, both of them shall be held guilty of professional misconduct.
- (b) There is no information contained in both the visiting cards, which leads to professional misconduct. All details mentioned are abiding the provisions of clause 7 of part I of First schedule of the CA Act, 1949.
- (c) Mentioning 'CPA Ireland' by Mr. K violates the provisions of clause 6 & clause 7 of part I of First schedule of the CA Act, 1949. Hence, Mr. K shall be held guilty of professional misconduct. However, as far as Mr. J's card is concerned, nothing mentioned in it is against the provision of CA Act, 1949, so he shall not be held guilty of professional misconduct.
- (d) Mentioning the term 'Insolvency Professional' by Mr. J violates the provisions of clause 7 of part I of First schedule of the CA Act, 1949. Hence, he shall be held guilty of professional misconduct. However, as far as Mr. K's card is concerned, nothing mentioned in it is against the provision of CA Act, 1949, so he shall not be held guilty of professional misconduct.

5. The firm had received the following assignments:

- (i) **Concurrent audit for T Bank Ltd.**

- (ii) Statutory audit for BBT Bank Ltd. (it is to be noted that the bank was not sponsored by T Bank)
- (iii) Offer to act as settlor of ZZ Charitable Trust.
- (iv) Internal audit of PF Trust of Government Company Ltd.
- (v) Statutory Auditor of Government Company Ltd.

Among the above assignments, which assignments can be accepted by the firm?

- (a) Either (i) or (ii), (iii) & Either (iv) or (v)
- (b) (i), (ii), (iii) & Either (iv) or (v)
- (c) Either (i) or (ii) & Either (iv) or (v)
- (d) (ii) only

INDEPENDENT MCQs

- 6 Mr. B one of the partners of the firm is facing a dilemma as to whether the firm BMY LLP should accept the appointment as Statutory Auditors of M/s Foam Limited wherein Mr. B had sent a communication in writing addressed to the outgoing auditor Mr. Dalai under certificate of posting & the outgoing auditor has sent an acknowledgement vide their official email, but this email address of the outgoing auditor is not registered with the ICAI. Mr. B is of the opinion that this is not positive evidence of delivery & violates the provisions of Code of Ethics if the firm accepts the audit assignment.

With respect to the dilemma being faced by Mr. B, partner of the firm regarding acknowledgment of the communication from the retiring auditor's vide their official email is not positive evidence of delivery?

- (a) The dilemma of Mr. B is correct as it is not positive evidence of delivery.
 - (b) The dilemma of Mr. B is not correct as it is positive evidence of delivery as the same
 - (c) is received from the official email of the outgoing auditor, as per the Code of Ethics.
 - (d) The dilemma of Mr. B is not correct as statutory auditors are not required to communicate with the retiring or outgoing auditors in this case.
7. The dilemma of Mr. B is correct as the email address of the outgoing auditor from which acknowledgement has come is not registered with the ICAI.

CA Z is appointed as a Statutory Auditor of JB Finance Limited (a Non- Banking Financial Company covered under Non-Banking Financial Company — Systematically important Non-Deposit taking Company & Deposit taking Company (Reserve Bank) Directions, 2016) for the year 2021-22. Following information is available with CA Z with respect to JB Finance Limited as at 31st March, 2022:

Particulars	₹ (in Lakh)
Standard Assets	700.00
Sub-standard Assets	200.00
Doubtful Assets (Secured & up-to one year)	10.00
Doubtful Assets (Secured & more than three years)	50.00

What will be the total provision required to be made in the books of JB Finance Limited for the year ended 31 March, 2022 for the above stated Assets?

- (a) ₹ 49.8 Lakh
 - (b) ₹ 47 Lakh
 - (c) ₹ 34.8 Lakh
 - (d) ₹ 52.8 Lakh
8. While auditing with respect to compliance with CARO, 2020, Mr. Omprakash, for additional reporting purpose, observed the following, relevant to Para 3(vii) of CARO, 2020:

Statutory Dues	Undisputed Amount (₹ in lakh)	Date Payable	Date Paid
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Provident Fund	1.5	24th September, 2021	27th March, 2022
GST	2.45	23rd October, 2021	24th April, 2022
Customs Duty	0.65	20th September, 2021	10th April, 2022
Income Tax Demand for A.Y. 2019-20	0.55	18th October, 2021	Not Paid till date

Also, a representation was made to GST Department for waiving a penalty of ₹ 1 lakh for late payment of GST demand. What total amount of statutory dues need to be reported by Mr. Omprakash as per Para 3 of CARO?

- (a) ₹ 3.10 lakh.
- (b) ₹ 0.65 lakh.
- (c) ₹ 3.65 lakh.
- (d) ₹ 2.70 lakh.

9. With respect to audit of public sector undertaking, which among the below is related to propriety audit?

- (a) This audit is carried out by assessing whether activities, financial transactions & information comply in all material aspects, with the regulatory & other authorities which govern the audited entity.
- (b) This auditing focuses on the areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action.
- (c) It is an audit under which the C&AG does not really cover again the field which has already been covered. He conducts an appraisal or an efficiency cum performance audit.
- (d) It stands for verification of transactions on the tests of public interest, commonly accepted customs & standards of conduct. This audit is directed towards an examination of managements decisions in sales, purchases, contracts, etc.

10. In case of peer review, which among the following the review shall covered?

- (a) Compliance with legal regulations governing the firm
- (b) Check whether the qualification of the articled assistants & other staffs are sufficient to be employed
- (c) Compliance with tax regulations of the firm, which includes filing IT return of the firm, payment of tax, etc.
- (d) Training program for staff concerned with assurance function, including availability of infrastructure

PART A : ANSWERS TO MULTIPLE QUESTIONS 1.

1.	(d)	2.	(a)	3.	(c)	4.	(b)	5.	(b)	6.	(b)	7.	(a)	8.	(b)	9.	(d)	10.	(d)
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PART B : DESCRIPTIVE QUESTIONS

STANDARDS ON AUDITING, STATEMENTS & GUIDANCE NOTES

QUESTION : 11

Abhinandan Limited a chemical manufacturing company, having its factory located at Nanded Village, for the year 2021-22 appointed Subahu & Co. as their statutory auditors. During the course of the audit, Subahu & Co. identified that Abhinandan Limited received a show cause notice from National Green Tribunal based on the investigation performed by the regional forest department for violating environmental laws. Upon gathering a further understanding of the said matter, it was identified that Abhinandan Limited was dumping toxic solid waste, without treating it, on the nearby grounds, & because of this, the nearby water bodies were getting polluted. Based on the preliminary investigation performed by the regional forest department under the directions of the National Green Tribunal, it was identified that these practices were carried out since 2009 & a lot of damage has been

done to the environment by Abhinandan Limited. A show cause notice was already issued to Abhinandan Limited by the National Green Tribunal for levying the penalty of an amount of ₹ 500 crore. The unaudited profit for the financial year 2021 -22 of Abhinandan Limited was ₹ 35 crore & the unaudited turnover was ₹ 100 crore. Upon inquiry it was identified that Abhinandan Limited has disclosed this matter in the financial statements by way of footnote, the extract of which is provided below:

"The company has received a show cause notice from the National Green Tribunal for some potential violation of environmental laws & the company's legal department has assessed & found that the judgment would be in favour of the company. Accordingly, no provision has been created for such notices."

In the light of the above scenario kindly provide what should be the appropriate option for the statutory auditor of the company to report this matter.

ANSWER: 11

As per SA 250, "Consideration of Laws & Regulations in an Audit of Financial Statements", the auditor is required to obtain an understanding & need to evaluate the impact of other laws & regulations that do not have a direct effect on the determination of the amounts & disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity's ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws & regulations may therefore have a material effect on the financial statements.

The auditor shall perform the following audit procedures to help identify instances of noncompliance with other laws & regulations that may have a material effect on the financial statements:

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

As per Section 143(3)(j) read with Rule 11(a), the auditor is required to report whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement.

As per SA 570, "Going Concern", if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements:

- (i) Adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern & management's plans to deal with these events or conditions; &
- (ii) Disclose clearly that there is material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern &, therefore, that it may be unable to realize its assets & discharge its liabilities in the normal course of business.

If adequate disclosure about the material uncertainty is not made in the financial statements, the auditor shall (a) Express a qualified opinion or adverse opinion, as appropriate, in accordance with SA 705; & (b) In the Basis for Qualified (Adverse) Opinion section of the auditor's report, state that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern & that the financial statements do not adequately disclose this matter.

In the current scenario, Abhinandan Limited has received a show cause notice from the National Green Tribunal of an amount which is more than the net profit & the turnover of the company for the year. In the event of an unfavourable order for Abhinandan Limited, there will be an impact on Abhinandan Limited's ability to continue as a going concern.

As a result, appropriate disclosure should be provided by management for such events which cast significant doubt on the entity's ability to continue as a going concern. As no appropriate disclosure has been provided by Abhinandan Limited for such show cause notice, Subahu & Co. should report this

matter in their audit report under "Going Concern Para" as per SA 570 & under clause (j) of Section 143(3) of the Companies Act, 2013. Also, the auditor is required to issue an adverse opinion as per SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

QUESTION : 12

Chintamani Ltd appoints Chintan & Mani as statutory auditors for the financial year 2021 - 2022. Chintan & Mani seem to have different opinions on Audit approach to be adopted for audit of Chintamani Ltd. Mani is of the opinion that 100% checking is not required & they can rely on Audit Sampling techniques in order to provide them a reasonable basis on which they can draw conclusions about the entire population.

Chintan is concerned that whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

You are required to guide Chintan about his role if audit sampling has not provided a reasonable basis for conclusions about the population that has been tested in accordance with SA 530.

ANSWER : 12

As per SA 530, "Audit Sampling", the auditor shall evaluate:

- (a) The results of the sample; &
- (b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may:

- (i) Request management to investigate misstatements that have been identified & the potential for further misstatements & to make any necessary adjustments; or
- (ii) Tailor the nature, timing & extent of those further audit procedures to best achieve the required assurance. For example, in the case of tests of controls, the auditor might extend the sample size, test an alternative control or modify related substantive procedures.

RISK ASSESSMENT & INTERNAL CONTROL**QUESTION : 13**

Arihant Limited was engaged in the business of owning & managing hotels & resorts, selling tourism packages & performing airline bookings for corporate & individuals. It appointed Upadhyay & Co. as its statutory auditor for the financial year 2021-22. While planning the audit, the audit team decided that the risk of improper revenue recognition from hotel business should not be treated as a fraud risk. This conclusion was based on the assessment of earlier years, wherein no fraud was identified in revenue recorded from such business. While testing the internal financial controls over the process of revenue recognition, it was identified that the controls are not properly designed to mitigate the risk of fraud & risk of improper revenue recognition. As a result, the audit team decided to perform additional substantive testing. However, the audit team still were to the conclusion that there is no risk of fraud in revenue recognition. During the course of substantive testing, it was identified that the management did not account for revenue received from corporate hotel bookings amounting to ₹ 35 crore. These amounts were partially received in the company's bank accounts & partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against the future bookings.

In the light of above scenario, kindly guide the statutory auditors with respect to their responsibility relating to fraud in an audit of a financial statement.

ANSWER : 13

As per SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" & SA 315, "Identifying & Assessing the Risks of Material Misstatement Through Understanding the Entity & Its Environment", the auditor shall identify & assess the risks of material misstatement due to fraud at the financial statement level, & at the assertion level for classes of transactions, account balances & disclosures. When identifying & assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

In accordance with SA 240, "The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements" & 330, "The Auditor's Responses to Assessed Risks" the auditor shall determine overall responses to address the assessed risks of material misstatement due to fraud at the financial statement level & assertion level.

The presumption that there are risks of fraud in revenue recognition may be rebutted. For example, the auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property. However, when there is a complex revenue structure or when there is lack of controls on revenue recognition, then there is a high probability of fraud risk in revenue recognition. Obtaining an understanding of the entity & its environment, including the entity's internal control (referred to hereafter as an "understanding of the entity"), is a continuous, dynamic process of gathering, updating & analysing information throughout the audit.

In the current scenario, the company was earning revenue from multiple streams. Also, it was identified that the controls are not properly designed to mitigate the risk of fraud & risk of improper revenue recognition. During the year it was identified that the management did not account for revenue from corporate hotel bookings amounting to ₹ 35 crore. These amounts were partially received in the company's bank accounts & partially received in the CFO's personal account. The amounts received in the bank account of the company were disclosed as advances received against future bookings.

Therefore, the auditor while performing the risk assessment procedures should consider the complexity & nature of the revenue for determining the fraud risks in revenue recognition. Also, there were no adequate controls addressing the risk of improper revenue recognition or fraud risk, the audit team rebutted the fraud risk. Moreover, the audit team should have recognised fraud risk by identifying the deficiencies of internal control over the revenue recognition process & should have treated the risk of improper revenue recognition as a significant risk. Also, as per Section 143(12), the auditor is required to report all the frauds identified during the course of the audit involving amounts above ₹ 1 crore within the prescribed time frame to the Central Government

SPECIAL ASPECTS OF AUDITING IN AN AUTOMATED ENVIRONMENT

QUESTION : 14

M/s RST & Associates have been appointed as auditors of ADI Ltd. for the financial year 2021-22. The processes, operations, accounting & decisions are carried out by using computers in ADI Ltd. M/s RST & Associates understand that there are several aspects that they should consider to determine the level of automation & complexity in the business environment of ADI Ltd. While planning the audit work, the engagement partners discussed with the audit staff about the various types of controls in the automated environment that are put in place to mitigate the IT risks & to maintain the confidentiality, integrity, availability & security of data such as General IT Controls; Application Controls; & IT-Dependent Controls.

You are required to briefly explain:

- (i) General IT Controls.
- (ii) Application Controls.
- (iii) IT-Dependent Controls.

ANSWER : 14

The controls that are put in place to mitigate the IT risks & to maintain the confidentiality, integrity, availability & security of data are General IT Controls, Application Controls & IT-Dependent Controls.

General IT Controls: "General IT controls are policies & procedures that relate to many applications & support the effective functioning of application controls. They apply to mainframe, miniframe, & end-user environment. General IT controls that maintain the integrity of information & security of data commonly include controls over the following:" (SA 315)

- Data center & network operations;
- System software acquisition, change & maintenance
- Program change;
- Access security;
- Application system acquisition, development, & maintenance (Business Applications).

These are IT controls generally implemented to mitigate the IT specific risks & applied commonly across multiple IT systems, applications & business processes. Hence, General IT controls are known as "pervasive" controls or "indirect" controls.

Application Controls: Application controls include both automated or manual controls that operate at a business process level. Application controls can be preventive as well as detective in nature & are designed to ensure the integrity of the accounting records. application controls relate to procedures used to initiate, record, process & report transactions or other financial data. These controls help ensure that transactions occurred, are authorised, & are completely & accurately recorded & processed. Automated Application controls are embedded into IT applications viz., ERPs & help in ensuring the completeness, accuracy & integrity of data in those systems. Examples of automated applications include edit checks & validation of input data, sequence number check, limit check, format check, range check, reasonableness check, mandatory data fields, existence check etc.

IT dependent controls: IT dependent controls are basically manual controls that make use of some form of data or information or report produced from IT systems & applications. In this case, even though the control is performed manually, the design & effectiveness of such controls depend on the reliability of source data.

Due to the inherent dependency on Information Technology, the effectiveness & reliability of Automated application controls & IT dependent controls require the General IT Controls to be effective.

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THE COMPANY AUDIT

QUESTION : 15

The Balance Sheet Extract of Siddha Limited, required to prepare financial statement under Ind-AS, as at 31st March, 2022 is as under. Comment on the presentation in terms of Division II of Schedule III to the Companies Act, 2013.

Particulars	As at 31st March, 2022	As at 31st March, 2021
<u>Property Plant & Equipment</u>		
Trademark	XXXX	XXXX
<u>Other Non-current Assets</u>		
Bank deposit with more than 12 months maturity	XXXX	XXXX
<u>Equity</u>		
Share Options Outstanding Account	XXXX	XXXX
<u>Other Current Liabilities</u>		
Application money received for allotment of securities to the extent refundable &	XXXX	XXXX

interest accrued thereon.		
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ANSWER : 15

Following Errors have been noticed in presentation, as per Division II of Schedule III:

- (i) "Trademark" is not to be classified under "Property Plant & Equipment" since they are specifically to be disclosed under 'Other Intangible Assets" as per Division II of Schedule III.
- (ii) "Bank deposit with more than 12 months maturity" is not to be classified under "Other Non-current Assets" since they are specifically to be disclosed under "Other Financial Assets" as per Division II of Schedule III.
- (iii) "Share Option Outstanding Accounts" is not to be classified under "Equity", since it has to be disclosed under "Other Equity" as per Division II of Schedule III.
- (iv) Interest accrued thereon" is not to be classified under "Other non-current assets", since they are specifically to be disclosed under the head "Other Financial Liabilities" as per Division II of Schedule III.

QUESTION : 16

Gautam Limited had borrowed ₹ 1000 crore from XYZ Bank, the principal of which was repayable after 5 years & interest was payable at the end of each year. For 4 years, Gautam Limited paid the interest amount on time. Gautam Limited defaulted the 5th instalment of interest payment & principal which was due on June 30, 2021. On March 31, 2021, Gautam Limited approached XYZ bank & MNO bank to restructure the existing liability. As a result, the existing principal & outstanding & overdue interest was restructured into a new loan amounting to ₹ 1,100 crore. The management did not provide any disclosure for the default on the loan on the belief that the old loan ceased to exist & the new loan has maturity after 5 years.

During the statutory audit for the financial year 2021-22, KP & Co. identified this transaction & obtained the relevant documents & understanding. Based on the underlying documents, it was identified that the said restructuring agreement was approved & signed on April 8, 2022, by both of the banks. As a result, on March 31, 2022, the restructuring was still not approved.

In the light of the above scenario, kindly guide the statutory auditors in the reporting of this transaction.

ANSWER : 16

As per Clause 3(ix) of CARO 2020, the auditor is required to report whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, the period & the amount of default to be reported as per the format below.

Nature of borrowing, including debt securities	Name of lender	Amount not paid on due date	Whether principal or interest	No. of days delay or unpaid	Remarks, if any
	lender wise details to be provided in case of defaults to banks, financial institutions & Government.				

In the given case, the company Gautam Limited defaulted in payment of the principal amount of the loan due of ₹ 1000 crore on 30 June 2021 & the interest instalment of ₹ 100 crore. The said default continued till the end of the year & on 8 April 2022, a restructuring agreement was signed by the banks

& company for re-structuring the outstanding loan. Moreover, no disclosure was provided by the company with respect to the said matter.

Hence the auditor is required to report the same matter under Clause (ix) of Para 3 of CARO 2020, i.e., whether the company has defaulted in repayment of loans or other borrowings or in the payment of interest thereon to any lender, if yes, then provide the details of the period & the amount of default. Also, the auditor needs to consider the impact of such non-disclosure & the non-compliance with the financial reporting framework & accordingly the auditor needs to either issue a qualified opinion or an adverse opinion as per SA 705, "**Modifications to the Opinion in the Independent Auditor's Report**".

AUDIT REPORT

QUESTION : 17

(a) CA Bahubali is the statutory auditor of Bharat Ltd. for the FY 2021-22. During the course of audit CA Bahubali noticed the following:

- (i) With respect to the debtors amounting to ₹ 240 crore, no balance confirmation was received by the audit team. Further, there have been defaults on the payment obligations by debtors on the due dates during the year under audit. The Company has created a provision for doubtful debts to the tune of ₹40 crore during the year under audit. The Company has stated that the provision is based on receivables which are older than 39 months, which according to the audit team is inadequate & as such the audit team is unable to ascertain the carrying value of trade receivables.
- (ii) In respect of Inventories (which constitutes 38% of the total assets of the company), during the reporting period, the management has not undertaken physical verification of inventories at periodic intervals. Also, the Company has not maintained adequate inventory records at the factory. The audit team was unable to undertake the physical inventory count as such the value of inventory could not be verified.

Under the above circumstances what kind of opinion should CA Bahubali give? Write the opinion paragraph & basis of opinion paragraph to be included in the Independent Auditor's Report.

(b) How should auditor give description of auditor's responsibilities for the audit of the financial statements when the auditor disclaims an opinion on the financial statements?

ANSWER : 17

(a) In the present case, CA Bahubali is unable to obtain sufficient & appropriate audit evidence with respect to the following:

- (i) The balance confirmation with respect to debtors amounting to ₹ 240 crore is not available. Further there has been default in payment by the debtors & the provision so made is not adequate. The audit team is also unable ascertain the carrying value of trade receivables.
- (ii) With respect to 38% of the company's inventory, neither the physical verification has been done by the management nor are adequate inventory records maintained. The audit team is also unable to undertake the physical inventory count as such the value of inventory could not be verified.

In the above two circumstances the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, & the possible effects on the financial statements of undetected misstatements, if any, could be both material & pervasive.

Thus, CA Bahubali should give a Disclaimer of Opinion.

The relevant extract of the Disclaimer of Opinion Paragraph & Basis for Disclaimer of Opinion paragraph is as under:

Disclaimer of Opinion

We do not express an opinion on the accompanying financial statements of Bharat Ltd. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report,

we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion

We are unable to obtain balance confirmation with respect to the debtors amounting to ₹ 240 crore. Further, there have been defaults on the payment obligations by debtors on the due dates during the year under audit. The Company has created a provision for doubtful debts to the tune of ₹ 40 crore during the year under audit which is inadequate in the circumstances of the company. The carrying value of trade receivables could not be ascertained.

Further, in respect of Inventories (which constitutes 38% of the total assets of the company), during the reporting period, the management has not undertaken physical verification of inventories at periodic intervals. Also, the Company has not maintained adequate inventory records at the factory. We were unable to undertake the physical inventory count & as such the value of inventory could not be verified.

(b) When the auditor disclaims an opinion on the financial statements due to an inability to obtain sufficient appropriate audit evidence, the auditor shall amend the description of the auditor's responsibilities required by SA 700, "Forming an Opinion & Reporting on Financial Statements", to include only the following:

- (i) A statement that the auditor's responsibility is to conduct an audit of the entity's financial statements in accordance with Standards on Auditing & to issue an auditor's report;
- (ii) A statement that, however, because of the matter(s) described in the Basis for Disclaimer of Opinion section, the auditor was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements; &
- (iii) The statement about auditor independence & other ethical responsibilities required in SA 700.

AUDIT OF CONSOLIDATED FINANCIAL STATEMENTS

QUESTION : 18

Jambu & Sudharma Investments Ltd. is a company having paid up share capital of ₹ 1 crore, it has a subsidiary, Investors Fund Management Ltd. Major business of Jambu & Sudharma Investments Ltd. is to pool money from investors on a collective basis & invest this money in various funds. This company pooled ₹ 12 crore from a number of clients, which represent the Company's shareholders.

While auditing books of accounts of Jambu & Sudharma Investments Ltd. CA Vardhman observed that whole amount of ₹ 12 crore pooled has been invested in shares & debentures of various companies & profit earned due to appreciation of the prices of these shares has been distributed to various shareholders of the company. Performance of all of its investments is measured on fair value basis.

Now, CA Vardhman raised an issue while auditing financial statements of Jambu & Sudharma Investments Ltd. whether the consolidated financial statements are required as per Section 129(3) of the Companies Act, 2013? Analyse the above issue & give your opinion.

ANSWER : 18

According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company & joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company & of all the subsidiaries in the same form & manner as that of its own.

As per sub-section 6 of the section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the Rules made thereunder.

An investment entity is an entity that:

- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
 - (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; &
 - (c) measures & evaluates the performance of substantially all of its investments on a fair value basis.
- An investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

However, as per paragraph 33 of Ind AS 110, parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Applying the above to the given case of Jambu & Sudharma Investments Ltd., which fulfils all the conditions stated above, it is an investment entity. By applying Para 31 & 33 of Ind AS 110, it can be concluded that Jambu & Sudharma Investments Ltd. is not required to consolidate as per Section 129 (3) of the Companies Act, 2013.

♦ ♦ ♦ ♦ ♦

AUDIT OF BANKS

QUESTION : 19

CA Prachi was conducting statutory audit of branch of a nationalized bank for the year 2021-22. While reviewing operations & documents/papers of a borrower enjoying overdraft credit facilities of ₹ 50 crore (availed against security of stocks & book debts), following observations were jotted down by her: -

- (i) The balance in overdraft credit facility as on 31st March, 2022 was ₹ 55.65 crore. The balance in account exceeded sanctioned limit during the whole month of March 2022.
- (ii) As per terms of sanction letter, stock/book debt statements were required to be submitted monthly. Latest available stock/book debt statement for the month of February, 2022 showed drawing power of ₹ 48.50 crore only. However, stock/book debt statements of previous months showed adequate drawing power.
- (iii) Stock audit of borrower was also conducted during the year by one of empanelled stock auditors of the bank. Stock audit report dated 31st December, 2021 placed on the record showed adequate drawing power in the account. However, it has commented adversely on the declining turnover of borrower in year 2021 -22 (till the date of stock audit report) as compared to proportionate turnover in preceding year.
- (iv) The renewal of overdraft facilities was due on 20th October, 2021. The account was short renewed by competent authority for a period of 3 months pending submission of complete papers.

However, borrower has not submitted complete renewal papers till 31st March, 2022. There is a request letter from borrower on record stating that valuation report of a property located at a faraway location was taking time.

The branch has classified the account as 'Standard Asset'. Considering above, CA Prachi is in dilemma relating to proper classification of above advance. Guide her.

ANSWER : 19

The borrower was enjoying overdraft credit facilities of ₹ 50 crore against security of stocks & debts. Further, though latest available stock statement for the month of February, 2022 showed inadequate drawing power, there was adequate drawing power available throughout the year. Stock audit report dated 31.12.2021 also reflected adequate drawing power. Hence, it shows that borrower had adequate drawing power during the year. Further, comment on declining sales is of general informative value to management for making credit decisions.

The fact of over drawings in account during the month of March, 2022 & inadequate drawing power in a month are in nature of temporary deficiencies & do not require account to be classified as NPA in accordance with asset classification & provisioning norms of RBI.

RBI instructions lay down that ordinarily credit limits need to be reviewed not later than three months from the due date. As per Guidance note on Audit of Banks, in case of constraints such as non-availability of financial statements & other data from the borrowers, the branch should furnish evidence to show that renewal/ review of credit limits is underway & would be completed soon. In any case, delay beyond six months is not considered desirable as a general discipline. Hence, an account where the credit limits have not been reviewed/ renewed within 180 days from the due date will be treated as NPA.

It would be pertinent to note that the counting of 180 days would be required to be done from the date of original due date for renewal & not from the date of expiry of short reviews / technical reviews. In the instant case, the original date of renewal was 20th October, 2021 & period of 180 days has still not expired as on balance sheet date.

Keeping in view all above factors, CA Prachi should accept classification of account as 'Standard Asset' made by branch.

AUDIT OF NON BANKING FINANCIAL COMPANY

QUESTION : 20

Sudarshan Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans & advances, acquisition of shares / stocks / bonds / debentures/securities issued by Government or local authorities. For the year ended 31st March, 2022 following are some extracts from the financial statements:

(i)	Paid-up share capital	₹ 40.53 Cr.
(ii)	Non-Current Assets - Loans & Advances	₹ 75.50 Cr.
(iii)	Current Assets - Loans & advances	₹ 294.33 Cr.
(iv)	Total assets of the company	₹ 618.55 Cr.
(v)	Intangible assets	₹ 6.35 Cr.
(vi)	Profit for the Year	₹ 8.15 Cr.
(vii)	Income from interest & dividends	₹ 62.31 Cr.
(viii)	Gross income	₹ 111.23 Cr.

Directors intend to apply for registration as Non-Banking Financial Company (NBFC) u/s 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise.

ANSWER : 20

In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets & 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

- (i) Financial assets constitute more than 50 % of the total assets (netted off by intangible assets) &
- (ii) Income from financial assets constitute more than 50 % of the gross income.

A company which fulfils both these criteria shall qualify as an NBFC & would require to be registered as NBFC by RBI.

In the given case, applying the Criteria (i) Financial assets constitute more than 50 % of the total assets (netted off by intangible assets),

A. Financial Assets of Sudarshan Ltd. are =

Non-Current Assets - Loans & Advances	₹ 75.50 Cr.
Add: Current Assets - Loans & advances	₹ 294.33 Cr.
Total Financial Assets	₹ 369.83 Cr.

B. Total Assets (netted off by intangible assets) of Sudarshan Ltd. are=

Total assets of the company	₹ 618.55 Cr.
Less: Intangible assets	₹ 6.35 Cr.
Total Assets (netted off by intangible assets)	₹ 612.20 Cr.

In view of above, Financial assets of Sudarshan Ltd. constitute more than 50 % of the total assets (netted off by intangible assets).

Applying the Criteria (ii) Income from financial assets constitute more than 50 % of the gross income.

Income from financial assets = ₹ 62.31 Cr

Gross Income = ₹ 111.23 Cr

From the above, it is clear that Sudarshan Ltd.'s financial assets constitute more than 50 % of the total assets (netted off by intangible assets) & income from financial assets constitutes more than 50 % of the gross income. Hence, Sudarshan Ltd. fulfills both these criteria to qualify as an NBFC.

Thus Sudarshan Ltd. can apply for registration u/s 45-IA of Reserve Bank of India (Amendment) Act, 1997 in prescribed form along with the necessary documents.

AUDIT UNDER FISCAL LAWS

QUESTION : 21

Billimoria & Billimoria, a partnership firm, is engaged in providing engineering consultancy services to insurance corporates in automobile sector. The firm conducts risk inspection of vehicles & submit their reports to insurance companies. Both the partners are Chartered Engineers. The Firm is one of your regular tax audit clients. The following information is culled out from the account books of the company for financial year 2021 -22 by the firm:

Particulars	₹ in Crore
Turnover	8.50
Receipt on account of sales/debtors	6.00
Cash receipt from debtors	0.10
Expenditure during year	7.00
Cash expenditure	0.21
Cash loan repayment	0.05

The partner of said firm informs you that due to changes in income-tax laws, their firm is not liable for audit u/s 44 AB of Income tax Act (commonly called as tax audit). How would you deal with the matter? Is contention of partner in accordance with law?

ANSWER : 21

Section 44 AB(a) of the Income Tax Act, 1961 prescribes that a person carrying on business shall get his accounts audited if his total sales, turnover or gross receipts exceed ₹ 1 crore in any previous year. However, this limit was enhanced to ₹ 10 crore in the following case where: -

- (a) aggregate of all amounts received including amount received for sales, turnover or gross receipts during the previous year, in cash, does not exceed 5 % of the said amount; &
- (b) aggregate of all payments made including amount incurred for expenditure, in cash, during the previous year does not exceed 5 % of the said payment.

However, section 44 AB(b) of the Income Tax Act, 1961 states that in case of profession, every person shall get his accounts audited, if his gross receipts in profession exceed ₹ 50 lakh. The above said firm is engaged in providing engineering consultancy services to insurance corporates. Hence, the benefit of enhanced threshold limit is not available to persons engaged in professional activities.

The information regarding cash receipt & payment although falling within 5% of total receipts/payments is not relevant in the instant case.

Hence, contention of partner is not correct, & firm is required to get its accounts audited under income tax law.

AUDIT OF PUBLIC SECTOR UNDERTAKINGS

QUESTION : 22

Comptroller & Auditor General appointed Sambhav & Associates, a chartered accountant firm, to conduct Performance audit of MAP Ltd., a public sector undertaking of Government of India. The firm conducted the audit with a view to check all the expenses of the unit are in conformity with the public interest & publicly accepted customs. The audit report submitted by audit firm was rejected by C&AG. Give your opinion on the action of C&AG.

ANSWER : 22

In the given scenario, C&AG appointed Sambhav & Associates, a chartered accountant firm, to conduct Performance Audit of MAP Ltd., a PSU of Government of India. The firm conducted audit with a view to check all the expenses of the unit are in conformity to the public interest & publicly accepted customs which is not Performance Audit.

A performance audit is an objective & systematic examination of evidence for the purpose of providing an independent assessment of the performance of a government organization, program, activity, or function in order to provide information to improve public accountability & facilitate decision-making by parties with responsibility to oversee or initiate corrective action.

Performance audit in PSUs is conducted by the C&AG (Supreme Audit Institutions) through various subordinate offices of Indian Audit & Accounts Department (IAAD). In conducting performance audit, the subordinate offices are guided by manual & auditing standards prescribed by C&AG.

Therefore, the objectives of performance auditing are evaluation of economy, efficiency, & effectiveness of policy, programmes, organization & management. It also promotes accountability by assisting those charged with governance & oversight responsibilities to improve performance; & transparency by affording taxpayers, those targeted by government policies & other stakeholders an insight into the management & outcomes of different government activities.

Performance auditing focuses on areas in which it can add value which have the greatest potential for development. It provides constructive incentives for the responsible parties to take appropriate action.

Regulations on Audit & Accounts issued by C&AG lay down that the responsibility for the development of measurable objectives & performance indicators as also the systems of measurement rests with the Government departments or Heads of entities. They are also required to define intermediate & final outputs & outcomes in measurable & monitorable terms, standardise the unit cost of delivery & benchmark quality of outputs & outcomes.

Thus, rejection of audit report (submitted by audit firm) by C&AG is in order as audit with a view to mere check all the expenses of the unit are in conformity to the public interest & publicly accepted customs done by audit firm is not performance audit in all aspects.

PEER REVIEW & QUALITY REVIEW

QUESTION : 23

- Evaluating the professional judgment exercised by the auditor is one of the important aspect under Quality Review, please explain the situation with reference to applicable Standard on Auditing.
- Prabhu & Co LLP is a large firm of Chartered Accountants based out of Mumbai. Prabhu & Co. LLP is subject to peer review which was last conducted 3 years back. For the peer review of the financial year ended 31st March 2021, the firm got an intimation on 29th May 2021. The process

of peer review got started & was completed on 27th September 2021. In view of peer reviewer, the systems & procedures of Prabhu & Co. LLP are deficient / non-compliant. The peer reviewer did not share any of his observations with Prabhu & Co LLP as draft & final report was submitted to the Board. Comment.

ANSWER : 23

- (a) **Evaluating the professional judgment exercised by the auditor:** It is also important for the Technical Reviewer (hereinafter referred as TR) to understand that "professional judgment", as defined in SA 200, "Overall Objectives of the Independent Auditor & the Conduct of an Audit in Accordance with Standards on Auditing" is an integral concept in the context of an audit & application of SAs in real life audit scenarios. SA 200 defines professional judgment as "the application of relevant training, knowledge & experience, within the context provided by auditing, accounting & ethical standards, in making informed decisions about the course of action that is appropriate in the circumstances of the audit engagement."

The concept of "professional judgment" underscores the fact that Standards, particularly, Standards on Auditing are written to lay down the fundamental principles that would apply to an audit situation. Hence, no Standard can have straight jacketed application/solutions for all audit scenarios. Above all, the Standards on Auditing issued by the ICAI are principle based rather than rule based. Hence, almost all the SAs envisage exercise of professional judgment by the auditor in their application in real life audit scenarios.

The TR would need to appreciate that the exercise of professional judgment in any particular case is based on the facts & circumstances that are known to the auditor as at the time of exercising that professional judgment. Normally, exercise of professional judgement by an auditor is preceded by consultation on the relevant matters both within the engagement team & between the engagement team & others at the appropriate level within or outside the firm.

In evaluating the professional judgment exercised by the auditor, the TR should consider the following factors:

- whether the judgment reached reflects a due consideration & application of the relevant auditing & accounting principles; &
- whether the judgment is appropriate in the light of, & consistent with, the facts & circumstances that were known to the auditor up to the date of the auditor's report. Hence, the TR & the QR Team should not, under any circumstance, use "hindsight" (i.e. perception or retrospection) in their evaluation of exercise of professional judgment by the auditor.

Since the auditor needs to exercise professional judgment throughout the audit, the latter also needs to be appropriately documented. Hence, the TR can expect to find such audit documentation as a part of the audit engagement file. It is important to note that professional judgment cannot be used by an auditor as a justification for decisions that are not otherwise supported by the facts & circumstances of the engagement or sufficient appropriate audit evidence.

- (b) **Peer Review Report of Reviewer:** After completing the on-site Review, the Peer Reviewer, before making his Report to the Board, shall communicate his findings in the Preliminary Report to the Practice Unit if in his opinion, the systems & procedures are deficient or non-compliant with reference to any matter that has been noticed by him or if there are other matters where he wants to seek clarification.

The Practice Unit shall within 15 days after the date of receipt of the findings, make any submissions or representations, in writing to the Reviewer. (i.e. Response to the Preliminary Report).

At the end of an on-site Review if the Reviewer is satisfied with the reply received from the Practice Unit, he shall submit a Peer Review Report to the Board along with his initial findings, response by the Practice Unit & the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

In case the Reviewer is of the opinion that the response by the Practice Unit is not satisfactory, the Reviewer shall accordingly submit a modified Report to the Board incorporating his reasons for the same. The Reviewer shall also submit initial findings (i.e. Preliminary Report), response by the Practice Unit (Response to Preliminary Report) & the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

In case of a modified report, The Board shall order for a "Follow On" Review after a period of one year from the date of issue of report as mentioned above. If the Board so decides, the period of one year may be reduced but shall not be less than six months from the date of issue of the report.

In the instant case, in view of Peer Reviewer systems & procedures in Prabhu & Co. LLP are deficient, therefore, Peer Reviewer should not submit the report directly to the Board. Thus, contention of Prabhu & Co. LLP is correct.

PROFESSIONAL ETHICS

QUESTION : 24

Comment on the following with reference to the with reference to the CA Act, 1949 & Schedules thereto:

- (a) CA Dev started practice in Punjab in the year 2019. CA Dev issued 'Turnover Certificate' for M/s. ASAUS Traders to be forwarded to the Bank for the purpose of availing cash credit facility & machinery term loan. Brother of CA Dev was proprietor of M/s. ASAUS Traders.
- (b) Aagam Private Limited requested CA Sheetal, a practicing Chartered Accountant, to digitally sign the form related to resignation of Mr. Rohit, one of the Director of Aagam Private Limited, along with the copy of Resignation Letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Rohit was simply copied & pasted by another Director of Aagam Private Limited. CA Sheetal, without verifying the genuineness of the resignation letter, digitally signed the form & the said form was uploaded on the website of Registrar of Companies.

ANSWER : 24

- (a) As per Clause (4) of Part I of Second Schedule to the CA Act, 1949, a Chartered Accountant in practice is deemed to be guilty if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

Further, it is not permissible for a member to undertake the assignment of certification, wherein the client is relative of the member. The "relative" for this purpose would refer to the definition mentioned in AS - 18.

In the given situation, CA Dev started practice in Punjab in the year 2019. CA Dev issued Turnover certificate for M/s. ASAUS Traders to be forwarded to the Bank for the purpose of obtaining Loan. Brother of CA Dev is proprietor of M/s. ASAUS Traders. Brother is very well covered in the definition of relative mentioned in AS-18.

Hence, CA Dev is guilty of professional misconduct.

- (b) As per Clause (7) of Part I of Second Schedule to the CA Act, 1949, a Chartered Accountant in practice is deemed to be guilty if he does not exercise due diligence or is grossly negligent in the conduct of this professional duties.

In the given case, Aagam Private Limited requested CA Sheetal, a practicing chartered accountant, to digitally sign the form related to resignation of Mr. Rohit, one of the Director of Aagam Private Limited, along with the copy of Resignation Letter to be uploaded on the website of Registrar of Companies. The signature of Mr. Rohit was simply copied & pasted by another Director of Aagam Private Limited.

CA Sheetal, without verifying the genuineness of the Resignation Letter, digitally signed the Form & the said form was uploaded on the website of Registrar of Companies.

Due to forged resignation letter, the resignation of Mr. Rohit from directorship of the Aagam Private Limited had been occurred. It was noted that CA Sheetal had not taken any step to verify forged signature on resignation letter which anyone would have taken in normal circumstances.

Consequently, CA. Sheetal would be held liable for professional misconduct as per Clause (7) of Part I of Second Schedule to the CA Act, 1949.

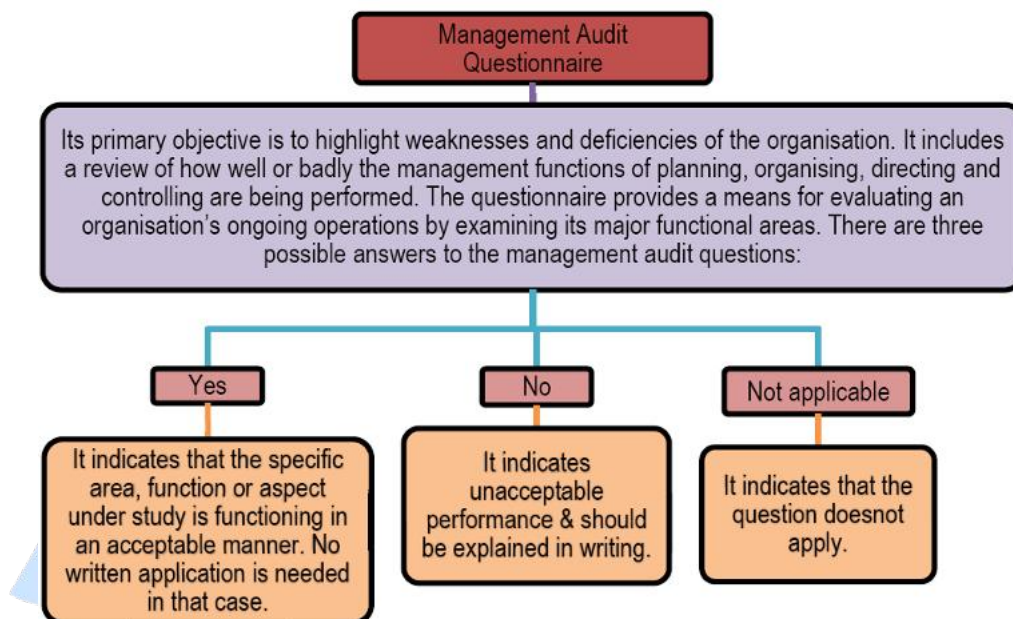
QUESTION : 25

Write a short note on the following:

- (a) **Management audit questionnaire.**
- (b) **Free look Cancellation (FRC)**
- (c) **Services rendered by Forensic Auditors**

ANSWER : 25

- (a) A **management audit questionnaire** is an important tool for conducting a management audit. It is through these questionnaires that the auditors make an inquiry into important facts by measuring current performance. Such questionnaires aim at a comprehensive & constructive examination of an organisation's management & its assigned tasks. Overall it is concerned with the appraisal of management actions in accomplishing the organisation's objectives.



Thus, management audit questionnaire for this part of the audit not only serves as a management tool to analyse the current situation; more importantly, it enables the management auditors to synthesis those elements that are causing organisational difficulties & deficiencies.

- (b) **Free Look Cancellation (FLC)** : As per clause 6(2) of IRDA (Protection of Policyholders Interest) Regulations, 2002, "the insurer shall inform by the letter forwarding the policy that he has a period of 15 days from the date of receipt of the policy document to review the terms & conditions of the policy & where the insured disagrees to any of those terms or conditions, he has the option to return the policy stating the reasons for his objection, when he shall be entitled to a refund of the premium paid, subject only to a deduction of a proportionate risk premium for the period on cover & the expenses incurred by the insurer on medical examination of the proposer & stamp duty charges".

Accordingly, FLC is an option provided to the policyholder wherein he has a period of 15 days from the date of receipt of the policy document to review the Terms & Conditions of the policy & in case of disagreement to any of the terms & conditions, he/ she has the option to return the policy stating

the reason for policy's cancellation. FLC requests can be received through any mode -e-mail, fax & letters depending on insurer's policy. In case of written letters, the signature of the policy holder should be matched with the original proposal form. FLC request is processed only when the policy holder is not satisfied with the terms & conditions of the policy document & not for any other reasons. FLC refund is paid either by cheque or in case the policy holder wants direct credit, then consent for direct credit along with cancelled cheque for bank account details is submitted.

(c) **Services rendered by Forensic Auditors are:**

- ✓ Crafting questions to be posed
 - ✓ Responding to questions posed
 - ✓ Identifying documents to be requested &/or subpoenaed
 - ✓ Identifying individuals to be most knowledgeable of facts
 - ✓ Conducting research relevant to facts of the case
 - ✓ Identifying & preserving key evidence
 - ✓ Evaluating produced documentation & information for completeness
 - ✓ Analysing produced records & other information for facts
 - ✓ Identifying alternative means to obtain key facts & information
 - ✓ Providing questions for deposition & cross examination of fact & expert witnesses
-

CA FINAL – ADVANCED AUDITING & PROFESSIONAL ETHICS

RTP – MAY 2022

QUESTIONS PART A: MULTIPLE CHOICE QUESTIONS

INTEGRATED CASE SCENARIO 1.

M/s JKL & Associates, Chartered Accountants were acting as the statutory auditors of M/s IBS Bank Limited. During the statutory audit for the relevant financial year, the following observations were made:

- Interest income included the following:
 - ◆ ₹ 5 lakh relating to a short-term crop loan where instalment was overdue for one crop season.
 - ◆ ₹ 7 lakh relating to an advance (guaranteed equally by Government of India & Government of Tamil Nadu) where the instalment was due for more than six months.
- A 25 month old NPA account worth ₹ 43 lakh (net book value) was sold to an asset reconstruction company for ₹ 45 lakh. The profit from the above transaction was taken to the P&L account. The above NPA was sold 'without recourse' & at cash basis. The auditors noticed a discrepancy in this transaction & hence decided to report the same.

After completing the bank audit, JKL & Associates agreed to take up the following management consultancy & other services for one of the start-up company based in Noida:

- (i) Setting up executive incentive plan & wage incentive plan.
- (ii) Price-fixation & other management decision making.
- (iii) Conduct a periodical audit & advisor for tax matters.

Mr. K, one of the partners of the firm felt that providing the above services could result in professional misconduct. Hence, he resigned from the partnership & became a sole practitioner. One of the clients of JKL & associates came to know about the issue & they approached Mr. K to conduct the statutory audit for the financial year. Mr. K took up the assignment without informing the previous firm. Annoyed by this, Mr. J filed a complaint to ICAI regarding the act of Mr. K. After enquiry, it was decided that Mr. K was guilty of professional misconduct.

After this incident, Mr. K also decided to file a complaint against Mr. J. When he was thinking about a reason for the same, he remembered that Mr. J had entered into an agreement with two of his articled clerks to pay stipend on an annual basis, while others were paid on monthly basis. Realising that this act is in violation of Regulation 48 of the Act, he filed a complaint to ICAI. After enquiry, it was found that Mr. J was guilty of professional misconduct.

On the basis of the abovementioned facts, you are required to choose the most appropriate answer for the following MCQs:

QUESTIONS:

1. From the above facts & details, what is the correct amount of interest which the bank should account in its financial statements?

- (a) Nil.
- (b) ₹ 8.5 lakh.
- (c) ₹ 5 lakh.
- (d) ₹ 3.5 lakh.

2. What could be the possible amount classified as NPA relating to the accounts with respect to observation regarding the inclusion of interest income given below:

- ₹ 5 lakh relating to a short-term crop loan where instalment was overdue for one crop season.
 - ₹ 7 lakh relating to an advance (guaranteed equally by Government of India & Government of Tamil Nadu) where the instalment was due for more than six months.
- (a) ₹ 12 lakh.
 - (b) ₹ 8.5 lakh.
 - (c) ₹ 7 lakh.

(d) ₹ 3.5 lakh.

3. In NPA, sale to asset reconstruction company, what discrepancy auditor might have noticed:

- (a) The NPA had not completed 30 months.
- (b) Sale was made 'without recourse'.
- (c) Sale was made for cash basis.
- (d) The profit of ₹ 2 lakh was taken to P&L account.

4. Being guilty of professional misconduct, which of the following punishment Mr. K will be subject to:

- (a) Removal of his name from members register for a period of 6 months.
- (b) Impose a penalty of ₹ 1000.
- (c) Removal of his name from members register up-to a period it thinks fit.
- (d) Impose a penalty up-to ₹ 2 lakh.

5. Being guilty of professional misconduct, which among the following punishment Mr. J will be subject to?

- (a) Impose a penalty up-to ₹ 1 lakh.
- (b) Remove his name from members register permanently.
- (c) Impose a penalty up-to ₹ 3 lakh.
- (d) Impose a penalty of ₹ 6 lakh.

INDEPENDENT MCQs

6. Moon Ltd. is a company engaged in the manufacture of iron & steel bars. VP & Associates are the statutory auditors of Moon Ltd. for the FY 2021-22. During the course of audit, CA Vikash, the engagement partner, found that the Company's financing arrangements have expired, & the amount outstanding was payable on March 31, 2022. The Company has been unable to re-negotiate or obtain replacement financing & is considering filing for bankruptcy. These events indicate a material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern & therefore it may be unable to realize its assets & discharge its liabilities in the normal course of business. The financial statements (& notes thereto) do not disclose this fact. What opinion should CA Vikash express in the case of Moon Ltd.?

- (a) Unmodified opinion.
- (b) Qualified opinion.
- (c) Adverse opinion.
- (d) Disclaimer of opinion.

7. As per the Quality Review Board, the term technical standards in the context of Chartered Accountants Rules 2006, includes which among the following?

- (a) ICDS notified under Income Tax Act, 1961.
- (b) Accounting standards notified under Companies Act, 2013.
- (c) Guidance notes on accounting & auditing matters issued by C&AG.
- (d) Notifications/ Directions issued on accounting & auditing matters issued by RBI/ SEBI/ other regulatory bodies.

8. Which among the following are the skills to be possessed by M/s ABC & Associates as forensic auditors?

- (a) Criminology & evidence gathering.
- (b) Confidence & curiosity.
- (c) Discretion & creativity.
- (d) Inquisitiveness & persistence.

9. Match the following terms to their definitions:

(i)	Accounting Estimates	1	The susceptibility of an accounting estimate & related disclosures to an inherent lack of precision in its measurement.
(ii)	Estimation uncertainty	2	A lack of neutrality by management in the preparation & presentation of information.
(iii)	Management bias	3	An approximation of a monetary amount in the absence of a precise means of measurement.
(iv)	Measurement objective for fair value Accounting Estimates	4	To forecast the outcome of one or more transactions, events or conditions.

- (a) (i)-3, (ii)-1, (iii) - 2, (iv)- 4.
 (b) (i)-2, (ii)-1, (iii) - 1, (iv)- 4.
 (c) (i)-1, (ii)-3, (iii) - 2, (iv)- 4.
 (d) (i)-4, (ii)-1, (iii) - 2, (iv)- 1.

PART A : ANSWERS TO MULTIPLE QUESTIONS

1	(c)	2	(d)	3	(d)	4	(b)	5	(b)	6	(c)	7	(b)	8	(a)	9	(a)
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PART B : DESCRIPTIVE QUESTIONS

STANDARDS ON AUDITING, STATEMENTS & GUIDANCE NOTES

QUESTION : 10

- (a) During the audit of Mahaveer Ltd, a listed company, Engagement Partner (EP) completed his reviews & also ensured compliance with independence requirements that apply to the audit engagement. The engagement files were also reviewed by the Engagement Quality Control Reviewer (EQCR) except the independence assessment documentation. Engagement Partner was of the view that matters related to independence assessment are the responsibility of the Engagement Partner & not Engagement Quality Control Reviewer. Engagement Quality Control Reviewer objected to this & refused to sign off the documentation. Please advise as per SA 220.
- (b) M/s Manidhari & Associates have been appointed as an auditor of JIN Limited, a multinational company dealing in spare parts. During the course of audit, CA Manidhari is facing many problems including the problem of not getting the desired information from the management. Accordingly, he decided to communicate with those charged with the governance about significant difficulties encountered during the audit. CA Manidhari seeks your guidance on matters which can be considered as significant difficulties as per SA 260.

ANSWER : 10

- (a) As per SA 220, 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 &, where applicable, network firms, to identify & evaluate circumstances & relationships that create threats to independence;
 - Evaluate information on identified breaches, if any, of the firm's independence policies & procedures to determine whether they create a threat to independence for the audit engagement; &
 - Take appropriate action to eliminate such threats or reduce them to an acceptable level by applying safeguards, or, if considered appropriate, to withdraw from the audit engagement, where withdrawal is permitted by law or regulation. The engagement partner shall promptly report to the firm any inability to resolve the matter for appropriate action.

Engagement Partner shall take responsibility for reviews being performed in accordance with the firm's review policies & procedures.

As per SA 220, "Quality Control for Audit of Financial Statements", for audits of financial statements of listed entities, Engagement Quality Control Reviewer (EQCR), on performing an engagement quality control review, shall also consider the engagement team's evaluation of the firm's independence in relation to the audit engagement.

In the given case, the Engagement Partner is not right. The independence assessment documentation should also be given to Engagement Quality Control Reviewer for his review.

- (b) As per SA 260, "Communication with Those Charged with Governance", significant difficulties encountered during the audit may include such matters as:
- (i) Significant delays by management, the unavailability of entity personnel, or an unwillingness by management to provide information necessary for the auditor to perform the auditor's procedures.
 - (ii) An unreasonably brief time within which to complete the audit.
 - (iii) Extensive unexpected effort required to obtain sufficient appropriate audit evidence.
 - (iv) The unavailability of expected information.
 - (v) Restrictions imposed on the auditor by management.
 - (vi) Management's unwillingness to make or extend its assessment of the entity's ability to continue as a going concern when requested.

In some circumstances, such difficulties may constitute a scope limitation that leads to a modification of the auditor's opinion. as per SA 705, Modifications to the Opinion in the Independent Auditor's Report.

QUESTION : 11

- (a) CA Abhinandan is an auditor of KM Private Limited. During the course of audit, CA Abhinandan becomes aware of information concerning an instance of noncompliance or suspected non-compliance with laws & regulations. Being a senior partner of CA. Abhinandan, guide him regarding audit procedures to be followed when non-compliance is identified or suspected.
- (b) In the audit plan for Shetrapal Ltd, as the audit partner you want to highlight the sources of misstatements, arising from other than fraud, to your audit team & caution them. Identify the sources of misstatements.
- (c) In the course of audit of Ambika Ltd, its auditor wants to rely on the audit evidence obtained in the previous audit in respect of the effectiveness of internal controls instead of retesting the same during the current audit. As an advisor to the auditor kindly caution him about the factors that may warrant a re-test of controls.

ANSWER : 11

- (a) As per SA 250, "Consideration of Laws & Regulations in an Audit of Financial Statements", if the auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws & regulations, the auditor shall obtain:
- (i) An understanding of the nature of the act & the circumstances in which it has occurred; &
 - (ii) Further information to evaluate the possible effect on the financial statements.

If the auditor suspects there may be non-compliance, the auditor shall discuss the matter with management &, where appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information that supports that the entity is in compliance with laws & regulations &, 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.

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.

The auditor shall evaluate the implications of non-compliance in relation to other aspects of the audit, including the auditor's risk assessment & the reliability of written representations, & take appropriate action.

- (b) According to SA 450 "Evaluation of Misstatements Identified During the Audit", the following are the sources of misstatements arising from other than fraud -
- (i) An inaccuracy in gathering or processing data from which the financial statements are prepared;
 - (ii) An omission of an amount or disclosure;
 - (iii) An incorrect accounting estimate arising from overlooking, or clear misinterpretation of facts; &
 - (iv) Judgments of management concerning accounting estimates that the auditor considers unreasonable or the selection & application of accounting policies that the auditor considers inappropriate.

(c) As per SA 330 on "The Auditor's Responses to Assessed Risks", changes may affect the relevance of the audit evidence obtained in previous audits such that there may no longer be a basis for continued reliance.

The auditor's decision on whether to rely on the audit evidence obtained in previous audits for control is a matter of professional judgment. In addition, the length of time between retesting such controls is also a matter of professional judgment.

Factors that may warrant a re-test of controls are-

- (i) A deficient control environment.
- (ii) Deficient monitoring of controls.
- (iii) A significant manual element to the relevant controls.
- (iv) Personnel changes that significantly affect the application of the control.
- (v) Changing circumstances that indicate the need for changes in the control.
- (vi) Deficient general IT-controls.

RISK ASSESSMENT & INTERNAL CONTROL

QUESTION : 12

PADHAM Ltd is engaged in the business of manufacturing of carpets. The company is planning to expand & diversify its operations. The management has increased the focus on internal controls to ensure better governance. The management discussed with the statutory auditors to ensure the steps required to be taken so that the statutory audit is risk based & focused on areas of greatest risk to the achievement of the company's objectives.

Name the key steps & phases involved in Risk Based Audit.

- (a) Also, discuss the steps to be taken for the risk assessment phase of the audit.**
- (b) Special Aspects of Auditing in an Automated Environment**

ANSWER : 12

- (a) The auditor's objective in a risk-based audit is to obtain reasonable assurance that no material misstatements whether caused by fraud or errors exist in the financial statements.

This involves the following three key steps:

- Assessing the risks of material misstatement in the financial statements
- Designing & performing further audit procedures that respond to assessed risks & reduce the risks of material misstatements in the financial statements to an acceptably low level; &
- Issuing an appropriate audit report based on the audit findings.

The risk-based audit process is presented in three distinct phases:

- ◆ Risk assessment.
- ◆ Risk response; &
- ◆ Reporting.

- (b) The risk assessment phase of the audit involves the following steps:

- Performing client acceptance or continuance procedures;
- Planning the overall engagement;

- Performing risk assessment procedures to understand the business & identify inherent & control risks;
- Identifying relevant internal control procedures & assessing their design & implementation (those controls that would prevent material misstatements from occurring or detect & correct misstatements after they have occurred);
- Assessing the risks of material misstatement in the financial statements;
- Identifying the significant risks that require special audit consideration & those risks for which substantive procedures alone are not sufficient;
- Communicating any material weaknesses in the design & implementation of internal control to management & those charged with governance; &
- Making an informed assessment of the risks of material misstatement at the financial statement level & at the assertion level.

SPECIAL ASPECTS OF AUDITING IN AN AUTOMATED ENVIRONMENT

QUESTION : 13

You came to know that the data stored & processed in systems can be used to get various insights into the way business operates in an automated environment. This data can be useful for the preparation of management information system (MIS) reports & electronic dashboards that give a high-level snapshot of business performance. In view of above you are required to briefly discuss the meaning of data analytics & example of circumstances when auditing in an automated environment, auditors can apply the concepts of data analytics.

ANSWER : 13

Data Analytics: Generating & preparing meaningful information from raw system data using processes, tools, & techniques is known as Data Analytics. The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs. When auditing in an automated environment, auditors can apply the concepts of data analytics for several aspects of an audit including the following:

- preliminary analytics;
- risk assessment;
- control testing;
- non-standard journal analysis;
- evaluation of deficiencies;
- fraud risk assessment.

THE COMPANY AUDIT

QUESTION : 14

AMC LLP is a newly set up LLP (Limited Liability Partnership). The operations of the LLP have been picking up & management is currently in the process of setting up processes & procedures in place. As per the understanding of the management of the LLP, its accounts would not be required to be audited mandatory because of its operations but still, the management has decided that they would get the accounts audited voluntarily. In this regard, the management would like to understand some of the aspects which they should consider not only limited to audit but also about the maintenance of books of accounts as per the relevant laws. Please advise.

ANSWER : 14

An LLP shall be under obligation to maintain annual accounts reflecting a true & fair view of its state of affairs. The accounts of every LLP shall be audited in accordance with Rule 24 of LLP Rules 2009. Such rules, inter-alia, provides that any LLP, whose turnover does not exceed, in any financial year, ₹ 40 lakhs, or whose contribution does not exceed ₹ 25 lakhs, is not required to get its accounts audited. However, if the partners of such limited liability partnership decide to get the accounts of such LLP audited, the accounts shall be audited only in accordance with such rule.

Appointment of Auditor: The auditor may be appointed by the designated partners of the LLP -

1. At any time for the first financial year but before end of the first financial year,
2. At least thirty days prior to the end of each financial year (other than the first financial year),
3. To fill the casual vacancy in the office of auditor,
4. To fill the casual vacancy caused by the removal of an auditor.

The partners may appoint the auditors if the designated partners have failed to appoint them.

LLPs are required to maintain books of accounts which shall contain -

1. Particulars of all sums of money received & expended by the LLP & the matters in respect of which the receipt & expenditure takes place,
2. A record of the assets & liabilities of the LLP,
3. Statements of costs of goods purchased, inventories, work-in-progress, finished goods & costs of goods sold,
4. Any other particulars which the partners may decide.

The auditor should read the LLP agreement & note the following provisions:

- (a) Nature of the business of the LLP
- (b) Amount of capital contributed by each partner
- (c) Interest - in respect of additional capital contributed
- (d) Duration of partnership
- (e) Drawings allowed to the partners
- (f) Salaries, commission etc payable to partners
- (g) Borrowing powers of the LLP
- (h) Rights & duties of partners
- (i) Method of settlement of accounts between partners at the time of admission, retirement, admission etc.
- (j) Any loans advanced by the partners
- (k) Profit sharing ratio.

QUESTION : 15

Mr. Arjun was appointed as the engagement partner on behalf of Bhism & Co., a Chartered Accountant Firm, for conducting statutory audit assignment of Sinwar Ltd., unlisted public company.

Mr. Brijesh, one of the senior engagement team members, was given the responsibility to audit the matters as per the requirements of CARO, 2020 & in that connection, he made the following observations, that may be relevant for reporting as per the said Order:-

Sr.No.	Observations
(a)	One of the Plant & Equipment taken on a lease ('right of use' asset) by Sinwar Ltd. was revalued based on the valuation by a registered valuer & the net carrying value of Plant & Equipment in aggregate was changed from ₹ 4 crore to ₹ 4.45 crore.
(b)	During the year under consideration, cash credit limit of ₹ 5.5 crore was sanctioned to Sinwar Ltd. by DMC Bank based on the security of current assets which was reduced to ₹ 4.5 crore after 6 months. In this connection, quarterly returns have been filed by the company with the DMC bank which are in agreement with Books of Accounts.

You are required to examine the contention of Mr. Brijesh regarding reporting of the above observations in accordance with CARO 2020.

ANSWER : 15

Matters to be reported by Mr. Brijesh as per CARO, 2020 are as follows:-

- (a) According to Clause (i) (d) of Para 3 of CARO 2020, the auditor is required to report whether the company has revalued its Property, Plant & Equipment (including Right of Use assets) or intangible assets or

both during the year &, if so, whether the revaluation is based on the valuation by a Registered Valuer; specify the amount of change, if the change is 10% or more in the aggregate of the net carrying value of each class of Property, Plant & Equipment or intangible assets;

In the given situation, Sinwar Ltd. has revalued one of the Plant & Equipment taken on a lease ('right of use' asset) based on the valuation by a registered valuer. The amount of change in the value of such Plant & Equipment is ₹ 45 lakh. As the net carrying value of Plant & Equipment in aggregate was changed from ₹ 4 crore to ₹ 4.45 crore i.e. change was 10% or more.

Thus, the auditor is required to report the amount of change of ₹ 45 lakh in accordance with Clause (i) (d) of Para 3 of CARO 2020.

(b) As per Clause (ii) (b) of Para 3 of CARO 2020, the auditor is required to report whether during any point of time of the year, the company has been sanctioned working capital limits in excess of ₹ 5 crores, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details;

In the instant case, Sinwar Ltd. has been sanctioned a cash credit limit of ₹ 5.5 crore by DMC Bank during the year under consideration, which is exceeding the prescribed limit of ₹ 5 crore based on the security of current assets. Further, quarterly returns have also been filed by the company with the DMC bank in this connection which is in agreement with Books of Accounts.

In view of the above, the auditor is required to report the same in accordance with Clause (ii) (b) of Para 3 of CARO 2020

AUDIT REPORT

QUESTION : 16

- (a) You have been appointed as an auditor of Dharmnath & Sons for FY 2020-21, as entity other than a company incorporated under the Companies Act, 2013, using a fair presentation framework. Appointment had been made in the month of April, 2021. The financial statements have been prepared by the management in accordance with the Accounting Standards. The management had introduced the new computerized accounts receivable system from November 2020 & still in the implementation phase & thus management is in the process of rectifying system deficiencies & correcting the errors. At the time of implementation of a new system, the earlier system of accounting of receivables had been discarded. The auditor was unable to obtain sufficient appropriate audit evidence about the entity's accounts receivable & inventories. The possible effects of the inability to obtain sufficient appropriate audit evidence are deemed to be both material & pervasive to the financial statements. Write the opinion paragraph & basis of opinion paragraph to be included in the Independent Auditor's Report.
- (b) What is the auditor's responsibility to report a key audit matter for which there are no relevant disclosures in the financial statements?
- (c) Where should the placement of the key audit matters section be in the auditor's report?

ANSWER : 16

(a) Opinion Paragraph

Disclaimer of Opinion

We were engaged to audit the financial statements of Dharmnath & Sons ("the entity"), which comprise the balance sheet as at March 31, 2021, the statement of

Profit & Loss, (the statement of changes in equity) & the statement of cash flows for the year then ended, & notes to the financial statements, including a summary of significant accounting policies.

We do not express an opinion on the accompanying financial statements of the entity. Because of the significance of the matters described in the Basis for Disclaimer of Opinion section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for Disclaimer of Opinion

We were not appointed as auditors of the Company until after March 31, 2021, & thus did not observe the counting of physical inventories at the beginning & end of the year. We were unable to satisfy ourselves by alternative means concerning the inventory quantities held at March 31, 2020, & 2021, which are stated in the Balance Sheets at ₹ xxx & ₹ xxx, respectively. In addition, the introduction of a new computerized accounts receivable system in November 2020 resulted in numerous errors in accounts receivable. As of the date of our report, management was still in the process of rectifying the system deficiencies & correcting the errors. We were unable to confirm or verify by alternative means accounts receivable included in the Balance Sheet at a total amount of ₹ xxx as at March 31, 2021. As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories & accounts receivable, & the elements making up the statement of Profit & Loss (& statement of cash flows)

- (b) When communicating key audit matters, the fact that there are no disclosures in the financial statements related to a matter determined to be a key audit matter does not relieve the auditor from the requirement to communicate it. An auditor may determine a key audit matter related to the audit for which relevant disclosure requirements do not exist in the applicable financial reporting framework. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular, if such a change had a significant effect on the auditor's overall audit strategy or related to significant risk (e.g., changes to a system affecting revenue recognition)

Also, if an auditor determines that it is necessary to include information about the entity in order to effectively describe a key audit matter that has not been disclosed by management & management does not agree to disclose that information, the auditor should reconsider the adequacy of the disclosures in accordance with applicable financial reporting framework. The auditor should communicate the matter as a key audit matter unless law or regulation precludes public disclosure about the matter or in extremely rare circumstances, the auditor determines that the matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

- (c) Generally, the Key Audit Matters section is required to be placed after the Basis for Opinion paragraph & before the Management's Responsibility paragraph.

In case, 'Material uncertainty relating to going concern' section is required as per SA 570, then KAM section is placed after that section.

Further, regarding placement of KAM section, SA 706, "Emphasis of Matter Paragraphs & Other Matter Paragraphs in the Independent Auditor's Report" provides as under:

When a Key Audit Matters section is presented in the auditor's report, an Emphasis of Matter (EOM) paragraph may be presented either directly before or after the Key Audit Matters section, based on the auditor's judgment as to the relative significance of the information included in the Emphasis of Matter paragraph. The auditor may also add further context to the heading "Emphasis of Matter", such as "Emphasis of Matter - Subsequent Event", to differentiate the Emphasis of Matter paragraph from the individual matters described in the Key Audit Matters section.

AUDIT COMMITTEE & CORPORATE GOVERNANCE
QUESTION : 17

Aadi Nath & Associates have been appointed as Statutory Auditor of Shikhar Ltd. for the F.Y 2020-21. Shikhar Ltd. enters into frequent business transactions with the entities belonging to promoter & promoter group. The company is a listed entity & has to submit a compliance certificate to the stock exchange. The auditors seek your guidance on the disclosure requirements in respect of related party transactions as per Listing Obligations & Disclosure Requirements (LODR) Regulations 2015 on Corporate Governance. Explain.

ANSWER : 17

Related Party Disclosure [Regulations 23, 27, 46 & Schedule V]: The listed entity shall submit a quarterly compliance report on corporate governance in the format as specified by the Board from time to time to the recognised stock exchange(s) within 21 days from the end of each quarter.

Details of all material transactions with related parties shall be disclosed therein. The report shall be signed either by the compliance officer or the chief executive officer of the listed entity.

The company shall disclose the policy on dealing with related party transactions on its website & a web link thereto shall be provided in the Annual Report.

The listed entity shall disclose the transactions with any person or entity belonging to the promoter/promoter group which hold(s) 10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results.

The listed entity shall submit within 30 days from the date of publication of its standalone & consolidated financial results for the half year, disclosures of related party transactions on a consolidated basis, in the format specified in the relevant accounting standards for annual results to the stock exchanges & publish the same on its website.

Provided that a 'high value debt listed entity' shall submit such disclosures along with its standalone financial results for the half year.

AUDIT OF BANKS
QUESTION : 18

You have been appointed as an auditor of OM Bank, a nationalized bank. OM Bank also deals in providing credit card facilities to its account holder. The bank is aware of the fact that there should be strict control over the storage & issue of credit cards. How will you evaluate the Internal Control System in the area of Credit Card operations of a Bank?

ANSWER : 18**Credit Card Operations:**

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

AUDIT OF INSURANCE COMPANY**QUESTION : 19**

ARHAM Limited is engaged in the business of Insurance for the last 27 years. KUSHAL & Co., a firm of Chartered Accountants are the statutory auditors of this company & have been required to perform the audit of all the divisions & head office for the financial year 2020-2021. At the planning state CA K, Engagement Partner has identified outstanding premium & agents' balances as a focus area. Guide CA K by explaining key audit procedures to be performed for verification of outstanding premium & agent's balance.

ANSWER : 19

Outstanding Premium & Agents' Balances: The following are the audit procedures to be followed for verification of outstanding premium & agents' balances:

- (i) Inquire reasons for long outstanding credit balances in outstanding premium accounts & examine the reasons for policies not being issued or the outstanding premium not adjusted against amounts due.
- (ii) Scrutinise & review control account debit balances & their nature should be enquired into.
- (iii) Examine inoperative balances & treatment given for old balances with reference to company rules.
- (iv) Enquire into the reasons for retaining the old balances.
- (v) Verify old debit balances which may require provision or adjustment. Notes of explanation may be obtained from the management in this regard.
- (vi) Check age-wise, sector-wise analysis of outstanding premium.
- (vii) Verify whether outstanding premiums have since been collected.
- (viii) Check the availability of an adequate bank guarantee or premium deposit for outstanding premium.

AUDIT UNDER FISCAL LAWS**QUESTION : 20**

CA Sumati has been appointed as a tax auditor u/s 44 AB of the Income-tax Act, 1961, of M/s Pal & Company, a partnership firm, following cash basis of accounting. CA Sumati made the qualification that ICDS were not followed by the entity while maintaining books of accounts. Whether qualification made by CA Sumati is correct? Explain the provisions of the applicability of ICDS with reference to Sec 145(2) of the Income Tax Act, 1961.

ANSWER : 20

Section 145(2) empowers the Central Government to notify in the Official Gazette from time to time, income computation & disclosure standards are to be followed by any class of assessee or in respect of any class of income.

Accordingly, the Central Government had, in the exercise of the powers conferred u/s 145(2), notified ten income computation & disclosure standards (ICDSs) to be followed by all assesses (other than an individual or a HUF who is not required to get his accounts of one previous year audited in accordance with the provisions of section 44AB), following the mercantile system of accounting, for the purposes of computation of income chargeable to income-tax under the head "Profit & gains of business or profession" or "Income from other sources". from the A.Y. 2017-18.

All the notified ICDSs are applicable for computation of income chargeable under the head "Profits & gains of business or profession" or "Income from other sources" & not for the purpose of maintenance of books of accounts. In the case of conflict between the provisions of the Income-tax Act, 1961 & the notified ICDSs, the provisions of the Act shall prevail to that extent.

In the given situation, Sumati has been appointed as a tax auditor of M/s Pal & Company, a partnership firm, following the cash basis of accounting. CA Sumati made the qualification that ICDS were not followed by the entity while maintaining books of accounts. In view of the above provisions, it is clear the ICDS is applicable on a mercantile system of accounting, & it is only for the purpose of computation of income chargeable to income tax under the head "Profits & Gains of business or profession" or "Income from other sources" & not for the maintenance of books of accounts. Thus, qualification made by CA. Sumati is not correct.

AUDIT OF PUBLIC SECTOR UNDERTAKINGS

QUESTION : 21

- (i) The objectives of audit in connection with a State Electricity Distribution Company were to ascertain whether the:
- (ii) total cost of providing electricity is being recovered by timely submissions to the State Electricity Regulatory Commission;
- (iii) tariff orders, sales circulars & sales instructions were issued timely, without any ambiguity. They were implemented in time;
- (iv) metering, billing & collection was managed efficiently & effectively;
- (v) monitoring & internal controls were efficient.

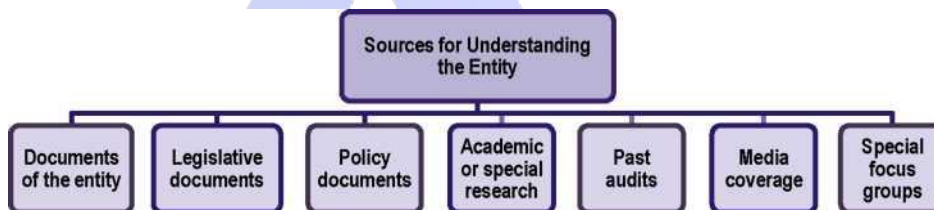
What kind of audit is referred in the above scenario? Also briefly discuss the steps suggested to the auditors for planning such an audit.

ANSWER : 21

In the given scenario, in view of the objectives discussed, performance audit is being referred.

The following steps are suggested to the auditors for planning while conducting the performance audit:

- (A) Understanding the Entity/Programme** - It is the starting point for planning individual performance audit.



The auditor may use the following sources for understanding the entity:

- (i) Documents of the entity: Documents on administration & functions of the entity, policy files, annual reports, budget documents, accounts, minutes of meetings, information on the website, internal audit reports, electronic databases & MIS reports, RTI material etc.
 - (ii) Legislative documents: Legislation, parliamentary questions & debates, reports of the Public Accounts Committee, the Committee on Public Undertakings, the Estimates Committee, & letters from Members of Parliament.
 - (iii) Policy documents: Documents of Planning Commission, Ministry of Finance etc.
 - (iv) Academic or special research: Independent evaluations on the entity, academic research & similar work done by other governments & other SAs.
 - (v) Past audits: Past financial & performance audits of the entity provide a major source of information & understanding.
 - (vi) Media coverage: Print & electronic media - their systematic documentation on regular basis in a transparent manner.
 - (vii) Special focus groups: Audit Advisory Committee concerns, annual & special reports of World Bank, Reserve Bank of India, reports by special interest groups, NGOs, etc.
- (B) Defining the Objectives & the Scope of Audit** - The audit objectives should be defined in a succinct manner as they will impact the nature of the audit, govern its conduct & affect audit conclusions. Setting audit objectives ensures good quality performance audits. It facilitates clarity, demonstrates the consistent quality of audit & serves as a measure of quality assurance of the audit.
- Defining the scope constricts the audit to significant issues that relate to the audit objectives. It mainly focuses on the extent, timing & nature of the audit.
- (C) Determining Audit Criteria** - Audit criteria are the standards used to determine whether a program meets or exceeds expectations. It provides a context for understanding the results of the audit. Audit

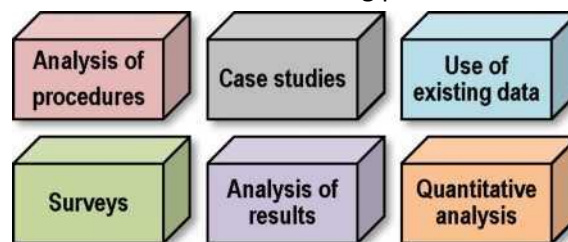
criteria are reasonable & attainable standards of performance against which economy, efficiency & effectiveness of programmes & activities can be assessed.

The audit criteria may be sought to be obtained from the following sources:

- (i) procedure manuals of the entity.
- (ii) policies, standards, directives, & guidelines.
- (iii) criteria used by the same entity or other entities in similar activities or programmes.
- (iv) independent expert opinion & know how.
- (v) new or established scientific knowledge & other reliable information.
- (vi) general management & subject matter literature & research papers.

(D) Deciding Audit Approach - There is no uniform audit approach prescribed that can be applicable to all types of subjects of performance audits. The selection of approach also determines methods & means used for conducting the audit.

Some of the methods which could be used in conducting performance audits include:



- (i) **Analysis of procedures:** It involves review of the systems in place for planning, conducting, checking & monitoring the activity. This would consist of examination of documents such as financial reports, budgets, programme guidelines, procedure manuals, etc.
 - (ii) **Case studies:** A case study is a descriptive analysis of an entity, scheme or programme. It involves analysis of a particular issue within the context of the whole area under review.
 - (iii) **Use of existing data:** The audit staff should investigate the data held by entity management & by other relevant sources. Audit conclusions based on testing of available data for correctness & completeness enhances the assurance level.
 - (iv) **Surveys:** Survey is a method of collecting information from members of a population to assess the interrelation of events & conditions. Surveys on predetermined parameters can supplement the audit findings & conclusions adding value to the performance audits.
 - (v) **Analysis of results:** It requires the auditor to carry out actual output-input analysis to determine the efficiency of the programme.
 - (vi) **Quantitative analysis:** It involves an examination of available data relating to financials like earnings, revenue, or data relating to programme implementation like details of beneficiaries etc. However, it may not be possible for the auditor to work with complete data due to its high volume. In such cases, sampling techniques are required to be used.
- (E) Developing Audit Questions** - Subsequent to designing of audit objectives & determination of audit criteria, the audit team is required to prepare a list of questions to which they would seek answers. The questions should be framed in a comprehensive manner involving a detailed hierarchy of questions.
- (F) Assessing Audit Team Skills & whether Outside Expertise required** - It is essential that the performance auditors possess special aptitude & knowledge. The Auditing Standards of C&AG of India provide that the audit institution should develop & train the auditors to enable them to perform their tasks effectively & efficiently & should prepare manuals & other written guidance notes & instructions concerning the conduct of audits.

Given the diverse range of subjects of performance auditing, the audit team needs to develop a sound understanding of the programme or entity proposed to be audited.

The audit team needs to decide at the planning stage on which aspect of expertise is required. Though the Accountant General may use the work of an expert, he retains full responsibility for the expression of opinion in the auditor's report.

- (G) Preparing Audit Design Matrix (ADM)** - Having determined the audit objective, audit criteria, audit approach, data collection etc., the audit team should prepare an Audit Design Matrix. It is a structured & highly focused approach to designing a performance audit study.

The ADM highlights the data collection & analysis method as well as the type & sources of evidence required to support audit opinion/findings.

A specimen of ADM is given as under:

Audit Objective (1)	Audit Questions (2)	Audit Criteria (3)	Evidence (4)	Data Collection & Analysis Method (5)

An ADM is prepared on the basis of information & know edge obtained during the planning stage. A well-designed ADM leads to effective audits thus providing the highest assurances to the auditing entities. It is desirable to prepare ADM for each of the audit objectives.

- (H) Establishing Time-Table & Resources** - It is significant to determine the timetable & desirable resources. Selection of an appropriate audit team is the most vital component in planning an audit. Considerations for the selection of an appropriate audit team should be recorded along with the proposed timelines for various activities to be undertaken as a part of the audit process. The progress should also be monitored against these timelines. The Accountant General would be liable for ensuring that the performance audit is completed on time. The variations between the

required & actual time spent should be compared & approved from the competent authority.

The team should build time for translation, approval & possible delays in their own schedule in order to meet the targets.

- (I) Intimation of Audit Programme to Audit Entities** - Audited entities must be intimated about the intention of taking up planned performance audit with the scope & extent of audit including the constitution of an audit team & the tentative time schedule, well before the commencement of Audit. Acknowledgement of this may be requested & placed on record.

It may be required to refine an audit's objectives as the audit progresses for gathering the requisite information to fulfil the audit. The reasons for such changes in the objectives should also be recorded & approved by the competent authority.

The audit programme should be flexible & reviewed from time to time as it is not possible to anticipate all the contingencies at the early stage.

The Accountant General should share all significant refinements in the approach & additional tests & findings, concurrently with other audit teams when different persons conduct the audit at different locations. The system of sharing of the significant field audit experience should be documented & reviewed.

INTERNAL AUDIT, MANAGEMENT & OPERATIONAL AUDIT

QUESTION : 22

One of the independent directors sought information regarding the appointment of internal auditors for following Group Companies in accordance with the Companies Act, 2013 of which certain Financial Information are given below:

Figures are in ₹ crore & correspond to the previous year.

Name	Nature	Equity Share Capital	Turnover	Loan from Bank & PFI	Public Deposits
AADI Ltd.	Listed	100	190	50	24
AJIT Ltd.	Unlisted Public	60	190	50	24
NEMI Ltd.	Unlisted Private	60	190	50	-

You are required to evaluate the requirements of the Companies Act, 2013 regarding the appointment of internal Auditors for the Group Companies. Discuss.

ANSWER : 22

Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, following class of companies (prescribed in Rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

- (A) every listed company;
- (B) every unlisted public company having-
 1. paid up share capital of ₹ 50 crores or more during the preceding financial year; or
 2. turnover of ₹ 200 crores or more during the preceding financial year; or
 3. outstanding loans or borrowings from banks or public financial institutions exceeding ₹ 100 crores or more at any point of time during the preceding financial year; or
 4. outstanding deposits of ₹ 25 crores or more at any point of time during the preceding financial year; &
- (c) every private company having-
 1. turnover of ₹ 200 crores or more during the preceding financial year; or
 2. outstanding loans or borrowings from banks or public financial institutions exceeding ₹ 100 crores or more at any point of time during the preceding financial year.

In the given case, AADI Ltd. is a listed company. As per section 138 of the Companies Act, 2013, every listed company is required to appoint an internal auditor or a firm of internal auditors. Thus, in view of the above, AADI Ltd. is required to appoint an internal auditor.

Further, AJIT Ltd. is unlisted public company. The company is having ₹ 60 crore as equity share capital which is exceeding the prescribed limit of ₹ 50 crores as per section 138. Thus, AJIT Ltd. is required to appoint an internal auditor as per section 138 of the Companies Act, 2013.

NEMI Ltd. is unlisted private company & having ₹ 60 crore as equity share capital, ₹ 190 crore as turnover & ₹ 50 crore loan from Bank & PFI. In view of provisions of section 138 of the Companies Act, 2013 discussed above, all the limits are below the prescribed limit for a private company. Therefore, NEMI Ltd. is not required to appoint an internal auditor.

It can be concluded that AADI Ltd. & AJIT Ltd. is required to appoint the internal auditor as per the provisions of the Companies Act, 2013 whereas NEMI Ltd. is not required to do the same.

DUE DILIGENCE, INVESTIGATION & FORENSIC AUDIT

QUESTION : 23

Shipra recently qualified as a Chartered Accountant & started her own practice. One of her friends told her that Forensic Audit is a new area & has a lot of potential in terms of professional opportunities & remuneration. Seema said that there is nothing new in this as ultimately forensic audit is also like other audits. Do you agree with the views of Seema? Support your answer with relevant explanation.

ANSWER : 23

A forensic accountant will often look for indications of fraud that are not subject to the scope of a financial statement audit. Forensic Accounting has an Investigative mentality" however auditing is done with "professional scepticism". A forensic accountant will often require more extensive corroboration. A forensic accountant may focus more on seemingly immaterial transactions. Therefore, the contention of Seema is not correct that ultimately forensic audit is also like other audits.

Difference between forensic audit & other audits

Sr.No	Particulars	Other Audits	Forensic Audit
1.	Objectives	Express an opinion as to 'True & Fair' presentation.	Whether fraud has actually taken place in books.
2.	Techniques	Substantive & Compliance. Sample based.	Investigative, substantive or in-depth checking.
3.	Period	Normally for a particular accounting period.	No such limitations.
4.	Verification of stock, Estimation of the realisable value of assets, provisions, liability etc.	Relies on the management certificate/Management Representation.	Independent/verification of suspected/selected items where misappropriation is suspected.
5.	Off balance sheet items (like contracts etc.)	Used to vouch the arithmetic accuracy & compliance with procedures.	Regulatory & propriety of these transactions/contracts are examined.
6.	Adverse findings if any	Negative opinion or qualified opinion expressed with/without quantification.	Legal determination of fraud impact & identification of perpetrators depending on scope.

PROFESSIONAL ETHICS**QUESTION : 24**

- (a) Mr. Avi, a newly qualified Chartered Accountant, started his practice & sought clients through telephone calls from his family & friends, almost all of them employed in one or the other retail trade business. One of his friends Mr. Ravi gave him an idea to start online services & give stock certifications to traders with Cash Credit Limits in Banks. Mr. Avi started a website with colourful catchy designs & shared the website address on his all social media posts & stories & tagged 40 traders of his local community with the caption "Simple Online Stock Certification Services". Besides, Mr. Avi entered into an agreement with a Digital Marketer to give him 8% commission on each service procured through him. Discuss if the actions of Mr. Avi are valid in the light of the Professional Ethics & various pronouncements & guidelines issued by ICAI.
- (b) CA Sheetal is contesting Central Council Elections of Institute, engages his Articled Assistant for his election campaigning promising him that he will come in contact with influential people which will help to enhance his career after completion of his training period. Comment on the action of CA. Sheetal with reference to the CA Act, 1949 & Schedules thereto.

ANSWER : 24

- (a) As per Clause (6) of Part I of the First Schedule of the CA Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means.
- Mr. Avi is wrong in seeking clients through family & friends. Creating a website is not a non-compliance provided it is in line with the guidelines issued by the Institute in this regard. One of the guidelines is that the website should not be in push mode. Further, mentioning of clients' names is also prohibited as per the guidelines.
- In the given situation, Mr. Avi shared the website address on his all social media posts & stories & tagged 40 traders of his local community with the caption "Simple Online Stock Certification Services" mentioning his current clients as well. This is in complete contravention of the guidelines on the website issued by the ICAI.
- Thus, CA, Avi would be held guilty of professional misconduct under clause 6 of Part 1 of First Schedule of the CA Act, 1949.
- (b) Other Misconduct: CA Sheetal has engaged his Articled Assistant for his election campaigning for the Central Council elections of ICAI.

This aspect is covered under 'Other Misconduct' which has been defined in Part IV of the First Schedule & Part III of the Second Schedule. These provisions empower the Council even if it does not arise out of his professional work. This is considered necessary because a Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs & any deviation from these standards, even in his non-professional work, would expose him to disciplinary action.

Thus, when a Chartered Accountant uses the services of his Articled Assistant for purposes other than professional practice, he is found guilty under 'Other Misconduct'.

Hence, CA Sheetal is guilty of 'Other Misconduct'.

QUESTION : 25

Write a short note on the following:

- (a) Eligibility to be a Reviewer in case of Peer Review.
- (b) Reporting in case the parent company's auditor is not the auditor of all its components.
- (c) Relationship between the overall audit strategy & the audit plan.

ANSWER : 25

(a) Eligibility to be a Reviewer

1. A Peer Reviewer shall: -

- (a) Shall be a member in practice with at least 7 years of audit experience.
- (b) In case a member has moved from industry to practice & is currently in practice he should have at least 10 years of audit experience in the industry & at least 3 years of audit experience in practice.
- (c) Should have undergone the requisite training & cleared the requisite test for Peer Review as prescribed by the Board.

2. A member on being appointed as a Reviewer shall be required to furnish -

- (a) a declaration as prescribed by the Board, at the time of Empanelment as a Peer Reviewer.
- (b) a Declaration of Confidentiality as per Annexure A to this Statement while giving consent for appointment as a Peer Reviewer.

3. A member shall not be eligible for being appointed as a Reviewer of a Practice Unit, if -

- (i) any disciplinary action/proceeding is pending against him,
- (ii) he has been found guilty of professional or other misconduct by the Council or the Board of Discipline or the Disciplinary Committee at any time,
- (iii) he has been convicted by a competent court whether within or outside India, of an offence involving moral turpitude & punishable with imprisonment,
- (iv) he or his partners have any obligation or conflict of interest in the Practice Unit.
- (v) He has undergone training/articleship under any of the partner of the Practice Unit.

4. A Reviewer shall not accept any professional assignment from the Practice Unit for a period of the next two years from the date of appointment. Further, he should not have accepted any professional assignment from the Practice Unit for a period of two years before the date of appointment as a reviewer of that Practice Unit.

- (b) **Reporting in case the Parent Company'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.

As prescribed in SA 706, 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 & cash flows of components included in the consolidated financial statements not audited by the parent's auditor.

Total assets, revenues & cash flows not audited by the parent's auditor should be presented before giving effect to permanent & 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 & its subsidiaries.

- (c) **Relationship between the Overall Audit Strategy & the Audit Plan:** The audit strategy is prepared before the audit plan. The audit plan is more detailed than the overall audit strategy. Audit strategy & audit plan are inter-related because a change in one would result into a change in the other. The audit strategy provides the guidelines for developing the audit plan. It establishes the scope & conduct of the audit procedures & thereby, works as a basis for developing a detailed audit plan. Detailed audit plan would include the nature, timing & extent of the audit procedures so as to obtain sufficient appropriate audit evidence.

The overall audit strategy & Audit plan should take into consideration the element of materiality & its relationship with Risks & procedures to be adopted. It is summarized as under:-

High Materiality	Detailed Procedures	High Risks
Low Materiality	Test Checks	Low Risks



CA FINAL – ADVANCED AUDITING & PROFESSIONAL ETHICS

RTP – NOVEMBER 2021

QUESTIONS PART A: MULTIPLE CHOICE QUESTIONS

INTEGRATED CASE SCENARIO 1.

Kiwapack Ltd. is an unlisted public company incorporated in the year 2009, having 90 shareholders with an equity share capital of ₹ 27 lakhs. There are total four directors in its board.

For the financial year 2020-21 as well as for the quarter ended on 30th June, 2021, Kiwapack Ltd. had suffered a loss. Despite of such loss, the board of Kiwapack Ltd. declared a total interim dividend of ₹ 20 lakhs for quarter ended March, 2021 on 25th April, 2021.

The details of dividends declared by Kiwapack Ltd. during preceding financial years are tabulated, as below:-

Financial Year	Rate of Dividend Declared
2019-20	12%
2018-19	16%
2017-18	10%
2016-17	15%
2015-16	20%
2014-15	14%

The said dividend was paid to the shareholders on 10th June, 2021, through account payee cheque, by withdrawing an amount of 5% from the total free reserves available with Kiwapack Ltd. The balance of free reserves after such withdrawal fell to 20% of its paid up share capital as appearing in the latest audited financial statements.

One of the shareholders, Mr. Mahesh, had submitted a transfer deed to the company on 28th April, 2021, for registration relating to transfer of all shares held by him in Kiwapack Ltd. in the name of Mr. Govardhan, along with an authorization letter for paying the amount of dividend on his shares to Mr. Govardhan.

However, till 10th June, 2020, due to certain reasons, Kiwapack Ltd. could not register the aforesaid transfer of shares in the name of Mr. Govardhan.

The dividend remaining unpaid of ₹ 2 lakhs was transferred to the unpaid dividend account by the company on 15th June, 2021.

Kiwapack Ltd. prepared a statement on 30th September, 2021, containing the names of shareholders to whom payment of dividend had remained pending, their last known addresses & the amount of dividend to be paid to them. The said statement was placed on the same date on the company's website & also on the website approved by the Central Government for this purpose.

Rao & Co. is the statutory auditor of Kiwapack Ltd. for F.Y. 2020-21 which issued its audit report on 30th June, 2021 on the financial statements approved on 20th June, 2021.

On the basis of the abovementioned facts, you are required to answer the following MCQs:

QUESTION NO.: (1-5)

- At what maximum rate, the board of Kiwapack Ltd. would have declared the interim dividend for quarter ended March, 2021?
 - 10.6%.
 - 12.67%.
 - 14.5%.
 - 15%.
- How much amount of interest shall be payable by Kiwapack Ltd. for delay in payment of dividend to the shareholders?
 - ₹ 13,151.

- (b) ₹ 8,877.
 - (c) ₹ 10,521
 - (d) ₹ 15,781
- 3. In which account, Kiwspack Ltd. would have transferred the dividend amount in relation to shares which were held by Mr. Mahesh?**
- (a) Account of Mr. Mahesh.
 - (b) Account of Mr. Govardhan.
 - (c) Unpaid Dividend Account.
 - (d) Investor Education & Protection Fund.
- 4. How much maximum amount of fine could be levied on every director of the company who was knowingly a party to the default in payment of dividend to the shareholders?**
- (a) ₹ 9,000.
 - (b) ₹ 11,000.
 - (c) ₹ 16,000.
 - (d) ₹ 1,00,000.
- 5. By what date, the unpaid or unclaimed dividend amount should have been transferred to Unpaid Dividend Account & also by what date, the statement in relation to details of such Unpaid Dividend should have been prepared by Kiwspack Ltd. & placed on its website?**
- (a) 01st June, 2021 & 13th September, 2021, respectively.
 - (b) 25th May, 2021 & 15th July, 2021, respectively.
 - (c) 01st June, 2021 & 15th July, 2021, respectively.
 - (d) 25th May, 2021 & 13th September, 2021, respectively.

INTEGRATED CASE SCENARIO 2

Ulip Ltd. is a public company listed on the National Stock Exchange since the year, 2015, with share capital of ₹ 150 crore.

SRS & Co. is being appointed as its statutory auditor for F.Y. 2020-21 & Mr. Raj is appointed as the engagement partner, on behalf of the firm, to conduct the said audit assignment including conducting of limited reviews & other statutory assignments.

Mr. Raj was conducting limited review for second quarter & during the same while adhering to the responsibilities as conferred upon by SA 250, "Consideration of Laws & Regulations in an Audit of Financial Statements", he evaluated the implications of non-compliance in relation to other aspects of the audit, including the auditor's risk assessment & the reliability of written representations & concluded that withdrawal from engagement was necessary in the given circumstances, after seeking legal advice, even though the non-compliance was not material to the financial statements but as the management or those charged with governance refrained from taking the remedial action that he considered appropriate in the circumstances. Such a withdrawal was not prohibited by any law or regulation.

Mr. Raj, on behalf of SRS & Co., brought to the notice of the Audit Committee of Ulip Ltd., all his concerns with respect to the proposed resignation, along with relevant documents.

After issuing the necessary reports, as required in the circumstances, SRS & Co gave its resignation letter to Ulip Ltd. at 1:00 p.m. on 20th November, 2021 vide its official email-id, which contained the detailed reasons for such resignation.

Such a letter was forwarded to the stipulated authority by Ulip Ltd. at 4:00 p.m. on 21 st November, 2021 vide its official email-id.

SRS & Co. filed the statement with respect to its resignation as a statutory auditor in prescribed form with Ulip Ltd. & the Registrar on 15th January, 2021, respectively, after receiving a notice from MCA.

For the purpose of filling the casual vacancy in the office of auditor, the Audit Committee of Ulip Ltd. gave recommendation of an audit firm for being appointed as the statutory auditor to which the Board disagreed & it referred back the recommendation to the committee for reconsideration citing reasons for such disagreement.

However, the Audit Committee, after considering the reasons given by the Board, decided not to reconsider its original recommendation, so, the Board of Ulip Ltd. after recording the reasons for its disagreement with the committee appointed Chavda & Co. as its new statutory auditor on 15th December, 2021.

Such an appointment of Chavda & Co. was also approved by the members of Ulip Ltd. at a duly convened general meeting on 3rd February, 2022.

On the basis of the abovementioned facts, you are required to answer the following MCQs:

Question No.: (6-10)

6. Whether the reasons for withdrawal from the engagement by SRS & Co. can be considered to be justifiable in the light of the fact that the non-compliance was not material to the financial statements?
 - (a) Yes, as such a withdrawal was not prohibited by any law or regulation.
 - (b) Yes, as the auditor had obtained legal advice for the same & also such a withdrawal was not prohibited by any law or regulation.
 - (c) Yes, in exceptional cases, the auditor may consider for such withdrawal provided that such a withdrawal is not prohibited by any law or regulation.
 - (d) Yes, as it does not matter whether non-compliance is material or not, management or those charged with governance should not refrain from taking the remedial action which the auditor has considered necessary, provided that such a withdrawal is not prohibited by any law or regulation.
7. In continuation of Question no. 6, above, if it is assumed that the auditor was prohibited by any law or regulation from such withdrawal from engagement, then how he would have reported the non-compliance in the audit report?
 - (a) In the "Basis for Qualified Opinion" paragraph.
 - (b) In the Other Matter(s) paragraph.
 - (c) the Emphasis of Matter(s) paragraph.
 - (d) In the "Basis for Disclaimer of Opinion" paragraph.
8. Ulip Ltd. was required to disclose to which authority, the detailed reasons for resignation of the auditor & by what time limit as per LODR 2015?
 - (a) Such reasons were required to be disclosed to MCA till 1:00 p.m. - 21st November, 2021.
 - (b) Such reasons were required to be disclosed to NSE & SEBI till 1:00 p.m. - 23rd November, 2021.
 - (c) Such reasons were required to be disclosed to NSE till 1:00 p.m. - 21st November, 2021.
 - (d) Such reasons were required to be disclosed to the Registrar till 1:00 p.m. - 22nd November, 2021.
9. What could be the penalty specified under the Company Act, 2013 that could be levied upon SRS & Co. for failure in filing the statement with respect to its resignation, within the prescribed time limit, with Ulip Ltd. & the Registrar, respectively, if its remuneration was ₹ 40,000?
 - (a) ₹ 62,500.
 - (b) ₹ 50,000.
 - (c) ₹ 40,000.
 - (d) ₹ 52,500.
10. What was the last date available with board of Ulip Ltd. for filing the casual vacancy in the office of the auditor & by what last date, the general meeting for approving the auditor as appointed by the board should have been made in accordance with the provisions of the Companies Act, 2013?
 - (a) 27th November, 2021 & 27th February, 2022.
 - (b) 20th December, 2021 & 15th February, 2022.
 - (c) 20th January, 2021 & 20th April, 2022.
 - (d) 20th December, 2021 & 15th March, 2022.

PART A : ANSWERS TO MULTIPLE QUESTIONS

1	(b)	2	(d)	3	(b)	4	(c)	5	(a)	6	(c)	7	(b)	8	(c)	9	(d)	10	(d)
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PART B : DESCRIPTIVE QUESTIONS**STANDARDS ON AUDITING, STATEMENTS & GUIDANCE NOTES****QUESTION : 11**

The audit report of Kolsi (P) Ltd. for F.Y. 2020-21 was issued by Bishnoi & Co. on 25th July, 2021. However, a case was filed against Kolsi (P) Ltd. on 4th August, 2021, with the Civil Court, with respect to an incident caused in its factory on 17th January, 2021, the outcome of which may result in paying heavy penalty by Kolsi (P) Ltd.

Mr. Raj Bishnoi, the partner of Bishnoi & Co., discussed the said matter with the management & it was determined to amend the financial statements for F.Y. 2020-21. Further, Mr. Raj inquired how the management intended to address the said matter in the financial statements to which he was told that the said matter was going to be disclosed as a "Contingent Liability for a Court case" to the foot note in the balance sheet with no additional disclosures.

The management told Mr. Raj that such disclosure was enough as he would further going a description of the said court case & its outcome in the 'Emphasis of Matter' paragraph in his amended audit report.

In the context of aforesaid case scenario, please answer the following questions:-

- (a) Whether Mr. Raj on behalf of Bishnoi & Co., has properly adhered to his responsibilities in accordance with SA 560, on becoming aware of the court case filed against Kolsi (P) Ltd.?
- (b) Whether the contention of management of Kolsi (P) Ltd. is valid with respect to the disclosure of the court case in the financial statements?

ANSWER : 11

- (a) As per SA 560, 'Subsequent Events', the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall:
 1. Discuss the matter with management &, where appropriate, those charged with governance.
 2. Determine whether the financial statements need amendment &, if so,
 3. Inquire how management intends to address the matter in the financial statements.

In the given case, on becoming aware of the court case filed against Kolsi (P) Ltd., Mr. Raj discussed the said matter with the management & it was determined to amend the financial statements. Also, he inquired how the management intended to address the said matter in the financial statements.

However, If management does not take the necessary steps to ensure that anyone in receipt of the previously issued financial statements is informed of the situation & does not amend the financial statements in circumstances where Mr. Raj (hereinafter referred as 'the auditor') believes they need to be amended, the auditor shall notify management &, those charged with governance (unless all of those charged with governance are involved in managing the entity), that the auditor will seek to prevent future reliance on the auditor's report. If despite such notification the management or those charged with governance do not take these necessary steps, the auditor shall take appropriate action to seek to prevent reliance on the auditor's report in accordance with SA 560.

- (b) As per SA 706, 'Emphasis of Matter Paragraphs & Other Matter Paragraphs in the Independent Auditor's Report', an Emphasis of Matter paragraph is not a substitute for:
 - (a) A modified opinion in accordance with SA 705 when required by the circumstances of a specific audit engagement;
 - (b) Disclosures in the financial statements that the applicable financial reporting framework requires management to make, or that are otherwise necessary to achieve fair presentation; or
 - (c) Reporting in accordance with SA 570 when a material uncertainty exists relating to events or conditions that may cast significant doubt on an entity's ability to continue as a going concern.

In the given case, the management of Kolsi (P) Ltd. has presumed that as the auditor was going to provide a description of the said court case & its outcome in the 'Emphasis of Matter' paragraph in his amended audit report, there was no further need for it to provide additional disclosures about the court case in the financial statements.

The said contention of management of Kolsi (P) Ltd. is not valid as 'Emphasis of Matter' paragraph cannot be used as a substitute for disclosures required to be made in the financial statements as per the applicable financial reporting framework or that is otherwise necessary to achieve fair presentation, which is the responsibility of the management.

QUESTION : 12

While formulating the audit plan & responding to the risks of material misstatement identified & assessed in related party transaction & relationships, Ms. K the engagement manager of the audit team of ABC Limited, decided to rely upon the internal controls placed for identification & disclosure of related party relationships & transactions in accordance with the applicable financial reporting framework.

You are requested to guide Ms. K regarding the necessity to test the controls to obtain sufficient & appropriate audit evidence. Also guide, whether Ms. K can use the audit evidence obtained, regarding operative effectiveness of control on identification & disclosure of related party relationships & transactions, in the interim period.

ANSWER : 12

As per SA 550, "Related Parties", according to para on "Responses to the risks of material misstatement associated with related party relationships & transactions", the auditor should design & perform further audit procedures to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement associated with related party relationships & transactions.

Further, as per SA 330, "The Auditor's Responses to Assessed Risks", the auditor shall design & perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls when:

- the auditor's assessment of risks of material misstatement at the assertion level includes an expectation that the controls are operating effectively (i.e., the auditor intends to rely on the operating effectiveness of controls in determining the nature, timing & extent of substantive procedures); or
- Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level.

In designing & performing tests of controls, the auditor shall obtain more persuasive audit evidence the greater the reliance the auditor places on the effectiveness of a control. Moreover, the auditor shall test controls for the particular time, or throughout the period, for which the auditor intends to rely on those controls, subject to when the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, & the timing of test of controls over significant risks, in order to provide an appropriate basis for the auditor's intended reliance.

When the auditor obtains audit evidence about the operating effectiveness of controls during an interim period, the auditor shall:

- Obtain audit evidence about significant changes to those controls subsequent to the interim period; &
- Determine the additional audit evidence to be obtained for the remaining period.

In the current case, Ms. K shall design & perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls as she intends to rely on the operating effectiveness of controls in determining the nature, timing & extent of substantive procedures.

Further, she is also required to obtain the audit evidence about significant changes to those controls subsequent to the interim period along with the additional audit evidence to be obtained for the remaining period in accordance with the requirements of Standards on Auditing as discussed above.

THE COMPANY AUDIT & AUDIT REPORT

QUESTION : 13

AB & Co. were appointed auditors for NOME Limited, a listed company, for the term of two five consecutive years from 2010-11, 2011-12, 2012-13, 2013-14, 2014-15, 2015-16, 2016-17, 2017-18, 2018-19, 2019-20. As per the provision of the section 139(2)(b) "No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint an audit firm as auditor for more than two terms of five consecutive years".

Hence, Management of NOME Limited reached out (based on the recommendation of Audit Committee) to BCD & Co. for their nomination as the appointment of Statutory Auditor for the financial year 2020-21. However, BCD & Co. did not provide any written consent to such appointment neither they provided a certificate that the appointment, if made, shall be in accordance with the conditions laid in the Act & Rules therein.

Still the management went ahead & proposed an appointment in AGM & BCD & Co. were appointed as an auditor for the financial year 2020-21. Post appointment, those charged with governance identified that majority of the partners in the BCD & Co. are same which were there in AB & Co. Now, fearing the contravention of the provision of Companies Act, 2013. Management, on guidance of those charged with governance, decided to file a complaint with tribunal u/s 140(5) of the Companies Act against statutory auditors.

You are required to guide the BCD & Co. regarding the contravention of the provisions of the Companies Act, 2013 with respect to appointment of Auditor.

ANSWER : 13

As per section 139(1) of the Companies Act, 2013, every company shall, at the first annual general meeting, appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting & thereafter till the conclusion of every sixth meeting & the manner & procedure of selection of auditors by the members of the company at such meeting shall be such as may be prescribed.

It may be noted further that before such appointment is made, the written consent of the auditor to such appointment, & a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.

It may also be noted that the certificate shall also indicate whether the auditor satisfies the criteria provided in section 141 of the Companies Act, 2013.

Further, as per section 139(2), "(2) No listed company or a company belonging to such class or classes of companies as may be prescribed, shall appoint or re-appoint (a) an individual as auditor for more than one term of five consecutive years; & (b) an audit firm as auditor for more than two terms of five consecutive years.

It may also be noted further that as on the date of appointment no audit firm having a common partner or partners to the other audit firm, whose tenure has expired in a company immediately preceding the financial year, shall be appointed as auditor of the same company for a period of five years."

In the current case, while appointing the auditors of the company a written consent of the auditor to such appointment was not obtained. Moreover a certificate from him that the appointment if made shall be in accordance with the conditions laid down in the Act & Rules was also not obtained. Further, majority of the partners of AB & Co. were partners in BCD & Co. AB & Co. already served two terms of five consecutive years i.e., from 2010-11 to 2019-20 as a statutory auditor of the company.

Hence, BCD & Co. were not eligible to be appointed as an auditor of NOME Limited as all partners of BCD & Co are partner of AB & Co. who have already served two terms of five consecutive years as an auditor of NOME Limited. Since, before the appointment of Statutory Auditor, the management should have obtained the required certification & written consent from BCD & Co., therefore, in this case both, the management & the auditors have contravened the provision of the Companies Act, 2013 as a result fine as per section 147 of Companies Act will be applicable i.e. if any of the provisions of sections 139 to 146 (both inclusive) is contravened, the company shall be punishable with fine which shall not be less than ₹ 25,000 but which may extend to ₹ 500,000 & every officer of the company who is in default shall be punishable with fine which

shall not be less than ₹ 10,000 but which may extend to ₹ 100,000. If an auditor of a company contravenes any of the provisions of section 139, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than ₹ 25,000, but which may extend to ₹ 500,000 or four times the remuneration of the auditor, whichever is less.

It may be noted that if an auditor has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year & with fine which shall not be less than ₹ 50,000, but which may extend to ₹ 25,00,000 or eight times the remuneration of the auditor, whichever is less.

QUESTION : 14

Mr. Hemant Ramsey was appointed as the engagement partner for conducting the audit of Kshetra Lap Ltd. for F.Y. 2020-21, on behalf of Ramsey & Associates. Mr. Vishay Tyagi was appointed as the engagement quality control reviewer by the firm for the said audit.

During F.Y. 2020-21, there was an implementation of ERP system in a phased manner, in Kshetra Lap Ltd. due to which some of its business processes got automated. As a result of the implementation of such a system, there was a significant effect on the auditor's overall audit strategy. Mr. Hemant discussed the implementation of such a system with Mr. Vishay & also told him that such a matter may be a key audit matter to be reported in the audit report.

Mr. Vishay considered the significance of such matter but however he was of the opinion that such a matter did not appear to link with the matters disclosed in the financial statements & so there was no need to disclose such matter as a key audit matter.

Whether the contention of Mr. Vishay is proper with respect to the matters to be communicated as a key audit matter?

ANSWER : 14

As per SA 701, 'Communicating Key Audit Matters in the Independent Auditor's Report', the auditor shall determine, from the matters communicated with those charged with governance, those matters that required significant auditor attention in performing the audit. In making this determination, the auditor shall take into account the following:

- (i) Areas of higher assessed risk of material misstatement, or significant risks identified in accordance with SA 315.
- (ii) Significant auditor judgments relating to areas in the financial statements that involved significant management judgment, including accounting estimates that have been identified as having high estimation uncertainty.
- (iii) The effect on the audit of significant events or transactions that occurred during the period.

The auditor shall determine which of the aforesaid matters considered were of most significance in the audit of the financial statements of the current period & therefore are the key audit matters.

These aforesaid considerations focus on the nature of matters communicated with those charged with governance. Such matters are often linked to matters disclosed in the financial statements & are intended to reflect areas of the audit of the financial statements that may be of particular interest to intended users.

The fact that these considerations are required is not intended to imply that matters related to them are always key audit matters; rather, matters related to such specific considerations are key audit matters only if they are determined to be of most significance in the audit.

In addition to matters that relate to the specific required considerations, there may be other matters communicated with those charged with governance that required significant auditor attention & that therefore may be determined to be key audit matters. Such matters may include, for example, matters relevant to the audit that was performed that may not be required to be disclosed in the financial statements. For example, the implementation of a new IT system (or significant changes to an existing IT system) during the period may be an area of significant auditor attention, in particular if such a change had a significant effect on the auditor's overall audit strategy or related to a significant risk (e.g., changes to a system affecting revenue recognition).

In the given case, there was implementation of ERP system in the company due to which some of its business processes got automated & which had a significant effect on the auditor's overall audit strategy during the period.

Accordingly, such a matter can be considered as a key audit matter if according to Mr. Hemant, such a matter required significant attention that had affected his overall audit strategy.

Thus, the contention of Mr. Vishay is not proper as matters that do not link with the matters disclosed in the financial statements can also be considered as a key audit matter if it required significant attention of the auditor which had an impact on its audit.

AUDIT COMMITTEE & CORPORATE GOVERNANCE

QUESTION : 15

Kayask Ltd. is a public company which got listed on BSE & NSE in the F.Y. 2015-16 & is amongst the top 500 listed entities on the basis of market capitalization. JP Bhuj & Co., a CA firm, has been appointed as its statutory auditor for the F.Y. 2020-21.

Mr. Pankaj Bhuj was assigned its audit as an engagement partner & he was verifying the composition of the Board of Director because of some changes in the same. The present composition of the Board of Kayask Ltd. is as follows: -

1. There are 9 directors out of which there are 4 non-executive directors & 3 independent directors. The board has only one woman director & she is an executive director.
2. Mr. Madhusudan Mehra has been appointed as the non-executive chairperson of the Board. He is brother in law of the Managing Director of Kayask Ltd.

Whether present composition of the board of Kayask Ltd. complies with the requirement of the provisions of SEBI LODR Regulations?

ANSWER : 15

As per Regulation 17 & 17A of the SEBI LODR Regulations, -

- The auditor should ascertain whether, throughout the reporting period, the Board of Directors comprises an optimum combination of executive & non-executive directors, with at least one woman director & not less than 50% of the Board of Directors comprising non-executive directors.
It may be noted that the Board of directors of the top 1000 listed entities shall have at least one independent woman director.
- The auditor should also verify that where the Chairperson of the Board is a nonexecutive director, at least one-third of the Board should comprise of independent directors.
- The auditor shall ensure that the Chairperson of the board of the top 500 listed entities is - (a) a non-executive director; (b) not related to the Managing Director or the Chief Executive Officer as per the definition of the term "relative" defined under the Companies Act, 2013.

As per the term "relative" defined under the Companies Act, 2013 - Brother-in-law i.e. sister's husband is not included.

In the given case, Kayask Ltd. is a public company which got listed on BSE & NSE in the F.Y. 2015-16 & is amongst the top 500 listed entities on the basis of market capitalization. The present composition of the board of Kayask Ltd includes 9 directors out of which there are 4 non-executive directors & 3 independent directors. The board has only one woman director & she is an executive director. In addition, Chairperson of the Board Mr. Madhusudan Mehra is brother in law of the Managing Director of Kayask Ltd. & has been appointed as the non-executive Chairperson.

In view of Regulation 17 & 17A of the SEBI LODR Regulations, there should at least 5 non-executive directors & 3 Independent directors as its Chairperson is a non-executive director.

Further as the company is amongst the top 500 listed entities, at least one independent woman director should be there in its board.

Thus, it can be concluded that the present composition of the board of Kayask Ltd. does not comply with the requirement of the provisions of SEBI LODR Regulations as the woman director should be an independent director & there should be 5 non-executive directors

AUDIT OF BANKS & INSURANCE COMPANY**QUESTION : 16**

- (a) Gupta & Co. has been appointed as a statutory auditor of TCB Bank Ltd., a private sector bank, registered with RBI. Mr. Kaival Gupta, the engagement partner, while performing the audit as per the checklist, noted down the following points, which would be part of the audit queries, as tabulated below:

Sr.No.	Queries
1	Interest on State Government Guaranteed advance has been taken to income even though such advance has remained overdue for more than 90 days.
2	There is an account for which an ad hoc limit has not been reviewed for 180 days from the date of such ad hoc sanction & such account has been treated as a performing asset in the books.
3	One of the NPAs was sold for a value higher than the net book value. Profit was not recognized but the excess provision in respect of the same has been reversed.
4	In case of one of the accounts, an additional temporary limit has been sanctioned for 25% of the existing limit & for 120 days tenure.
5	On verification of outstanding forward exchange contracts, the 'net position' in respect of one of the foreign currencies was not squared & was uncovered by a substantial amount.

You are required to provide the reasons due to which such queries would have been raised by Mr. Kaival & describe the actions that may be taken by the person responsible on behalf of TCB Bank Ltd. for solving such queries.

- (b) You have been appointed to carry out the audit of 'The Blue Insurance Company Ltd.' for the year 2019-20. In the course of your audit, you observed that the commission paid to agents constituted a major expense in operating expenses of the Company. Enumerate the audit concerns that address to the assertions required for the Auditor to ensure the continued existence of internal control as well as fairness of the amounts in accounting of commission paid to agents.

ANSWER : 16 (a)

Sr.No	Reason for such Query	Action that may be taken in response to the query
1	A State Government Guaranteed advance has to be treated as NPA even if it remains overdue for more than 90 days & in case of NPA, for the purpose of income recognition, interest on such advance should not be taken to income unless interest is realized.	Interest income recognized on such advance would be reversed & would be taken to income only when it is realized.
2	Accounts for which an ad hoc limit has not been reviewed for 180 days from the date of such ad hoc sanction, should be considered as NPA.	It's treatment in the books would be changed from performing asset to a non-performing asset from the date when such change in the treatment was required.
3	In case of sale of NPA, where the sale is for a value higher than the NBV, the auditor is required to ensure that no profit is recognized, & the excess provision has not been reversed but retained to meet the shortfall/ loss that may arise because of the sale of other	The entry for reversal of the excess provision would be cancelled in the books & such excess provision would be retained to meet the shortfall/ loss that may arise because of the sale of other non-performing financial assets.

	nonperforming financial assets.	
4	Additional temporary limit may be sanctioned, for a maximum of 20% of the existing limit & 90 days maximum tenure.	The terms of additional temporary limit in case of such account would be revised to 20% of the existing limit & for 90 days maximum tenure.
5	Net position in respect of each of the foreign currencies should be generally squared & should not be uncovered by a substantial amount.	The net "position" of the branch in relation to each foreign currency should be squared off & get covered by a substantial amount.

- (b) **Commission/Brokerage:** The commission is the consideration payable for getting the insurance business. The term 'commission' is used for the payment of consideration to get Direct business. Commission received on amount of premium paid to a re-insurer is termed 'Commission on reinsurance accepted' & is reduced from the amount of commission expenditure. The internal control with regard to commission is aimed at ensuring that commission is paid in accordance with the rules & regulations of the company & in accordance with the agreement with the agent, commission is paid to the agent who brought the business & the legal compliances, for example, tax deduction at sources, GST on reverse charge mechanism & provisions of the Insurance Act, 1938 have been complied with.

It is a well-known fact that insurance business is solicited by insurance agents. The remuneration of an agent is paid by way of commission which is calculated by applying a percentage to the premium collected by him. Commission is payable to the agents for the business procured through them & is debited to Commission on Direct Business Account. There is a separate head for commission on reinsurance accepted which usually arise in case of Head Office. It may be noted that u/s 40 of Insurance Act, 1938, no commission can be paid to a person who is not an agent of the insurance company. Commission cannot be paid in excess of the maximum rates of commission as framed by IRDAI. The rates of commission/brokerage are agreed & documented with the agent & filed with IRDAI.

Role of Auditor: The auditor should, inter alia, do the following for verification of commission:

- ➔ Ensure that commission/brokerage is not paid in excess of the limits specified by IRDAI
- ➔ Ensure that commission/brokerage is paid as per rates with the agent & rates filed with IRDAI
- ➔ Ensure that commission/brokerage is paid to the agent/broker who has solicited the business
- ➔ Ensure that the agent/broker is not blacklisted by IRDAI & is not terminated for fraud etc.
- ➔ Vouch disbursement entries with reference to the disbursement vouchers with copies of commission bills & commission statements.
- ➔ Check whether the vouchers are authorised by the officers-in-charge as per rules in force & income tax is deducted at source, as applicable.
- ➔ Test check correctness of amounts of commission allowed.
- ➔ Scrutinise agents' ledger & the balances, examine accounts having debit balances, if any, & obtain information on the same. Necessary rectification of accounts & other remedial actions have to be considered.
- ➔ Check whether commission outgo for the period under audit been duly accounted.

AUDIT UNDER FISCAL LAWS

QUESTION : 17

UT & Co. is a Chartered Accountant Firm, that provides consultancy services. Recently, it got queries from different clients with respect to applicability of tax audit provisions to their businesses.

In response to such queries, UT & Co., asked from them details such as turnover, total receipts & total payments made during the year respectively along with mode of receipt/payment, whether filing return of Income under normal tax provisions or presumptive tax provisions such as section 44AD, 44AE, etc.

So, in the trailing mail, UT & Co., got the aforesaid details from different clients, which it classified into following categories for ease of framing an opinion, as follows:

Client Sr. No.	Turnover (₹ in crore)	% of Cash Receipts in Total Receipts	% of Cash Payments in Total Payments	Remarks
1	9.5	5%	5%	Has been filing return as per the regular provisions of income tax.
2	1.8	7%	4%	Has declared business income as per presumptive taxation u/s 44AD of the Income-tax Act, 1961.
3	0.85	6%	4%	Has declared business income as per presumptive taxation u/s 44AD of the Income-tax Act, 1961 during last 2 previous years but during current previous year has declared income lower than as per section 44AD & the total income is less than basic exemption limit.
4	3.2	8%	6%	Has declared business income as per presumptive taxation u/s 44AE of the Income-tax Act, 1961 during last 4 previous years but during current previous year has declared income lower than as per section 44AE & the total income is less than basic exemption limit.

On behalf of UT & Co., please provide your opinion, along with reasons, as a consultant in case of aforesaid clients that whether tax audit is applicable to them or not?

ANSWER : 17

Applicability of Tax Audit:

Client Sr. No.	Opinion (Tax Audit applicable or not)	Reason
1	No	As the turnover is upto ₹ 10 crore, Cash Receipts & Cash Payments are upto 5% of total receipts & total payments, respectively, & has been filing return as per the regular provisions of income tax, so tax audit is not applicable.
2	No	Even though turnover exceeds ₹ 1 crore & Cash Receipts are greater than 5% of Total Receipts but as the business income has been declared as per presumptive taxation u/s 44AD of the Income-tax Act, 1961, so tax audit is not applicable.
3	No	Even though business income as per presumptive taxation u/s 44AD of the Income-tax Act, 1961 has been declared during last 2 previous years but has not been declared during the current previous year but as the total income is less than basic exemption limit, so tax audit is not applicable.
4	Yes	Has been declaring total income as per presumptive taxation u/s 44AE of the Income-tax Act, 1961 during last 4 previous years but during current previous year has declared income lower than as per section 44AE, so tax audit is applicable.

PEER REVIEW

QUESTION : 18

- (a) Roshan, a practicing Chartered Accountant is appointed to conduct the peer review of another practicing unit. What areas Roshan should review in the assessment of independence of the practicing unit?
- (b) You are required to classify the following practice units into Level I entity or Level II entity for the purpose of peer review along with providing the reason for such classification, assuming the services have been undertaken in the period under review by such CA firms:

Name of the Firm	Data of assurance services provided by such firms
MT & Co.	Conducted statutory audit of a private company having a net worth of ₹ 300 crore.
GBL & Co.	Conducted statutory audit of a Mutual Fund Company.
IML & Associates	Conducted statutory audit of a company registered u/s 8 of the Companies Act, 2013 but is not covered as a public interested entity. However, it has raised a contribution of ₹ 60 crore.
BTS & Co.	Conducted statutory audit of an unlisted public company having net worth of ₹ 4 crore & turnover of ₹ 55 crore.
TJK & Associate	Conducted statutory audit of LLP which has raised has a loan of ₹ 35 crore from a bank & a loan of ₹ 10 crore from an NBFC, respectively.

- (c) Evaluating the professional judgment exercised by the auditor is one of the important aspects under Quality review, please explain the situation with reference to applicable SA.

ANSWER : 18

- (a) Review in the Assessment of Independence of the Practicing Unit - The reviewer should carry out the compliance review of the five general controls, i.e., independence, maintenance of professional skills & standards, outside consultation, staff supervision & development & office administration & evaluate the degree of reliance to be placed upon them. The degree of reliance will, ultimately, affect the attestation service engagements to be reviewed.

Independence is the main quality expected of an auditor. That is the very basis for the existence of the profession of auditing. Independence is a condition of mind as well a personal character of a person. It is difficult to define but very easy to perceive. Guidance Note on Independence of Auditors clarifies that independence is of two types, viz. independence of mind & independence of appearance. The Guidance Note further states that there are certain threats to independence which are classified as self interest threats, self review threats, advocacy threats, familiarity threats & intimidation threats.

The responsibility of the Peer Reviewer, therefore, is to ascertain the existence of independence & the absence of threats to independence.

The reviewer should, therefore, check the following aspects in respect of assessment of independence of the practicing unit:

- Does the practice unit have a policy to ensure independence, objectivity & integrity, on the part of partners & staff? Who is responsible for this policy?
- Does the practice unit communicate these policies & the expected standards of professional behaviour to all staff?
- Does the practice unit monitor compliance with policies & procedures relating to independence?
- Does the practice unit periodically review the practice unit's association with clients to ensure objectivity & independence?
- How does the practice unit deal with the threats to independence ?

- (b) Classification of Entity as per Statement of Peer Review

Name of Entity	Type of Entity	Reason for such classification based on the Statement of Peer Review
MT & Co.	Level I entity	A Practice Unit which has undertaken Statutory Audit of a company which is having net worth of more than ₹ 100 Crores at any time during the period under Review, shall be treated as a Level I entity.
GBL & Co.	Level I entity	A Practice Unit which has undertaken Statutory Audit of a mutual fund shall be treated as a Level I entity.
IML & Associates	Level I entity	A Practice Unit which has undertaken Statutory Audit of an Entity which has raised donations & / or contributions over ₹ 50 crore during the period under Review, shall be treated as a Level I entity.
BTS & Co.	Level II entity	A Practice Unit which has undertaken Statutory Audit of a company which having net worth of less than ₹ 100 Crores or turnover of less than ₹ 250 crores, at any time during the period under Review, shall be treated as a Level II entity.
TJK & Associate	Level II entity	A Practice Unit which has undertaken Statutory Audit of an entity which has raised funds from public or banks or financial institutions of less than ₹ 50 crore during the period under Review, shall be treated as a Level II entity.

- (c) **Evaluating the professional judgment exercised by the auditor:** It is also important for the Technical Reviewer (hereinafter referred as TR) to understand that "professional judgment", as defined in SA 200, "Overall Objectives of the Independent Auditor & the Conduct of an Audit in Accordance with Standards on Auditing" is an integral concept in the context of an audit & application of SAs in real life audit scenarios. SA 200 defines professional judgment as "the application of relevant training, knowledge & experience, within the context provided by auditing, accounting & ethical standards, in making informed decisions about the course of action that is appropriate in the circumstances of the audit engagement."

The concept of "professional judgment" underscores the fact that Standards, particularly, Standards on Auditing are written to lay down the fundamental principles that would apply to an audit situation. Hence, no Standard can have straight jacketed application/solutions for all audit scenarios. Above all, the Standards on Auditing issued by the ICAI are principle based rather than rule based. Hence, almost all the SAs envisage exercise of professional judgment by the auditor in their application in real life audit scenarios.

The TR would need to appreciate that the exercise of professional judgment in any particular case is based on the facts & circumstances that are known to the auditor as at the time of exercising that professional judgment. Normally, exercise of professional judgement by an auditor is preceded by consultation on the relevant matters both within the engagement team & between the engagement team & others at the appropriate level within or outside the firm.

In evaluating the professional judgment exercised by the auditor, the TR should consider the following factors:

- whether the judgment reached reflects a due consideration & application of the relevant auditing & accounting principles; &
- whether the judgment is appropriate in the light of, & consistent with, the facts & circumstances that were known to the auditor up to the date of the auditor's report. Hence, the TR & the QR Team should not, under any circumstance, use "hindsight" (i.e. perception or retrospection) in their evaluation of exercise of professional judgment by the auditor.

Since the auditor needs to exercise professional judgment throughout the audit, the latter also needs to be appropriately documented. Hence, the TR can expect to find such audit documentation as a part of the audit engagement file. It is important to note that professional judgment cannot be used by an

auditor as a justification for decisions that are not otherwise supported by the facts & circumstances of the engagement or sufficient appropriate audit evidence.

PROFESSIONAL ETHICS

QUESTION : 19

The Director (Discipline) of the ICAI received information of alleged misconduct against Mr. Jayprakash, the proprietor of JP & Associates, as follows:-

- (i) Audit of a college was accepted by JP & Associates in which Mr. Jayprakash is working as a part-time lecturer & also, he had not taken permission of the ICAI for working as a part-time lecturer in the college.
- (ii) An event relating to Corporate Social Responsibility was sponsored by JP & Associates, whereby in the sponsorship banner, name of Mr. Jayprakash as 'CA Jayprakash, Proprietor, JP & Associates' was mentioned.

On the basis of above information & along with certain evidence against Mr. Jayprakash, he was found guilty & so he was reprimanded & a fine of ₹ 1 lakh was imposed by an order passed against him dated 12th July, 2020.

Against the said order, Mr. Jayprakash preferred an appeal with the Appellate Authority on 17th August, 2020 by submitting a statement of appeal along with the application form of appeal. During such appellate proceedings, it was discovered that the said statement of appeal contained some facts which were false to which Mr. Jayprakash admitted it to be false & apologized for it.

- (a) Mr. Jayprakash has violated which of the provisions of the CA Act, 1949?
- (b) Before which authority, the matter of Mr. Jayprakash would have been placed & what maximum punishment could have been imposed on him by the said authority in accordance with the Chartered Accountant Act, 1949?

ANSWER : 19

- (a) Mr. Jayprakash has violated following provisions of the CA Act, 1949:

- (i) As per Clause (4) of Part I of the Second Schedule to the CA Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct, if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

In this connection, as per the decision of the Council of the ICAI, a Chartered Accountant should not by himself or in his firm name accept the audit of a college, if he is working as a part-time lecturer in the college.

Thus, by accepting audit of a college in which he is working as a part-time lecturer, Mr. Jayprakash has violated the restriction imposed under Clause (4) of Part I of the Second Schedule to the CA Act, 1949.

- (ii) As per Clause (11) of Part I of the First Schedule to the CA Act, 1949, a Chartered Accountant in practice shall be 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.

Members of the Institute in practice may engage in a part-time or full-time tutorship under any educational institution other than the coaching organization of the Institute, after obtaining the specific & prior approval of the Council in each case.

Mr. Jayprakash had not taken permission of the ICAI for working as a part-time lecturer in the college & so has violated the restriction imposed under Clause of Part I of the First Schedule to the CA Act, 1949.

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

In this connection, members sponsoring activities relating to Corporate Social Responsibility may mention their individual name with the prefix "CA". However, mentioning a firm's name or CA Logo is not permitted.

An event relating to Corporate Social Responsibility was sponsored by JP & Associates, whereby in the sponsorship banner, name of Mr. Jayprakash as 'CA Jayprakash, Proprietor, JP & Associates' was mentioned. Thus, firm's name was mentioned which is not allowed & thus, Mr. Jayprakash has violated the restriction imposed under Clause (6) of Part I of the First Schedule to the CA Act, 1949.

- (iv) As per Clause (3) of Part II of the Second Schedule to the CA Act, 1949, a member of the ICAI shall be deemed to be guilty of professional misconduct, if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority, any particulars knowing them to be false.

Mr. Jayprakash in the statement of appeal submitted with the Appellate Authority mentioned some facts knowing them to be false & thus, he has violated the restriction imposed under Clause (3) of Part II of the Second Schedule to the CA Act, 1949.

- (b) As Mr. Jayprakash has been alleged of misconduct falling in First as well as Second Schedule, so the matter would be placed before the Disciplinary Committee.

The maximum punishment which could have been imposed on him by the said authority would be:-

- (i) reprimanding the member.
- (ii) removing name of the member permanently or for any duration, it thinks fit.
- (iii) imposing fine upto ₹ 5,00,000.

QUESTION : 20

Write a short note on the following:

- (a) Responsibility of holding company for preparation of Consolidated Financial Statements.
- (b) Summary Written Report.
- (c) Direction by Tribunal in case auditor acted in a fraudulent manner.
- (d) Example of Headings of a Due Diligence Report.

ANSWER : 20

- (a) **Responsibility of holding company for preparation of Consolidated Financial Statements:** The responsibility for the preparation & presentation of consolidated financial statements, among other things, is that of the management of the parent.

This includes:

- (a) identifying components, & including the financial information of the components to be included in the consolidated financial statements;
- (b) where appropriate, identifying reportable segments for segmental reporting;
- (c) identifying related parties & related party transactions for reporting;
- (d) obtaining accurate & complete financial information from components;
- (e) making appropriate consolidation adjustments;
- (f) harmonization of accounting policies & accounting framework; &
- (g) GAAP conversion, where applicable.

Apart from the above, the parent ordinarily issues instructions to the management of the component specifying the parent's requirements relating to financial information of the components to be included in the consolidated financial statements. The instructions ordinarily cover the accounting policies to be applied, statutory & other disclosure requirements applicable to the parent, including the identification of & reporting on reportable segments, & related parties & related party transactions, & a reporting timetable.

(b) **Summary Written Report:** These summary reports are also referred to as 'flash' reports'. In a number of companies, the practice has developed of issuing an annual (or sometimes more frequent) report summarising the various individual reports issued & describing the range of their content. These summary reports in some cases are primarily for audit committees of Boards of Directors, but in other cases for higher level management. They are especially useful to top level managers who do not actively review the individual reports. They are also useful to the general auditor in seeing his total reporting effort with more perspective & on an integrated basis.

(c) **Direction by Tribunal in case auditor acted in a fraudulent manner:** As per subsection (5) of the section 140, the Tribunal either suo motu or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government & the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor & the Central Government may appoint another auditor in his place.

It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order & the auditor shall also be liable for action u/s 447.

It is hereby clarified that the case of a firm, the liability shall be of the firm & that of every partner or partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

(d) **Example of Headings of a Due Diligence Report**

- ➔ Executive Summary
- ➔ Introduction
- ➔ Background of Target company
- ➔ Objective of due diligence
- ➔ Terms of reference & scope of verification
- ➔ Brief history of the company
- ➔ Share holding pattern
- ➔ Observations on the review
- ➔ Assessment of management structure
- ➔ Assessment of financial liabilities
- ➔ Assessment of valuation of assets
- ➔ Comments on properties, terms of leases, lien & encumbrances.
- ➔ Assessment of operating results
- ➔ Assessment of taxation & statutory liabilities
- ➔ Assessment of possible liabilities on account of litigation & legal proceedings against the company
- ➔ Assessment of net worth
- ➔ Interlocking investments & financial obligations with group / associates companies, amounts receivables subject to litigation, any other likely liability which is not provided for in the books of account
- ➔ SWOT Analysis
- ➔ Comments on future projections
- ➔ Status of charges, liens, mortgages, assets & properties of the company
- ➔ Suggestion on ways & means including affidavits, indemnities, to be executed to cover unforeseen & undetected contingent liabilities
- ➔ Suggestions on various aspects to be taken care of before & after the proposed merger/acquisition.

CA FINAL - ADVANCED AUDITING & PROFESSIONAL ETHICS

MOCK TEST PAPER – APRIL 2022

DIVISION A - MCQs (30 Marks)

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

1. Shripal Company got a show cause notice from State Pollution Control Board for the contravention of the provisions of Hazardous & waste Management Rule. As per SA 250, the auditor shall perform the audit procedures to help identify instances of non-compliance with other laws & regulations that may have a material effect on the financial statements. As the audit team of the company became aware of information concerning an instance of non-compliance with law, what would NOT be the audit procedure to be performed?
 - (a) Understand the nature of the act & circumstances in which it has occurred & obtain further information to evaluate the possible effect on the financial statement.
 - (b) Discuss the matter with management & if they do not provide sufficient information; & if the effect of non-compliance seems to be material, legal advice may be obtained.
 - (c) Monitoring legal requirement & compliance with code of conduct & ensuring that operating procedures are designed to assist in the prevention of non-compliance with law & regulation & report accordingly.
 - (d) Evaluate the implication of non-compliance in relation to other aspects of audit including risk assessment & reliability of written representation & take appropriate action.
2. Bhagwan & Co. has received an order in writing from the Central Government, in respect of one of its clients, to carry out an investigation u/s 210 of the Companies Act 2013. During the course of carrying out investigation as above, Bhagwan & Co. requires certain evidence from a place outside India in order to establish the correctness of an investment in the shares of a company outside India. What should be the procedure of Bhagwan & Co. to seek evidence from outside India for the investigation?
 - (a) Seeking evidence from outside India for investment in shares outside India is outside the scope of investigation.
 - (b) An application is to be made to the competent court in India by the inspector & such court may issue a letter of request to a court or an authority in such country for seeking evidence.
 - (c) The evidence can be sought by electronic mail by writing to the concerned authorities of the entity outside India.
 - (d) Powers of seeking evidence outside India is available only to an investigator u/s 212- Serious Fraud Investigation.
3. While reporting under clause (ii) of Paragraph 3 of CARO 2020, which of the following is correct:
 - (a) The 10% threshold for reporting must be applied on a gross basis before adjusting excesses & shortages within the class of an inventory & must be based on value for each class of Inventory.
 - (b) The 10% threshold for reporting must be applied on a gross basis before adjusting excesses & shortages within the class of an inventory & must be based on value for all classes of Inventory.
 - (c) The 10% threshold for reporting must be applied on a net basis after adjusting excesses & shortages within the class of an inventory & must be based on value for each class of Inventory.
 - (d) The 10% threshold for reporting must be applied on a net basis after adjusting excesses & shortages within the class of an inventory & must be based on value for all classes of Inventory.
4. The Splendid General Insurance Company has entered into reinsurance contract with Adi Reinsurance Co. Ltd. against the risk of fire only. Adi Reinsurance Co. Ltd. is one of the largest reinsurers in India. Identify the type of reinsurance contract between Splendid General Insurance Company & Adi Reinsurance Co. Ltd.
 - (a) Treaty Reinsurance.
 - (b) Proportional Treaty Reinsurance.
 - (c) Non-Proportional Treaty Reinsurance.
 - (d) Facultative Reinsurance.

5. Amount of materiality initially determined needs to be revised as the audit progresses:

- (a) If there is a delay in the audit.
 - (b) In the event of becoming aware of information during the audit that would have caused the auditor to have determined a different amount (or amounts) initially.
 - (c) Only in the event of becoming aware of information during the audit that would have caused the auditor to have determined a higher amount (or amounts) initially.
 - (d) Only in the event of becoming aware of information during the audit that would have caused the auditor to have determined a lower amount (or amounts) initially.
- 6. While examining the computation of Demand & Time liabilities which of the following is to be included in liabilities:**
- (a) Part amounts of recoveries from the borrowers in respect of debts considered bad & doubtful of recovery.
 - (b) Amounts received in Indian Currency against import bills & held in sundry deposits pending receipts of final rates.
 - (c) Net credit balance in branch adjustment accounts including these relating to foreign branches.
 - (d) Margins held & kept in sundry deposits for funded facilities.
- 7. While verifying the salary expense of employees, the auditor has been asked to rely on the values as per SAP software & some hard copy reports & documents as the HRMS package (source software) has become corrupt during the year & the management is not having any data backup. How should the auditor deal with the same?**
- (a) The auditor should issue a qualified opinion as records are destroyed & he is unable to obtain sufficient appropriate audit evidence.
 - (b) The auditor should perform alternative procedures to obtain sufficient & appropriate audit evidence before disclaiming the opinion.
 - (c) The auditor should issue an adverse opinion stating that it is deficiency in internal controls.
 - (d) The auditor can rely on the SAP data & there is no need for qualification of report.
- 8. As per SA 701- Communicating Key audit matters in the Independent auditor's Report, which among the following areas should CA & Co. take into account to determine "Key Audit Matter"?**
- (i) The effect on audit of significant transactions that took place in the financial year.
 - (ii) Areas of high risk as assessed & reported by management's expert.
 - (iii) Significant auditor judgement relating to areas in the financials that involved significant management judgement.
- (a) (i) & (ii)
 - (b) (ii) only
 - (c) (i) & (iii)
 - (d) (i), (ii) & (iii)
- 9. Rimmi Ltd. was set up initially as a private limited company. Subsequently, it got converted into a public company. The company's management has plans of expansion but the business was not growing in an organic manner. Therefore, the management decided to acquire the competitors. During the financial year ended 31st March, 2021, the company acquired two companies in India & France in September, 2020 & January, 2021 respectively. The company controls both of these companies as per the criteria laid down in the Companies Act, 2013 as well as the applicable accounting standards.**
- The management started discussions with the auditors regarding the audit wherein it was also pointed out by the auditors that the management should also prepare consolidated financial statements (CFS), if they want. Management needs your advise on the same.**
- (a) Management must prepare the CFS as per the requirements of the Companies Act, 2013.
 - (b) Management has a choice not to prepare CFS but should go for that considering that its true performance & financial position can then be demonstrated.
 - (c) Management could have prepared CFS if the acquired companies would have completed at least one year post acquisition.
 - (d) Management must prepare CFS but it should include only the company acquired in India.
- 10. Gamma Private Ltd. duly appoints CA Palak as the tax auditors of their Company & the appointed Tax-auditor chalks out a detailed Audit Programme to be assigned to her audit engagement team to carry**

out the tax audit efficiently & effectively. Which of the following situations wouldn't warrant an alteration in the Audit Programme during the course of Audit by the Tax Auditor of Gamma Private Limited during the next Financial Year ?

- Significant changes in Procedures & Personnel of the Company subsequent to audit Procedures.
- A Substantial increase in the volume of turnover as against the anticipated results of the Company.
- An extraordinary increase in the amount of Book Debts as compared to that in the First Year.
- A New Contract received by Gamma Ltd. from a Foreign Client during the course of the audit.

(10 x 1 = 10 Marks)

Questions (11-20) carry 2 Marks each

MCQ 11. -15.

Integrated Case Scenario 1

While preparing the financial statement for the year ended on 31 March 2022, ABC Limited, a listed entity, provided the below information:

Excerpt of Standalone Balance sheet of ABC Ltd as of 31 March 2022

(in ₹ Lakhs)

Particulars	Note No	As on 31.03.2022	As on 31.03.2021
Equity & Liabilities			
Current liabilities			
(a) Financial Liabilities			
(ii) Trade Payables: -	10		
(A) total outstanding dues of micro enterprises & small enterprises; &		300	
(B) total outstanding dues of creditors other than micro enterprises & small enterprises.		210	
(iii) Other financial liabilities (other than those specified in item (c))			

Note 10: Ageing of Trade Payables

Particulars	Ageing of Trade Payables					(₹ in Lakhs)
Ageing	Less than 3 Year	3-5 Years	More than 5 Years	Total Non- MSME Trade Payables	MSME Trade Payables	Total Trade Payables
Undisputed	100	50	30	180	160	340
Disputed	10	20	0	30	40	70
Total	110	70	30	210	200	410

Additional Information:

- Mr. A while performing the statutory audit of ABC Ltd identified that the total trade payables reported in the Balance Sheet as of 31 March 2022 & the amount reported in Note 10: Ageing of Trade Payables are different. Upon inquiry, management informed that the difference between both amounts is the Intercompany Trade Payables which is eliminated as part of consolidation Adjustment. Hence, there was no requirement to show intercompany Trade Payables in the ageing schedule. Mr. A accepted the explanation & did not perform any further procedures to validate the explanation.
- When Audit Committee inquired with Mr. A as to how they have verified & validated the segregation of the trade payables, Mr. A replied that they purely relied upon the management representation as there was no alternate procedure available to gather sufficient & appropriate audit evidence to validate the said information. Moreover, they informed the management that they have not qualified their audit opinion as they have relied in true faith upon management representation.
- While performing the audit procedure to validate the Trade Payables ageing, Mr. A identified that management has calculated the due date of trade payables from the end of 180 days from the date of transaction. Mr. A found it appropriate based on the conservative approach.
- Mr. A did not qualify his audit opinion on the financial statement prepared for the period ending on 31 March 2022 on any grounds. Also, Mr. A specified that :

"The financial statements for the year ended on 31 March 2022 give a true & fair view of the state of affairs of the company, comply with the accounting standards notified u/s 133 & are in the form provided for the company in Schedule III of the Act"

5. While preparing the audit report Mr. A, provided the following information in Key Audit Matters.

Key Audit Matters	How our audit addressed KAM
While auditing the Trade Payables, the auditor identified that the trade payables balance includes ₹ 100 lakh payable to the intercompany which is aged more than 3 years. Upon Inquiry with management, it was identified the same amount is not paid on account of a dispute with respect to commercial terms. However, no such amount was outstanding as receivable in the accounts statement shared by Intercompany. The amount was already written off by such an Intercompany in past years.	We have relied upon the assessment performed by the management with respect to the litigation & disputed Trade Payables Balance. Moreover, the amount is not material & hence no further procedure other than obtaining management representation was performed on the said balance.

6. Other than the disputed trade payables disclosed, there were claims against the company which were not yet acknowledged as debt. The aggregate amount & exposure for such claims were ₹ 25 Lakh. As per an expert hired by the management, no amount is required to be provided in books of accounts as in all the claims there are high chances that the decision will be in favour of the company.
7. Following were the materiality levels decided by the auditor for the current period's audit:
- Overall Materiality: ₹ 50 Lakh;
 - Performance Materiality: 5 Lakh;
 - Materiality for Aggregate Uncorrected Misstatement: ₹ 1 Lakh.

On the basis of the abovementioned facts, you are required to answer the following MCQs:

Multiple Choice Questions (5 questions of 2 Marks each):

11. In the given situation whether Mr. A will be held guilty of professional Misconduct.

- Yes, Mr. A, is guilty of professional misconduct under Clause 7 of Part I of First Schedule.
- Yes, Mr. A, is guilty of professional misconduct under Clause 7 & 8 of Part I of First Schedule.
- Yes, Mr. A, is guilty of professional misconduct under Clause 7 & 8 of Part I of the Second Schedule.
- No, Mr. A is not guilty of professional misconduct as he has performed all the audit procedures appropriately.

12. Whether Financial statements given in the scenario are in confirmation with the requirements of Division II of Schedule III?

- Yes, the financial statements are in confirmation with requirements mentioned in Division II of Schedule III
- No, management should have eliminated the Intercompany Trade Payables balance from the amount disclosed in the Standalone Balance Sheet. This will bring Note 10: Ageing Schedule & Standalone Balance Sheet in alignment.
- No, Management should not have disclosed the disputed trade payables less than 3 years as these trade payables are still under the period of limitation as per Limitation Act & they should not be disclosed in Financial Statement.
- No, management should have added the Intercompany Trade Payables balance to the ageing schedule. This will bring Note 10: Ageing Schedule & Standalone Balance Sheet in alignment.

13. In continuation to MCQ no 12, what is an appropriate way to report the above-mentioned issues?

- Mr. A should have expressed a modified opinion if he was not able to gather appropriate & sufficient audit evidence to validate the disputed trade payables. Moreover, he should have modified or issued an adverse opinion as Financial Statements were not in confirmation with requirements of Division II of Schedule III.
- Mr. A should have expressed an unmodified opinion if he was not able to gather appropriate & sufficient audit evidence to validate the intercompany trade payables. Moreover, he should have

been unmodified as Financial Statements were not in confirmation with requirements of Division II of Schedule III.

- (c) Mr. A should have expressed an unmodified opinion as per SA 700, as he was able to obtain all the explanation & information required & sought by him. Moreover, he should have modified it as the Cash Flow Statement was not in confirmation with the requirements of Division II of Schedule III.
- (d) Mr. A should have reported matters related to Trade Payables Ageing as a qualification in Key Audit Matters, as he was not able to obtain all the explanation & information required & sought by him.

14. Whether the reporting performed by Mr. A related to intercompany trade payables under the paragraph/section of Key Audit Matter in the audit report appropriate? Select from the below option to support your answer.

- (a) Mr. A should have expressed an unmodified opinion if he was not able to gather appropriate & sufficient audit evidence to validate the disputed intercompany trade payables. As per SA 701, those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period are Key Audit Matters. The auditor shall not communicate a matter in the Key Audit Matters section of the auditor's report when the auditor would be required to modify the opinion in accordance with SA 705 as a result of the matter.
- (b) Mr. A should have expressed a modified opinion if he was not able to gather appropriate & sufficient audit evidence to validate the disputed intercompany trade payables. As per SA 701, those matters that, in the auditor's professional judgment, were of most significance in the audit of the financial statements of the current period are Key Audit Matters. The auditor shall not communicate a matter in the Key Audit Matters section of the auditor's report when the auditor would be required to modify the opinion in accordance with SA 705 as a result of the matter.
- (c) Mr. A should have expressed an unmodified opinion if he was not able to gather appropriate & sufficient audit evidence to validate the disputed intercompany trade payables. As per SA 701, the auditor shall report the matter in Key Audit Matters in the auditor's report when the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement or the auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement.
- (d) The auditor shall express an adverse opinion & report the said matter in Key Audit Matter Para when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material & pervasive to the financial statements. In the current case, the auditor has appropriately disclosed the said matter in Key Audit Matter Paragraph.

15. As per the expert appointed by the Auditor, the exposure for the company can be ₹ 20 lacs as in past in similar cases, the judgement was delivered against the company. However, the management of ABC Limited was of the view that when management has already hired an expert, then there is no need to hire another expert by the auditor. Seeking your advice, kindly guide the auditor by selecting the below option, & what next steps should perform.

- (a) The auditor shall design & perform audit procedures in order to identify litigation & claims involving the entity which may give rise to a risk of material misstatement. Also, if expertise in a field other than accounting or auditing is necessary to obtain sufficient appropriate audit evidence, the auditor shall determine whether to use the work of an auditor's expert. Hence auditor can appoint his expert to validate the assumption & estimate performed by the management's expert.
- (b) The auditor shall rely upon the work performed by the management's expert. Management expert will be equivalent to the auditor's expert & hence no other expert is required to be appointed.
- (c) The auditor shall not rely upon the management's expert unless he evaluates the adequacy of the expert's work for the auditor's purposes, including the relevance & reasonableness of that expert's findings or conclusions, & their consistency with other audit evidence. Although in the current case, there is no consonance between the management's expert's findings & other audit evidence, the auditor is still required to rely upon the findings of the management's expert.

- (d) The auditor shall rely upon the management's expert without evaluating the adequacy of the expert's work for the auditor's purposes, including the relevance & reasonableness of that expert's findings or conclusions, & their consistency with other audit evidence. Hence auditor is required to rely upon the findings of management's expert in the current case.

MCQ 16. -20.**Integrated Case Scenario 2**

HF Limited - ND, a Non-Banking financial company which is exclusively into housing finance business completed one month of operations. They approached their auditor M/s UVW & Co. Chartered Accountants to know about the process to apply for certificate of registration u/s 45 IA of RBI Act. After calculating the net owned funds (which stood at ₹ 249 lakh) & considering other details, the company was told that they need not apply for the certificate.

After the completion of the financial year, UVW & Co. started the statutory audit & tax audit for HF limited. During the course of the audit, the management disagreed on the following matters:

- (i) The company had revalued a particular class of its asset (no intangible asset was revalued). The carrying value before revaluation was ₹ 77 lakh & the value post revaluation was ₹ 84.70 lakh. The auditors wanted to mention the same along with the amount of change in CARO.
- (ii) It was found that an amount of ₹ 5 lakh had been written off as bad debts. The complete amount was not admissible as per the Income tax Act & hence the auditor decided to mention about the same under clause 19 of the tax audit report & disallow the inadmissible amount.

MC Limited approached UVW & Co. for providing few management & consultancy services for their company. The offers given by the company was:

- (i) Inventory management, material handling & storage
- (ii) Personnel recruitment & selection
- (iii) Tax representation & advice concerning tax matters

Mr. U, the senior partner of the firm was not consulted while deciding to respond to the above offers made by MC Limited. Hence, he resigned from the partnership & went into practice as a sole proprietor.

Since

Mr. U was having an interest in the field of merchant banking, he applied & obtained a registration as category IV merchant banker under SEBI's Rules & Regulations. Upon obtaining the same, he was approached by HF limited, who wanted to go for a capital issue. Mr. U accepted the offer. The offer document & advertisements regarding the capital issue prominently displayed the name & address of Mr. U, under the caption 'Advisor to the Issue'. It was later found that Mr. U was guilty of professional misconduct because of the above incident.

On the basis of the abovementioned facts, you are required to answer the following MCQs:

Multiple Choice Questions (5 questions of 2 Marks each):

16. Why the auditor advised HF Limited - ND, a Non-Banking financial company not to apply for certificate u/s 45 IA ?

- (a) Since the company is Non-Deposit taking NBFC, there is no need to apply for certificate of registration.
- (b) The company needs to completed one year of operations before applying for the certificate.
- (c) Net owned funds are below the stipulated limit of ₹ 250 lakh, hence the company need not apply for certificate.
- (d) The company falls under exempt category as notified by RBI.

17. Is the auditor's decision to report issue I given in the situation correct? What is the reason?

- (a) Yes. Since the revaluation of asset has brought a change of 10% in the carrying amount, the same shall be reported in CARO, including the amount.
- (b) No. The reporting requirement under CARO relates to physical verification of assets, record maintenance, etc. only. It does not require the details of revaluation to be provided.
- (c) No. Since no intangible asset is revalued, the above matter need not be reported.
- (d) No. Since the revaluation of asset has not reduced the carrying value, the same need not be reported.

18. Assuming yourself to be a part of the management, how would you respond to point II relating to reporting of written off Bad debts in Tax Audit Report ?

- (a) Completely agree with the above matter as told by the auditor.
- (b) Disagree to the point, since the above details need not be reported under clause 19 of Form 3CD.
- (c) Disagree to the point, since the above details need not be reported under clause 19 of Form 3CD, but under clause 25 of Form 3CD.
- (d) Partially agree with respect to reporting the same, but not with respect to the amount being disallowed by the auditor.

19. Assuming all responsibilities & protocols being fulfilled properly, from the above case scenario, what can you infer about the appointment of M/s UVW & Co. as auditors for HF limited?

- (a) They were appointed by Shareholders.
- (b) They were appointed by Empanelment Committee.
- (c) They were appointed by Board of Directors.
- (d) They were re-appointed as auditors.

20. In the above case of Mr. U, which act of his could have led to professional misconduct?

- (a) Obtaining registration as category IV merchant banker.
- (b) Allowing the caption 'Advisor to the Issue' in the offer document & advertisement.
- (c) Accepting the offer of HF limited without communicating the same to their auditors.
- (d) Allowing his name & address to be displayed prominently in the offer document & advertisement.

(10 x 2 = 20 Marks)

MCQ - Answers

1	(c)	2	(b)	3	(c)	4	(d)	5	(b)	6	(b)	7	(c)	8	(a)	9	(d)	10	(c)
11	(d)	12	(a)	13	(b)	14	(a)	15	(d)	16	(c)	17	(a)	18	(b)	19	(c)	20	(d)

DIVISION B- Descriptive Questions-70 Marks**Question No. 1 is compulsory.****Attempt any four questions from the Rest.****QUESTION : 1 (a)**

After accepting the statutory audit of M/s All-in-All Ltd., a departmental store, you became aware of the fact that management of the company have imposed certain limitations on the scope of your assurance function which may adversely affect & result in your inability to obtain sufficient appropriate audit evidence to discharge your responsibility required by the statute. Indicate the consequences & your response to the limitations imposed by the management on your scope. (5 Marks)

ANSWER : 1 (a)

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

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

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

- (i) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or
- (ii) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material & pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:

1. Withdraw from the audit, where practicable & possible under applicable law or regulation; or
2. If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

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

QUESTION : 1 (b)

M/s Krishna Associates, Chartered Accountants, while conducting the audit of Love Kush Ltd want to conduct an inquiry of management & those charged with governance as to whether any subsequent events have occurred which might affect the financial statements. Guide M/s Krishna Associates with the matters where specific inquiries may be conducted to evaluate subsequent events. (4 Marks)

ANSWER : 1 (b)

Specific Inquiries to Evaluate Subsequent Events: As per SA 560, "Subsequent Events", in inquiring of management &, where appropriate, those charged with governance, as to whether any subsequent events have occurred that might affect the financial statements, the auditor may inquire as to the current status of items that were accounted for on the basis of preliminary or inconclusive data & may make specific inquiries about the following matters:

- (i) Whether new commitments, borrowings or guarantees have been entered into.
- (ii) Whether sales or acquisitions of assets have occurred or are planned.
- (iii) Whether there have been increases in capital or issuance of debt instruments, such as the issue of new shares or debentures, or an agreement to merge or liquidate has been made or is planned.
- (iv) Whether any assets have been appropriated by government or destroyed, for example, by fire or flood.
- (v) Whether there have been any developments regarding contingencies.
- (vi) Whether any unusual accounting adjustments have been made or are contemplated.
- (vii) Whether any events have occurred or are likely to occur that will bring into question the appropriateness of accounting policies used in the financial statements, as would be the case, for example, if such events call into question the validity of the going concern assumption.
- (viii) Whether any events have occurred that are relevant to the measurement of estimates or provisions made in the financial statements.
- (ix) Whether any events have occurred that are relevant to the recoverability of assets.

QUESTION : 1 (c)

Yupee (P) Ltd. got incorporated on 15th May 2021 & Mr. Harsh, the director of Yupee (P) Ltd. proposed to Kamal & Co. on 24th May 2021, for being appointed as its statutory auditor. Mr. Kamal, the sole proprietor of Kamal & Co., after checking the compliance with all the statutory requirements, accepted the said offer & issued an audit engagement letter vide email to Yupee (P) Ltd.

Mr. Harsh found all terms of audit engagement to be proper but in the paragraph relating to auditor's responsibility in the engagement letter, as produced below:-

"We will conduct our audit in accordance with Standards on Auditing, issued by the ICAI. Those Standards require that we comply with ethical requirements & plan & perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement."

Certain queries raised in his mind that what does reasonable assurance meant? Which Standard on Auditing requires the auditor to obtain such reasonable assurance? Is it possible to give absolute assurance on such financial statements?

Assuming that you are Mr. Kamal, the newly appointed statutory auditor of Yupee (P) Ltd. Please address to the queries of Mr. Harsh as stated above. (5 Marks)

ANSWER : 1 (c)

As per SA 200, "Overall Objectives of the Independent Auditor & the Conduct of an Audit in Accordance with Standards on Auditing", the auditor is required: -

"To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework."

Reasonable assurance is a high level of assurance & is less than absolute assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level.

The auditor is not expected to, & cannot, reduce audit risk to zero & cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit, which result in most of the audit evidence on which the auditor draws conclusions & bases the auditor's opinion being persuasive rather than conclusive. The inherent limitations of an audit arise from:

- The nature of financial reporting;
- The nature of audit procedures; &
- The need for the audit to be conducted within a reasonable period of time & at a reasonable cost.

QUESTION : 2 (a)

Sambhav & Co., a Chartered Accountant Firm, is appointed as the principal auditor of a listed company, Moksh Ltd.

Figures of income & net-worth of five out of seven components of Moksh Ltd., which are its unlisted subsidiaries, is tabulated below for the immediate preceding financial year along with the consolidated amount: (₹ in crore)

Particulars	Consolidated	Component 'A'	Component 'B'	Component 'C'	Component 'D'	Component 'E'
Income	600	70	20	140	130	40
Net Worth	1,600	80	40	280	360	100

The remaining two components i.e., Component 'F' & Component 'G' of Moksh Ltd. were unaudited. According to Mr. Sambhav, the engagement partner, Component 'F' is material to the consolidated financial statements whereas Component 'G' is not material to consolidated financial statements & this fact has also been discussed in writing with those charged with governance of Moksh Ltd.

- (i) Which of the components of Moksh Ltd. can be termed as "material subsidiary" & in the
- (ii) Board of which of the unlisted subsidiaries at least one independent director of Moksh Ltd. needs to be appointed or would be appointed? (4 Marks)
- (iii) What shall be the audit consideration in relation to reporting in case of unaudited components
- (iv) of Moksh Ltd. by Sambhav & Co. & how Sambhav & Co. as a principal auditor shall report in case of Component 'F' & Component 'G', respectively? (5 Marks)

ANSWER : 2 (a)

- (i) As per Regulation 16(c) of the SEBI (LODR) Regulations, 2015, "material subsidiary" shall mean a subsidiary, whose income or net worth exceeds ten percent of the consolidated income or net worth respectively, of the listed entity & its subsidiaries in the immediately preceding accounting year. [Explanation- The listed entity shall formulate a policy for determining 'material' subsidiary.]

Regulation 24(1) of the SEBI (LODR) Regulations, 2015, provides that at least one independent director on the board of directors of the listed entity shall be a director on the board of directors of an unlisted material subsidiary, whether incorporated in India or not.

[Explanation- For the purposes of Regulation 24(1), notwithstanding anything to the contrary contained in regulation 16, the term "material subsidiary" shall mean a subsidiary, whose income or net worth exceeds twenty percent of the consolidated income or net worth respectively, of the listed entity & its subsidiaries in the immediately preceding accounting year]

On the basis of above provisions, following information is tabulated as below:

Particulars	Share in Consolidated Income	Share in Consolidated Net Worth
Component 'A'	11.67%	5%
Component 'B'	3.33%	2.5%
Component 'C'	23.33%	17.5%
Component 'D'	21.67%	22.5%
Component 'E'	6.67%	6.25%

It can be observed that Component 'A', Component 'C' & Component 'D', respectively, can be termed as "material subsidiary" as their shares in either consolidated Income or net worth exceeds 10%.

Further, at least one independent director from the board of directors of Moksh Ltd. shall be appointed or would have been appointed on the board of Component 'C' & Component 'D', respectively, as their shares in either consolidated income or net worth exceeds 20%.

- (ii) Generally, the financial statements of all components included in consolidated financial statements should be audited or subjected to audit procedures in the context of a multi - location group audit. Such audits & audit procedures can be performed by the auditor reporting on the consolidated financial statements or by the components' auditor.

Where the financial statements of one or more components continue to remain unaudited, the auditor reporting on the consolidated financial statements should consider unaudited components in evaluating a possible modification to his report on the consolidated financial statements. The evaluation is necessary because the auditor (or other auditors, as the case may be) has not been able to obtain sufficient appropriate audit evidence in relation to such consolidated amounts/balances. In such cases, the auditor should evaluate both qualitative & quantitative factors on the possible effect of such amounts remaining unaudited when reporting on the consolidated financial statements using the guidance provided in SA 705, "Modifications to the Opinion in the Independent Auditor's Report".

In the given situation, two out of seven components of Moksh Ltd. have remained unaudited where Component 'F' is material & Component 'G' is not material to the consolidated financial statements.

Thus, in case of Component 'F', the Principal Auditor needs to consider its impact on the auditor's opinion on the consolidated financial statements of the group, in terms of the principles laid down in SA 705, Modifications to the Opinion in the Independent Auditor's Report. Whereas in case of Component 'G', the principal auditor should make appropriate reporting under the "Other Matters" paragraph, pursuant to SA 706, Emphasis of Matter Paragraphs & Other Matter Paragraphs, in the Independent Auditor's Report.

QUESTION : 2 (b)

The auditors are required to understand, evaluate & validate the entity level controls as a part of audit engagement, the result of which has an impact on the nature, timing & extent of other audit procedures. In evaluating the effect of such control, existence, effectiveness & assessment of the whistle-blower policy in the company is very important. Specify the procedure you would perform for an understanding & evaluation of such whistle-blower policy. (5 Marks)

ANSWER : 2 (b)

Procedure for understanding & evaluation of whistle-blower policy - Auditors are required to understand, evaluate & validate the entity level controls as a part of an audit engagement. The results of testing entity level controls could have an impact on the nature, timing & extent of other audit procedures including testing of controls. For example, when the entity level controls at a company are effective, the auditor may consider reducing the number of samples in the test of controls & where the auditor finds the entity level

controls ineffective, the auditor may consider to increase the rigour of testing by increasing sample sizes. In small & less complex companies, the entity level controls may not formally defined or documented. In such situations, the auditor should design audit procedures accordingly to obtain evidence of the existence & effectiveness of entity level controls.

The following example shows how the auditor performs an understanding & evaluation of the whistle-blower policy in a company:

- (i) Does the company have a whistle-blower policy?
- (ii) Is this policy documented & approved?
- (iii) Has the whistle-blower policy been communicated to all the employees?
- (iv) Are employees aware of this policy & understand its purpose & their obligations?
- (v) Has the company taken measures viz., training, to make the employees understand the contents & purpose of the policy?
- (vi) Does the company monitor effectiveness of the policy from time-to-time?
- (vii) How does the company deal with deviations & non-compliance?

QUESTION : 3 (a)

You are an auditor of Great Insurance Company Ltd. which offers variety of risk management products to business entities wishing to protect their business activities against losses due to various probable risks. Great Insurance Company Ltd. is in the process of offering to Unique Ltd., a multinational group having worldwide market, "Trade Credit Insurance Policy" to cover domestic risk, export risk & political risk. You as an auditor of Insurance Company have been requested to ensure that all the requirements have been met by Great Insurance Company Ltd. before Trade Credit Insurance Product is offered to Unique Ltd. List down those requirements. (5 Marks)

ANSWER : 3 (a)

Basic Requirements of a Trade Credit Insurance Product: An insurer shall offer trade credit insurance product only if all requirements mentioned below are met -

- Policyholder's loss is non-receipt of trade receivable arising out of a trade of goods or services.
- Policyholder is a supplier of goods or services in consideration for a fair market value.
- Policyholder's trade receivable does not arise out of factoring or reverse factoring arrangement or any other similar arrangement.
- Policyholder has a customer (i.e. Buyer) who is liable to pay a trade receivable to the policyholder in return for the goods & services received by him from the policyholder, in accordance with a policy document filed with the insurer.
- Policyholder undertakes to pay premium for the entire Policy Period.
- Any other requirement that may be specified by the Authority from time to time.

QUESTION : 3 (b)

While conducting the tax audit of RRR Ltd. you observed that company has timely filed ETDS return for TDS deducted on salary u/s 192 of the Income Tax Act, 1961 in form 24Q in respect of fourth quarter period from 1st January 2021 to 31st March 2021. The company has not furnished list of details which are not reported in the statement of tax deducted at source under the pretext that TDS statements are furnished within the prescribed time. As a Tax Auditor of RRR Ltd. how you would deal & report?

(5 Marks)

ANSWER : 3(b)

As per Clause 34 (b) of the Form 3CD, the auditor has to report whether the assessee is required to furnish the statement of tax deducted or tax collected. If yes, please furnish the details:

Tax deduction &	Type of Form	Due date for furnishing	Date of furnishing, if furnished	Whether the statement of tax deducted or collected contains information about all transactions	If not, please furnish list of details/trans
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collection Account Number (TAN)				which are required to be reported	actions which are not reported

Accordingly, clause 34 (b) requires, a list of details/transactions which are not reported in the statement of tax deducted at source & statement of tax collected at source are required to be furnished. The reporting requirement is notwithstanding the fact that the assessee has furnished the statements of tax deducted at source & tax collected at source within the prescribed time.

In the given situation, RRR Ltd., has timely filed ETDS return for TDS deducted on Salary u/s 192 of the Income Tax Act in Form 24Q in respect of 4th quarter. The company has not furnished list of details which are not reported in the statement of tax deducted at source under the pretext that TDS Statements are furnished within the prescribed time. Therefore, in view of above, RRR Ltd. is required to furnish list of details which are not reported in the statement of tax deducted at source.

QUESTION : 3 (c)

Sanyam, a chartered accountant in practice is owner of three agriculture lands. He lost his father due to Covid Pandemic. After death of his father, he started carrying out agricultural activities. His neighbour Raja who is a farmer, filed a complaint against him to ICAI that being a member he is carrying out agricultural activities, therefore, he is liable for misconduct. You are required to examine the same with reference to the CA Act, 1949 & Schedules thereto. (4 Marks)

ANSWER : 3 (c)

Engaging into Agricultural Activity: As per Clause (11) of Part I of First Schedule of CA 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 has granted general permission to the members to engage in certain specific occupation. In respect of all other occupations specific permission of the Institute is necessary.

In this case, CA. Sanyam is owner of 3 agriculture lands, & he is carrying out agricultural activities which is covered under the general permission.

Therefore, CA Sanyam is not guilty of professional misconduct under Clause (11) of Part I of First Schedule of CA Act, 1949 & complain of neighbour to the Institute is not correct.

QUESTION : 4 (a)

OM & Co. is the statutory auditor of OTAPS NBFC Ltd. While planning the audit procedures to be done during the audit of entity, there was a difference of opinion between Mr. O & his partner Mr. M. Mr. O is of the opinion that evaluation of internal control system & verification of registration with RBI should not be the part of audit procedure, as it is the part of internal audit only. Briefly state what broad areas should mandatorily become part of the audit procedure of OM & Co. for conducting the audit of OTAPS NBFC Ltd.? Also comment whether contention of Mr. O is correct? (6 Marks)

ANSWER : 4 (a)

Following are broad areas that should be mandatorily part of the audit procedure for conducting the audit of NBFC:

- Ascertaining the Business of the Company** - The first step in carrying out the audit of a NBFC is to scan through the Memorandum & Articles of Association of the company, so as to acquaint oneself with the type of business that the company is engaged into. The task of ascertaining the principal business activity of any NBFC is of paramount importance since the very classification of a company as a NBFC & its further classification would all depend upon its principal business activity. Based on the classification of a company, it will be required to comply with the provisions relating to limits on acceptance of public deposits as contained in the NBFC Public Deposit Directions.

- (2) **Evaluation of Internal Control System** - An auditor should gain an understanding of the accounting system & related internal controls adopted by the NBFC to determine the nature, timing & extent of his audit procedures. An auditor should also ascertain whether the internal controls put in place by the NBFC are adequate & are being effectively followed. In particular, an auditor should review the effectiveness of the system of recovery prevalent at the NBFC. He should ascertain whether the NBFC has an effective system of periodical review of advances in place which would facilitate effective monitoring & follow up. The absence of a periodical review system could result in non-detection of sticky advances at their very inception which may ultimately result in the NBFC having an alarmingly high level of NPAs.
- (3) **Registration with the RBI** - Section 45-IA of the RBI Act, 1934, has made it incumbent on the part of all NBFCs to comply with registration requirements & have minimum net owned funds. An auditor should obtain a copy of the certificate of registration granted by the RBI or in case the certificate of registration has not been granted, a copy of the application form filed with the RBI for registration. It may particularly be noted that NBFCs incorporated after 9th January, 1997 are not entitled to commence business without first obtaining a registration certificate from the RBI. An auditor should, therefore, verify whether the dual conditions relating to registration with the RBI & maintenance of minimum net owned funds have been duly complied with by the concerned NBFC. The auditor should ascertain whether investment in prescribed liquid assets have been made & whether quarterly returns as mentioned above have been regularly filed with the RBI by the concerned NBFC.
- The auditors must ascertain whether the company properly classified as per the requirements of various regulations. In case, the NBFC has not been classified by the RBI, the classification of a company will have to be determined after a careful consideration of various factors such as particulars of earlier registration granted, if any, particulars furnished in the application form for registration, company's Memorandum of Association & its financial results.
- (4) **NBFC Prudential Norms Directions** - Check compliance with prudential norms encompassing income recognition, income from investments, accounting standards, accounting for investments, asset classification, provisioning for bad & doubtful debts, capital adequacy norms, prohibition on granting of loans by a NBFC against its own shares, prohibition on loans & investments for failure to repay public deposits & norms for concentration of credit/investments.

In the given situation, OM & Co., is the statutory auditor of OTAPS NBFC Ltd. While planning the audit procedures to be done during the audit of entity, there was difference of opinion between O & his partner M regarding evaluation of internal control & verification of registration with RBI. As discussed above NBFCs are not entitled to commence business without first obtaining a registration certificate from the RBI. An auditor should, therefore, verify whether the dual conditions relating to registration with the RBI & maintenance of minimum net owned funds have been duly complied with by the concerned NBFC. Further, auditor should gain an understanding of the accounting system & related internal controls adopted by the NBFC to determine the nature, timing & extent of his audit procedures. An auditor should also ascertain whether the internal controls put in place by the NBFC are adequate & are being effectively followed. Accordingly, contention of Mr. O regarding evaluation of internal control system & verification of registration with RBI should not be part of the audit procedure as it is part of internal audits only, is not correct.

QUESTION : 4 (b)

The Marketing Department of Charitra Ltd. has been consistently showing a lower performance whereas the cost of the department is increasing in spurts over the years. The management believes that since the marketing department is under a regular radar of the CFO, an audit might result in the employee hostility. Also, an operational audit of Marketing Department was done two years back however, the recommendations of the previous audit were not followed by the concerned employees. Please advise the management if another audit is the solution & whether only one-time operational audit is enough? Further, advise on the ways to deal with the employee hostility. (4 Marks)

ANSWER : 4 (b)

The Operational Audit is not one-time activity. It should be viewed as a continuous improvement cycle:



The continuous improvement cycle of Operational Audit can be depicted through Plan, Do, Check & Act diagram.

All the significant operations must be subjected to the scrutiny of operational audit, at least, once in three years. Therefore, the operational audit should be done in the current scenario. However, to deal with the employee hostility the participative approach of the audit should be adopted:

In this approach the auditor discusses the ideas for improvements with those managers that have to implement them & make them feel that they have participated in the recommendations made for improvements. By soliciting the views of the operating personnel, the operational audit becomes a co-operative enterprise.

This participative approach encourages the auditee to develop a friendly attitude towards the auditors & look forward to their guidance in a more receptive fashion. When the participative method is adopted then the resistance to change becomes minimal, feelings of hostility disappear & gives room for feelings of mutual trust. Team spirit is developed. The auditors & the auditee together try to achieve the common goal. The proposed recommendations are discussed with the auditee & modifications as may be agreed upon are incorporated in the operational audit report. With this attitude of the auditor, it becomes absolutely easy to implement the proposed suggestions as the auditee themselves take initiative for implementing & the auditor does not have to force any change on the auditee.

QUESTION : 4 (c)

Mr. Shreyansh, a Chartered Accountant in practice was invited to deliver a seminar on Amendments in Schedule III & CARO 2020 which was attended by professionals as well as by representatives of various Industries. One section of audience raised a particular issue unique to the industry to which it pertains. Mr. Shreyansh enthusiastically explained the issue & elaborated how he solved this, for his client facing the same issue with worked out examples from the computer storage device using the actual data of one of his clients with full identification of client details being displayed to the group for the sake giving clarity on a topic in a real-life situation. Comment with reference to the CA Act, 1949, & Schedules thereto.

(4 Marks)

ANSWER : 4 (c)

Disclosure of Information to third Party: Clause (1) of Part I of the Second Schedule to the CA Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of the client or otherwise than as required by law for the time being in force.

SA 200 on "Overall Objectives of the Independent Auditor & the Conduct of an Audit in Accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of information acquired during his work & should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose".

In the instant case, Mr. Shreyansh is a Chartered Accountant in practice & he was invited to deliver a seminar on Amendments in Schedule III & CARO 2020 which was attended by professional as well as by representatives of various industries. During his session, a query was raised on particular issue & Mr. Shreyansh used the actual data of one of his clients with full identification of client details displayed to explain & elaborate such query. Applying the above provision, the auditor cannot disclose the information in his possession without specific permission of the client.

Thus, CA. Shreyansh will be liable for professional misconduct under clause 1 of Part I of the Second Schedule to the CA Act, 1949.

QUESTION : 5 (a)

Dharam & Karam Company Ltd. had prepared its financial statements for the financial year 2021-22 which were approved by the Board of Directors of the company & thereafter they were signed by the Chairperson of the company as authorized by the Board, as well as by its CEO, CFO & CS, respectively. Also, its board report was signed by its Managing Director as well as by an Executive Director. You are required to comment whether financial statements & the Board's report of the company have been signed by the persons mandatorily required to sign, as prescribed by the relevant Act. (4 Marks)

ANSWER : 5 (a)

As per section 134 of the Companies Act, 2013, the financial statements, including consolidated financial statements, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board by the Chairperson of the Company where he is authorized by the Board or by two directors out of which one shall be Managing Director, if any, & the Chief Executive Officer, the Chief Financial Officer & the Company Secretary of the Company, wherever they are appointed, or in the case of One Person Company, only by one director, for submission to the auditor for his report thereon.

The Board's report shall be signed by its chairperson of the company if he is authorised by the Board & where he is not so authorised, shall be signed by at least two directors, one of whom shall be a Managing Director.

Here, Dharam & Karam Company Ltd. had prepared its financial statements for the financial year 2021-22 which were approved by the Board of Directors of the company & thereafter they were signed by the Chairperson of the company as authorised by the Board, as well as by its CEO, CFO & CS, respectively. Also, its board report was signed by its Managing Director as well as by an Executive Director.

Hence, it can be said that the financial statements & the Board's report of the Dharam & Karam Company Ltd. have been signed are in accordance with section 134 of the Companies Act, 2013.

QUESTION : 5 (b)

Darshan Ltd. is a manufacturing company, provided following details of wastages of raw materials in percentage, for various months. You have been asked to enquire into causes of abnormal wastage of raw materials. Draw out an audit plan.

Wastage percentage are -

July 2021	1.3%
Aug 2021	1.6%
Sep 2021	1.5%
Oct 2021	3.9%

(6 Marks)

ANSWER : 5 (b)

Audit Plan to locate the Abnormal Wastage of Raw Material: To locate the reasons for the abnormal wastage, the auditor of Darshan Ltd. should first assess the general requirements as under:

- Procure a list of raw materials, showing the names & detailed characteristics of each raw material.
- Obtain the standard consumption figures, & ascertain the basis according to which normal wastage figures have been worked out. Examine the break-up of a normal wastage into that in process, storage & handling stages. Also obtain control reports, if any, in respect of manufacturing costs with reference to predetermined standards.
- Examine the various records maintained for recording separately the various lots purchased & identification of each lot with actual material consumption & for ascertaining actual wastage figures therein.

- (iv) Obtain reports of Preventive Maintenance Programme of machinery to ensure that the quality of goods manufacture is not of sub-standard nature or leads to high scrappage work.
- (v) Assess whether personnel employed are properly trained & working efficiently.
- (vi) See whether quality control techniques have been consistent or have undergone any change.
- (vii) Examine inventory plans & procedures in report of transportation storage efficiency, deterioration, pilferage & whether the same are audited regularly.
- (viii) Examine whether the basis adopted for calculating wastage for September is the same as was adopted for the other three months.
- (ix) Obtain a statement showing break up of wastage figures in storage, handling & process for the four months under reference & compare the results of the analysis for each of the four months.

In addition, some specific reasons for abnormal wastage in process may be considered by the auditor are as under:

- (i) Examine laboratory reports & inspection reports to find out if raw materials purchased were of a poor quality or were of sub-standard quality. This will be most useful if it is possible to identify the wastage out of each lot that has been purchased.
- (ii) Machine breakdown, power failure, etc. may also result into loss of materials in process. Check the machine utilisation statements.
- (iii) A high rate of rejections in the finished lots may also be responsible for abnormal wastage; therefore, examine the inspectors' reports in respect of inspection carried out on the completion of each stage of work or process.
- (iv) It is possible that the wastage may have occurred because the particular lot out of which issues were made was lying in the store for a long time, leading to deterioration in quality or because of a change in the weather which may have led to the deterioration. Compare the wastage figures.
- (v) Abnormal wastage in storage & handling may arise due to the following reasons:
Write offs on account of reconciliation of physical & book inventories: In case of periodical physical inventory taking, such write offs will be reflected only in the month such reconciliation takes place.
Accidental, theft or fire losses in storage: The auditor should examine the possibility of these for the purpose.
- (vi) Examine whether any new production line was taken up during the month in respect of which standard input-output ratio is yet to be set-up.

QUESTION : 5 (c)

BR Construction was into the business of building roads & other infrastructure facilities for government contracts. Mr. Tiwari, one of the senior official, was looking after the procurement of cement required at the construction sites. There was a substantial increase in the price of cement bags bought as compared to those bought prior to the appointment of Mr. Tiwari. The management of the company decides to get a forensic audit done for the transactions handled by Mr. Tiwari. What points should be kept in mind by the management while appointing a forensic auditor? (4 Marks)

ANSWER : 5 (c)

A Forensic Auditor is often retained to analyze, interpret, summarize & present complex financial & business-related issues in a manner which is both understandable & properly supported.

Forensic Accountants are trained to look beyond the numbers & deal with the business reality of the situation. Forensic auditor needs to have an understanding on various frauds that can be carried off & how evidence need to be collected.

While appointing a forensic auditor, the Management of BR Construction must initially consider whether the firm has the necessary skills & experience to accept the work. In view of above, Management of BR Construction should ensure that the forensic auditor should necessarily possess the following characteristics & skills:

- Crafting questions to be posed.
- Responding to questions posed.
- Identifying documents to be requested &/or subpoenaed.

- Identifying individuals to be most knowledgeable of facts.
- Conducting research relevant to facts of the case.
- Identifying & preserving key evidence.
- Evaluating produced documentation & information for completeness.
- Analysing produced records & other information for facts.
- Identifying alternative means to obtain key facts & information.
- Providing questions for deposition & cross examination of fact & expert witnesses.

QUESTION : 6 (a)

The Comptroller & Auditor General of India has appointed a chartered accountant firm to conduct the comprehensive audit of Tram Company Limited (a listed government company) which is handling the Metro project of the metropolitan city for the period ending 31-03-2021. The work to be conducted under Project 'D' handled by the Tram Company Limited was of laying down railway line of 124 kilometers. [The chartered accountant firm reviewed the internal audit report & observed the shortcoming reported about the performance of Project 'D' regarding the understatement of the Current liabilities & Capital work in progress by ₹ 95.39 crore.] Explain some of the matters to be undertaken by the chartered accountant firm while conducting the comprehensive audit of Tram Company Limited. (5 Marks)

ANSWER : 6 (a)

A CA Firm has been appointed to conduct comprehensive audit of Tram Company Limited, which is a listed Govt Company handling the Metro project. CA firm has observed the shortcomings as stated in internal audit report regarding understatement of Current liabilities & CWIP by ₹ 95.39 crore.

Matters to be undertaken by the CA Firm while conducting the comprehensive audit of Tram Company Limited are:

- How does the overall capital cost of the project compare with the approved planned costs?
- Were there any substantial increases &, if so, what are these & whether there is evidence of extravagance or unnecessary expenditure?
- Have the accepted production or operational outputs been achieved? Has there been under utilisation of installed capacity or shortfall in performance &, if so, what has caused it?
- Has the planned rate of return been achieved?
- Are the systems of project formulation & execution sound? Are there inadequacies? What has been the effect on the gestation period & capital cost?
- Are cost control measures adequate & are there inefficiencies, wastages in raw materials consumption, etc.?
- Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores & spares?
- Does the enterprise have research & development programmes? What has been the performance in adopting new processes, technologies, improving profits & in reducing costs through technological progress?
- If the enterprise has an adequate system of repairs & maintenance?
- Are procedures effective & economical?
- Is there any poor or insufficient or inefficient project planning?

QUESTION : 6(b)

Samyak Limited is engaged in the business of trading leather goods. You are the internal auditor of the company for the year 2021-22. In order to review internal controls of the Sales Department of the company, you visited the Department & noticed the work division as follows:

1. An officer was handling the sales ledger & cash receipts.

2. Another official was handling dispatch of goods & issuance of Delivery challans.

3. One more officer was there to handle customer/ debtor accounts & issue of receipts.

As an internal auditor, you are required to briefly discuss the general condition pertaining to the internal check prevalent in internal control system. Do you think that there was proper division of work in Samyak Limited? If not, why? (5 Marks)

ANSWER : 6 (b)

The general condition pertaining to the internal check system may be summarized as under:

- (i) No single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.
- (ii) Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
- (iii) Every member of the staff should be encouraged to go on leave at least once a year.
- (iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.
- (v) There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.
- (vi) Mechanical devices should be used, wherever practicable to prevent loss or misappropriation of cash.
- (vii) Budgetary control should be exercised & wide deviations observed should be reconciled.
- (viii) For inventory taking, at the close of the year, trading activities should, if possible be suspended, & it should be done by staff belonging to several sections of the organization.
- (ix) The financial & administrative powers should be distributed very judiciously among different officers & the manner in which those are actually exercised should be reviewed periodically.
- (x) Procedures should be laid down for periodical verification & testing of different sections of accounting records to ensure that they are accurate.

In the given scenario, Samyak Limited has not done proper division of work as:

- (i) the receipts of cash should not be handled by the official handling sales ledger &
- (ii) delivery challans should be verified by an authorised official other than the officer handling despatch of goods.

QUESTION : 6 (c)

Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank. The Bank follows financial year as accounting year. Your Audit Manager informed that the bank has recognised on accrual basis income from dividends on securities & Units of Mutual Funds held by it as at the end of financial year. The dividends on securities & Units of Mutual Funds were declared after the end of financial year. Comment. (4 Marks)

ANSWER : 6 (c)

Banks may book income from dividend on shares of corporate bodies on accrual basis, provided dividend on the shares has been declared by the corporate body in its annual general meeting & the owner's right to receive payment is established. This is also in accordance with AS 9. In this case the dividends have been declared after the financial year end. Therefore, the recognition of income by the bank on accrual basis is not in order.

In respect of income from government securities & bonds & debentures of corporate bodies, where interest rates on these instruments are pre-determined, income could be booked on accrual basis, provided interest is serviced regularly & as such is not in arrears. It was further, however, clarified that banks may book income on accrual basis on securities of corporate bodies/public sector undertakings in respect of which the payment of interest & repayment of principal have been guaranteed by the Central Government or a State Government.

OR

QUESTION : 6 (c)

CA. Sita, appointed as a Peer Reviewer for M/s. Ram Associates, has asked for all the compilation & the Due Diligence engagements carried out by M/s. Ram Associates for her peer review during the period considered for peer review purposes by the board. She has also sent out a mail to Peer Review Board regarding her selection. Mr. Ram, the managing partner of the firm seeks your advice on this matter.

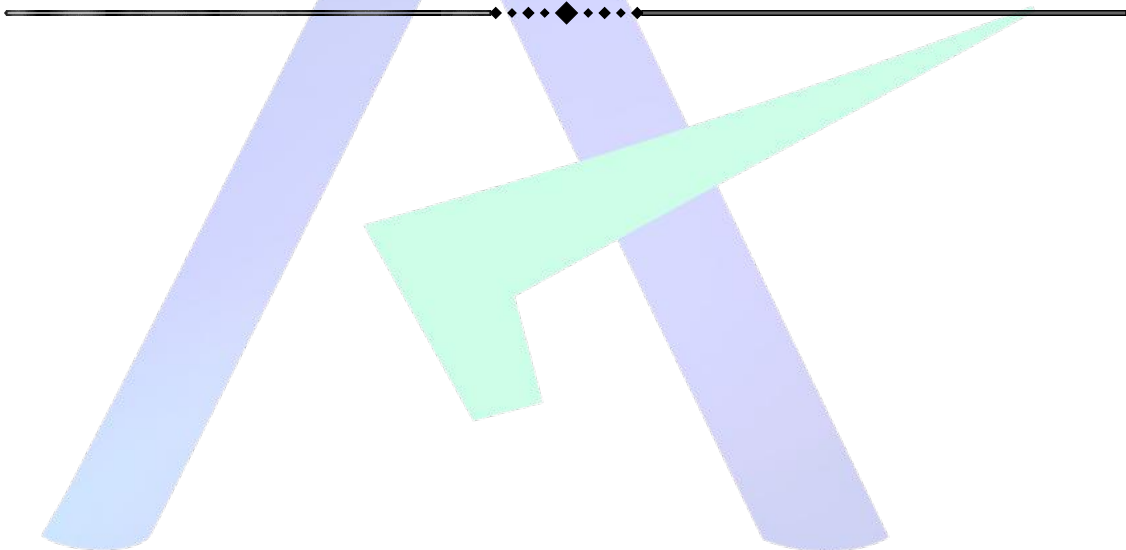
(4 Marks)

ANSWER : 6 (c)

Selection of Assurance Service Engagements for Review: The Statement on Peer Review defines the scope of peer review which revolves around compliance with technical, ethical & professional standards; quality of reporting; office systems & procedures with regard to compliance of assurance engagements; &, training programmes for staff including articled & audit assistants involved in assurance engagements. The entire peer review process is directed at the assurance services.

Assurance Services means assurance engagements services as specified in the "Framework for Assurance Engagements" issued by the ICAI & as may be amended from time to time. Assurance engagements does not include engagements for the compilation of financial statements or engagements solely to assist the client in preparing, compiling or collating information other than financial statements; or engagement for Due diligence.

In the given situation, CA. Sita is appointed as a peer reviewer for M/s Ram Associates, has asked for all the compilations & the due diligence engagements carried out by M/s Ram Associates for her peer review. In view of above, Peer Review of compilation & due diligence at the time of execution step by CA. Sita is not correct as due diligence & compilation engagements are not covered in the scope of Assurance engagement & Peer Review is directed at assurance engagement only.



CA FINAL – ADVANCED AUDITING & PROFESSIONAL ETHICS

MOCK TEST PAPER – March 2022

DIVISION A - MCQs (30 Marks)

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

1. M/s. ASH Brothers is a partnership firm engaged in the business of selling old vehicles. Mr. A, Mr. S & Mr. H are the three partners of the firm. In the month of January 2021, Mr. H's son (a minor) was admitted for the benefit of partnership who attained majority in April 2022, but no change was made in the Partner's share during the year. Whether the tax auditor is required to mention the details of Mr. H's son admitted to the partnership during the year, as per clause 9 of Form 3CD of the Income Tax?
 - (a) Since the minor has not attained majority during the audit period, no details need to mention in Form 3CD.
 - (b) The auditor is not required to give details of minor admitted to partnership as there was no change in the Partner's Share during the year.
 - (c) Any change in the Partners since the last date of the preceding year has to be mentioned under clause 9(b) of Form 3CD.
 - (d) As the father of minor is his guardian till he attains majority & Mr. H was already partner in the firm, there is no need to mention the details of minor in Form 3CD.
2. M/s Brahmi & Associates have been appointed as the statutory auditor of Prompton Leaves Limited, a manufacturer of gas geysers for the FY 2021-22. During the course of audit, the auditor found that two customer complaints have been filed against the company in the FY 2021-22, for the use of sub standard pipes & wires in manufacture of gas geysers. The gas geyser blasted at high temperature leading to severe injuries to the family of complainant along with damage to their property. They have sought a demand of ₹ 10 crores. However, the lawyer of Prompton Leaves Limited believes that such claim is unsustainable as the incident occurred due to short circuit at both the complainants place. The management of Prompton Leaves Limited accordingly did not include any reference to the litigation in the financial statements. The auditor obtained legal advice from some independent lawyer according to whom the outcome of the case is not ascertainable as of now.
 - (a) The statutory auditor should give an unqualified opinion.
 - (b) The statutory auditor should give an unqualified opinion with Emphasis of Matter paragraph.
 - (c) The statutory auditor should withdraw from the audit engagement.
 - (d) The statutory auditor should give a qualified opinion.
3. M/s Vardhman & Associates have been appointed as the statutory auditors of a NBFC (UVW Ltd.) for the financial year 2021-22. The company is required to comply with the Indian Accounting Standards. During the course of audit CA Vardhman found that the company has classified its Assets & Liabilities as financial & non-financial instead of current & non-current. What should CA Vardhman advice the management of NBFC UVW Ltd. in this regard?
 - (a) The management of NBFC UVW Ltd. is correct in classifying the Balance Sheet items as financial & non-financial as per requirement of Division III of Schedule III of Companies Act 2013.
 - (b) The management of NBFC UVW Ltd. is not correct in this regard & should classify the Balance Sheet items as current & non-current as is required by all other companies as per the requirement of the Division III under Schedule III of the Companies Act 2013.
 - (c) The management of NBFC UVW Ltd is right in this regard as the NBFC has the option to classify the balance sheet items either as current & non-current or as financial & non- financial.
 - (d) The management of NBFC UVW Ltd. should classify the Balance Sheet items as current & non-current as per the requirement of Division II of Schedule III of the Companies Act 2013 applicable in case of NBFC.

4. **M/s Shiva & Associates have been appointed as statutory auditors of Kailash Ltd. which is the company registered u/s 8 of the Companies Act 2013. During the course of audit, CA Shiva noticed that the Board of Directors have held their meetings only twice, in the financial year under audit. How should CA Shiva deal with the same in the compliance certificate to be issued by him?**
- (a) CA Shiva should give an adverse statement stating that the meeting of board of directors were held only twice as against the minimum requirement of 4 meetings of financial year.
 - (b) CA Shiva need not mention regarding the same in the compliance certificate as there is no minimum requirement of meeting of board of directors in case of companies registered u/s 8.
 - (c) Kailash Ltd. being a company registered u/s 8 of the Companies Act 2013 is exempt from obtaining compliance certificate from the statutory auditors.
 - (d) Kailash Ltd. is correct in conducting two meeting of board of directors therefore, CA Shiva should not give an adverse or qualified statement in this regard.
5. **M/s Sati & Associates were appointed as the statutory auditors of Power King Limited for the audit of financial year 2021-22. Power King Limited has a power generating plant in Sikkim. At the time of accepting the engagement, it was decided among the engagement partner (CA Sati) & the management that since CA Sati & his team is doing the audit of a client having power plant in Sikkim for the first time, it will be the duty of the management to update the audit team regarding all the taxes & statutes applicable to units situated in Sikkim. Which of the following is correct in this regard?**
- (a) The engagement team, being the auditor of Sikkim based power plant for the first time can always rely on the management's information & can work accordingly.
 - (b) The engagement team should understand the Power King Limited business environment & should obtain knowledge about the laws & statutes applicable in this case.
 - (c) The engagement team should not accept the audit of such power plant situated in Sikkim of which he has no prior knowledge.
 - (d) The engagement team can very well accept the audit of Power King Limited & with respect to aspects related to Sikkim law he can give disclaimer of opinion, if required.
6. **Employees of Star Ltd. have to travel frequently for business purposes, so the company entered into a contract with a Sudarshan Travels Ltd. for managing booking, cancellation & other services required by their employees. As per contract terms, Sudarshan travels has to raise its monthly bills for the tickets booked or cancelled during the period & the same are paid by Star Ltd. within 15 days of the bill date. The bills raised by Sudarshan travels were of huge amount, so the management of Star Ltd. decided to get an audit conducted of the process followed for booking/ cancellation of tickets & verify the accuracy of bills raised by the travel agency. Which audit do you feel the management should opt for?**
- (a) Internal audit, as it relates to examine the operational efficiency of the organisation.
 - (b) Management audit, as it is an audit desired by the management.
 - (c) Performance audit so as to assess the performance of the Sudarshan travels appointed by the organisation.
 - (d) Operational audit, as it is the audit for the management & involves verifying the effectiveness, efficiency & economy of operations done by the Sudarshan travels for the organisation.
7. **PRS Ltd. issued a prospectus in respect of an IPO which had the auditor's report on the financial statements for the year ended 31st March 2021. The issue was fully subscribed. During this year, there was an abnormal rise in the profits of the company for which it was found later on that it was because of manipulated sales in which there was participation of whole-time director & other top officials of the company. On discovery of this fact, the company offered to refund all moneys to the subscribers of the shares & sued the auditors for the damages alleging that the auditors failed to examine & ascertain any satisfactory explanation for steep increase in the rate of profits & related accounts. The company emphasized that the auditor should have proceeded with suspicion & should not have followed selected verification. The auditors were able to prove that they found internal controls to be satisfactory & did not find any circumstance to arouse suspicion. The company was not able to prove that auditors were negligent in performance of their duties. Please suggest your views on this.**

- (a) The stand of the company was correct in this case. Considering the nature of the work, the Auditors should have proceeded with suspicion & should not have followed selected verification.
- (b) The approach of the auditors looks reasonable in this case. The auditors found internal controls to be satisfactory & also did not find any circumstance to arouse suspicion & hence they performed their procedures on the basis of selected verification.
- (c) In the given case, the auditors should have involved various experts along with them to help them on their audit procedures. Prospectus is one area wherein management involves various experts & hence the auditors should also have done that. In the given case, by not involving the experts the auditors did not perform their job in a professional manner. If they had involved experts like forensic experts etc., the manipulation could have been detected. Hence the auditors should be held liable.
- (d) In case of such type of engagements, the focus is always on the management controls. If the controls are found to be effective, then an auditor can never be held liable in respect of any deficiency or misstatement or fraud.

8. Which of the following is not an indicator about material uncertainty over the entity's ability to continue as a going concern:

- (a) Net liability or net current liability position.
- (b) Cancellation of company's production license due to change on government policies.
- (c) Non-declaration of dividend to equity shareholders.
- (d) Substantial operating losses or significant deterioration in the value of assets used to generate cash flows.

9.approach to sampling has the following characteristics:

- (i) Random selection of the sample items; &
- (ii) The use of probability theory to evaluate sample results, including measurement of sampling risk.
- (a) Statistical sampling
- (b) Non-statistical sampling
- (c) Stratified sampling
- (d) Haphazard sampling

10. Which of the following is an example of Direct Entity level control

- (a) Company code of conduct & ethics policies.
- (b) Human resource policies.
- (c) Job roles & responsibilities of employees.
- (d) Monitoring of effectiveness of controls activities by Internal Audit function. (10 x1 = 10 Marks)

Questions (11-20) carry 2 Marks each

MCQ 11. -15.

Integrated Case Scenario 1

M/s Head Limited, had recently issued right shares for all the existing shareholders. The total proceeds collected amounted to ₹ 200 crore, out of which 50 % was planned to be used for construction of a new factory next to the existing one & the balance was to be used for working capital purpose. However, due to the Covid-19 pandemic, the proposed factory work was affected & hence the company decided to park 9% of the specific fund in a debt mutual fund instead of keeping it idle. Similarly, the company decided to park 11% of the working capital fund in government securities.

M/s Legs Limited, an unlisted associate entity of Head Limited had similarly raised funds through qualified institutional placement & used the funds fully for the specified purpose. The auditor of the Legs Limited (Mr. G, partner of M/s GK & Associates) & the auditor of Head Limited (Mr. Q, partner of M/s CYQ & Associates) suggested that they shall mandatorily disclose the details of utilization of funds, as per SEBI LODR Regulation 32.

However, Mr. C, one of the partners of M/s CYQ & Associates argued that there is no need to report the above matter under SEBI LODR Regulations, but the same shall be reported under CARO 2020. Mr. Q argued that the matter need not be reported under CARO 2020. This argument had spoiled the relationship between the two partners, as a result of which, Mr. C decided to quit from the partnership & started his own practice.

Mr. C then decided to induct Mr. J, a newly qualified Chartered Accountant as a partner in his firm. After this, the firm got an audit assignment from M/s Bank Limited. Mr. C consulted with his partner whether to accept the offer. Mr. J told that he has a loan (amounting to 75% of FD) against fixed deposit (of ₹6.8 lakh) in the said bank & feared that they cannot accept the offer. However, Mr. C told that since the loan is against fixed deposit there is no problem in taking up the offer, but he didn't want to force Mr. J in giving his acceptance. Therefore, the offer was dropped.

Few months later, Mr. C passed away & the whole firm was managed by his partner Mr. J. The legal representative of Mr. C (Mrs. C) quoted the partnership agreement clause regarding the right of legal representative of the deceased partner to receive share of profit from the firm & requested for such share of profit. However, Mr. J informed that there is no such provision as per the CA Act & denied to share any profits/ revenue from the firm. Agitated by the decision of Mr. J, Mrs. C filed a complaint with the ICAI against Mr. J.

On the basis of the abovementioned facts, you are required to answer the following MCQs:

Multiple Choice Questions (5 questions of 2 Marks each):

11. Is the advice of Mr. Q correct in case of Head Limited? If yes what are the details which need to be disclosed by the company?

- (a) Yes. The company shall indicate the deviations in use of proceeds & category wise variation between projected utilization & actual utilization.
- (b) No. There is no need to indicate the statement since such deviations were due to Covid-19 pandemic.
- (c) Yes. The company shall indicate the deviations in use of proceeds in form of an explanatory statement.
- (d) Yes. The company shall indicate the % of deviation if such deviation is more than 10% of the total funds allotted for the specified purpose. Hence, the company shall indicate only the deviation in utilization funds allocated for working capital purpose.

12. In case if Head Limited is to report the deviation in use of funds, at what interval should it report the same?

- (a) Disclose it every year in its Annual Report
- (b) Biannual reporting
- (c) Every quarter
- (d) Monthly reporting, till the funds are fully utilised.

13. Assuming yourself as the auditor of Head Limited, what would be your stand on reporting the deviation in utilization of funds under CARO 2020?

- (a) There is no need to report the matter under CARO, since such deviations were due to Covid-19 pandemic.
- (b) The matter should be reported under CARO, under clause (xi)(a)
- (c) The matter should be reported under CARO, under clause (x)
- (d) The matter should be reported under CARO, under clause (xvi)(b)

14. In the above case, is the act of Mr. J to deny share of profits to legal representative of Mr. C right? What is the relevant provision of the CA Act which you need to refer in this case?

- (a) Mr. J has no right to deny the share of profit since it is given in the partnership agreement. The relevant provision to be considered here is Clause 2 of Part I of First Schedule of CA Act.
- (b) Mr. J has all right to deny the share of profit since it shall lead to professional misconduct. The relevant provision to be considered here is clause 2 of Part I of First Schedule of CA Act.

- (c) Mr. J has no right to deny the share of profit since it is given in the partnership agreement. The relevant provision to be considered here is Clause 4 of Part I of First Schedule of CA Act.
- (d) Mr. J is correct in denying the share of profit. Though the same is mentioned in the agreement, it is against the provisions of CA Act. The relevant provision to be considered here is Clause 1 of Part II of Second Schedule.

15. Had the firm accepted the audit assignment of Bank Limited, would it have led to invalid appointment as per the Companies Act, 2013? If yes, under what provision?

- (a) No. As explained by Mr. C, since the loan was against a fixed deposit (loan against a collateral) appoint of the firm would not be void had they accepted the offer.
- (b) Yes. The acceptance of the offer would have led to invalid appointment of the firm as per the section 141 (3)(d)(ii) of the Companies Act, 2013.
- (c) Yes. The acceptance of the offer would have led to invalid appointment of the firm as per the section 141 (3)(d)(iii) of the Companies Act, 2013.
- (d) Yes. The acceptance of the offer would have led to professional to invalid appointment of the firm as per the section 141 (3)(c)(ii) of the Companies Act, 2013.

MCQ 16. -20.

Integrated Case Scenario 2

M/s Audit & Co. were appointed as internal auditors of M/s Manufacturing Limited, whose shares were held by Mr. F, Mrs. F, Mr. S & Ms. D in equal proportion.

CA Senior & his articled assistant Mr. Junior were a part of the team which was looking after the above assignment. As a part of the work, Mr. Junior was required to take care of the P2P internal controls established to ensure the three-way match is properly functioning. Being new to internal audit, he asked from help from a fellow team member regarding the above matter.

After completion of the audit, the firm submitted its report directly to the Board of Directors of the company. A copy of the same was also sent to the company's statutory auditors. The report had clearly mentioned that the existing internal audit system in the company was not commensurate with its size & nature of business.

Following this, the company offered the assignment of Tax Audit to M/s Audit & Co. itself. All the partners were happy to accept the offer, except CA New, an ex-articled assistant & newly inducted partner of the firm. He was of the opinion that if the above offer was accepted, it would lead to professional misconduct under the CA Act. However, despite his advice, the firm went on to accept the offer.

After the above incident, CA New resigned from the firm & started his own practice as a sole proprietor. Few days after the resignation of CA New, the following things happened:

- (i) M/s Audit & Co. had advertised the changes in partnership of the firm, by limiting the ad to a bare statement of facts & consideration given to the appropriateness of the area of distribution of the magazine.
- (ii) CA New issued a classified advertisement in the newsletter of the Institute, for seeking partnership. The ad contained his name, phone number & addresses of Social Networking sites.

On the basis of the abovementioned facts, you are required to answer the following MCQs:

Multiple Choice Questions (5 questions of 2 Marks each):

16. Assuming yourself to be a fellow team member of Mr. Junior, explain him what is a three-way match internal control involved in P2P process.

- (a) Matching of Purchase order, Sales order & Invoice raised to ensure all ordered quantity of intended goods have been invoiced & proper control over quantity of inventory is maintained.
- (b) Matching of Sales order, Goods delivery note & invoice to ensure all ordered quantity of intended goods have been delivered & invoiced accordingly.
- (c) Matching of Sales order, Invoice & Payment receipt details to ensure all ordered quantity of intended goods have been invoiced & payment for the same is received.
- (d) Matching of Purchase order, Goods receipt note & invoice to ensure all ordered quantity of intended goods have been received & invoiced accordingly.

17. Assuming yourself to be the statutory auditors of the company, would you need to mention about the details in the internal audit under CARO 2020? If yes, under what clause should it be mentioned?

- (a) The above matter should be reported under clause (xiv) of CARO 2020
- (b) The above matter need not be reported under CARO, but it shall be reported under Emphasis of Matter Paragraph as per SA 706.
- (c) The above matter should be reported under clause (xviii) of CARO 2020
- (d) The above matter should be reported under clause (xv) of CARO 2020

18. From the above information that M/s Manufacturing Limited appointed an internal auditor, what could you infer about their Paid-up share capital, outstanding deposit & turnover?

- (a) Paid up share capital of > 40 crore Outstanding deposits > 20 crore; Turnover > 190 crore
- (b) Paid up share capital of > 25 crore Outstanding deposits > 25 crore; Turnover > 100 crore
- (c) Paid up share capital of > 50 crore Outstanding deposits > 25 crore; Turnover > 200 crore
- (d) Paid up share capital of > 45 crore Outstanding deposits > 15 crore; Turnover > 100 crore

19. Will accepting the Tax Audit offer lead to professional misconduct? If yes, as per which clause?

- (a) No. There will be no professional misconduct on the firm, if it accepts the offer.
- (b) Yes. By accepting the offer, the firm will be guilty of professional misconduct as per clause 4 of Part I of Second Schedule read along with Council Guidelines.
- (c) Yes. By accepting the offer, the firm will be guilty of professional misconduct as per clause 12 of Part I of First Schedule.
- (d) Yes. By accepting the offer, the firm will be guilty of professional misconduct as per clause 2 of Part I of Second Schedule read along with Council guidelines.

20. Comment on following incidents (i) & (ii) discussed in the scenario from the perspective of Professional Ethics as per the CA Act.

- (i) M/s Audit & Co. had advertised the changes in partnership of the firm, by limiting the ad to a bare statement of facts & consideration given to the appropriateness of the area of distribution of the magazine.
 - (ii) CA New issued a classified advertisement in the newsletter of the Institute, for seeking partnership. The ad contained his name, phone number & addresses of Social Networking sites.
- (a) Incident (ii) makes CA New guilty of professional misconduct, since he is advertising for seeking partnership.
 - (b) Neither of the incidents violate any provisions of CA Act. Hence, there is no professional misconduct.
 - (c) Incident (i) makes M/s Audit & Co. firm guilty of professional misconduct, as the advertisement is published in newspaper other than that issued by the Institute.
 - (d) Incident (ii) makes CA New guilty of professional misconduct, since he has provided the addresses of his social networking sites.

(10 x 2 = 20 Marks)

MCQ - Answers

1	(c)	2	(d)	3	(a)	4	(d)	5	(b)	6	(d)	7	(b)	8	(c)	9	(a)	10	(d)
11	(a)	12	(c)	13	(c)	14	(a)	15	(b)	16	(d)	17	(a)	18	(c)	19	(b)	20	(b)

DIVISION B- DESCRIPTIVE QUESTIONS-70 MARKS

Question No. 1 is compulsory.

Attempt any four questions from the Rest.

QUESTION : 1 (a)

M/s Chandra & Co., Chartered Accountants were appointed as Statutory Auditors of Green Essence Limited for the F.Y 2021-2022. The previous year's audit was conducted by M/s. Nath & Associates. After the audit was completed & report submitted, it was found that closing balances of last financial year i.e., 2020-21 were incorrectly brought forward. It was found that M/s Chandra & Co. did not apply any audit

procedures to ensure that correct opening balances have been brought forward to the current period. Accordingly, a complaint was filed against Chandra & Co. in relation to this matter.

You are required to inform what policies are required to be implemented by Chandra & Co. for dealing with such complaints & allegations as required by Standard on Quality Control (SQC). (5 Marks)

ANSWER : 1 (a)

In the given question, Chandra & Co. did not apply audit procedures to ensure that opening balances had been correctly brought forward. A complaint was filed against the auditors in this context. As per Standard on Quality Control (SQC) 1 "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, & Other Assurance & Related Services Engagements",

- (i) The firm should establish policies & procedures designed to provide it with reasonable assurance that it deals appropriately with:
 - (a) Complaints & allegations that the work performed by the firm fails to comply with professional standards & regulatory & legal requirements; &
 - (b) Allegations of non-compliance with the firm's system of quality control.
- (ii) Complaints & allegations (which do not include those that are clearly frivolous) may originate from within or outside the firm. They may be made by firm personnel, clients or other third parties. They may be received by engagement team members or other firm personnel.
- (iii) As part of this process, the firm establishes clearly defined channels for firm personnel to raise any concerns in a manner that enables them to come forward without fear of reprisals.
- (iv) The firm investigates such complaints & allegations in accordance with established policies & procedures. The investigation is supervised by a partner with sufficient & appropriate experience & authority within the firm but who is not otherwise involved in the engagement, & includes involving legal counsel as necessary. Small firms & sole practitioners may use the services of a suitably qualified external person or another firm to carry out the investigation. Complaints, allegations & the responses to them are documented
- (v) Where the results of the investigations indicate deficiencies in the design or operation of the firm's quality control policies & procedures, or non-compliance with the firm's system of quality control by an individual or individuals, the firm takes appropriate action.

QUESTION : 1 (b)

M/s. Sumati & Co. was appointed as an auditor of Mati Limited, a company operating its business in telecom sector. As per spectrum allocation agreement with Government, Mati Limited is required to pay certain percentage of its annual revenue as license fee. Mati Limited paid the license fee on its core business for last two years. At the end of third year, the communication was received from Government that it needs to pay agreed percentage on its total revenues & not only on core business revenues. Matter was disputed & went to court of law. On prudence basis, Mati Limited made a provision on estimated business in its books of accounts of agreed percentage on noncore business receipts also. The amount of provision was of such huge amount that the Mati Limited's profit & loss account for that quarter reflected loss due to that provision. How you as an auditor can evaluate this accounting estimate which involves significant risk & what if Management has not addressed the effects of estimation uncertainty on provision made? (4 Marks)

ANSWER : 1 (b)

In the given case, Sumati & Co. was appointed as an auditor of Mati Ltd., operating in Telecom sector. GSB Ltd paid the license fee on its core business revenue whereas Govt required it to pay on non-core business receipts as well. Consequently, the amount of provision was of such a huge amount that Mati Ltd.'s profit & loss account reflected a loss due to that provision. As an auditor evaluation would be done as under:

For accounting estimates that give rise to significant risks, in addition to other substantive procedures performed to meet the requirements of SA 330, the auditor shall evaluate the following:

- (i) How management has considered alternative assumptions or outcomes, & why it has rejected them, or how management has otherwise addressed estimation uncertainty in making the accounting estimate.
- (ii) Whether the significant assumptions used by management are reasonable.

- (iii) Where relevant to the reasonableness of the significant assumptions used by management or the appropriate application of the applicable financial reporting framework, management's intent to carry out specific courses of action & its ability to do so.
- (iv) If, in the auditor's judgment, management has not adequately addressed the effects of estimation uncertainty on the accounting estimates that give rise to significant risks, the auditor shall, if considered necessary, develop a range with which to evaluate the reasonableness of the accounting estimate.

QUESTION : 1 (c)

In the financial year 2020-21, Shreyansh Ltd. faced an extraordinary event (earthquake), which destroyed a lot of business activity of the company. These circumstances indicate material uncertainty on the company's ability to continue as going concern. Due to such event it may not be possible for the company to realize its assets or pay off the liabilities during the regular course of its business. The financial statement & notes to the financial statements of the company do not disclose this fact. What kind of opinion should the statutory auditor of Shreyansh Ltd. issue in such circumstances & why? Also, draft the opinion & basis for opinion para for the same. (5 Marks)

ANSWER : 1 (c)

In the present case, there exists a material uncertainty that cast a significant doubt on the company's ability to continue as going concern & the same is not disclosed in the financial statements of Shreyansh Ltd.

As such, the financial statements of Shreyansh Ltd. for the FY 2020-21 are materially misstated & the effect of the misstatement is so material & pervasive on the financial statements that giving only a qualified opinion will be insufficient & therefore the statutory auditor of Shreyansh Ltd. should issue an adverse opinion.

The relevant extract of the Adverse Opinion Paragraph & Basis for Adverse Opinion paragraph is as under:

Adverse Opinion

In our opinion, because of the omission of the information mentioned in the Basis for Adverse Opinion section of our report, the accompanying financial statements do not present fairly, the financial position of Shreyansh Ltd. as at March 31, 2021, & of its financial performance & its cash flows for the year then ended in accordance with the Accounting Standards issued by the ICAI.

Basis for Adverse Opinion

Shreyansh Ltd. has faced an extraordinary event (earthquake), which destroyed a lot of business activity of the company. Due to such event it may not be possible for the company to realize its assets or pay off the liabilities during the regular course of its business. This situation indicates that a material uncertainty exists that may cast significant doubt on the Company's ability to continue as a going concern. The financial statement & notes to the financial statements of the company do not disclose this fact.

QUESTION : 2 (a)

Prabhu Ltd., a company incorporated in India & listed on a recognized Stock Exchange in India, has entered into various related parties transactions during the financial year. You are required to answer the following keeping in mind the Listing Obligations & Disclosure Requirements (LODR) on Corporate Governance.

- (i) Who should sign the report of material transactions with related parties? (1 Mark)
- (ii) What type of transactions & policy are required to be disclosed in relation to related party transactions? (2 Marks)
- (iii) Whether disclosures of related party transactions on consolidated financial statements are required to be made? If yes, what are the guidelines? (2 Marks)

ANSWER : 2 (a)

An Indian company, Prabhu Ltd., listed on stock exchange entered into various related party transactions.

- (i) The report shall be signed either by the compliance officer or the chief executive officer of the listed entity.

- (ii) (a) The company shall disclose the policy on dealing with related party transactions on its website & a web link thereto shall be provided in the Annual Report.
- (b) The listed entity shall disclose the transactions with any person or entity belonging to the promoter/ promoter group which hold(s) 10% or more shareholding in the listed entity, in the format prescribed in the relevant accounting standards for annual results.
- (iii) (a) Yes, disclosures of related party transactions on consolidated financial statements are required to be made by the listed entity within 30 days from the date of publication of its standalone & consolidated financial results for the half year.
- (b) The listed entity shall disclose related party transactions on a consolidated basis, in the format specified in the relevant accounting standards for annual results to the stock exchanges & publish the same on its website. Provided that a 'high value debt listed entity' shall submit such disclosures along with its standalone financial results for the half year.

QUESTION : 2 (b)

The volatility, unpredictability & pace of fast changes that exists in the automated environment today is far greater than in the past & consequently it throws more risk to business which requires them to have a need to continuously manage such risks. State various risks which an enterprise may have to face & manage. (4 Marks)

ANSWER : 2 (b)

Various Risk: Businesses today operate in a dynamic environment. The volatility, unpredictability & pace of changes that exist in the business environment today is far greater than in the past. Some of the reasons for this dynamic environment include globalization, use of technology, new regulatory requirements, etc. Because of this dynamic environment the associated risks to business have also increased & companies have a need to continuously manage risks.

Examples of risks include:

- Market Risks;
- Regulatory & Compliance Risks;
- Technology & Security Risks;
- Financial Reporting Risks;
- Operational Risks;
- Credit Risk;
- Business Partner Risk;
- Product or Project Risk;
- Environmental Risks.

QUESTION : 2 (c)

CA Bahu, a newly qualified professional with certificate of practice, approached CA Subahu, the auditor of his father's company Apex Ltd., to allow him to have some practical & professional knowledge & experience in his firm before he can set up his own professional practice. CA Subahu allowed him to sit in his office for 6 month & allotted a small chamber with other office infrastructure facility. In the course of his association with CA Subahu's office, he used to provide tax consultancy independently to the client of the firm & also filed few IT & GST return & represented himself before various tax authorities on behalf of the firm although no documents were signed by him. During his association in CA Subahu's office, he did not get any salary or share of profit or commission but only re-imbursement of usual expenses like conveyance, telephone etc. was made to him. After the end of the agreed period, he was given a lump sum amount of ₹ 2,50,000 by CA Subahu for his association out of gratitude. Give your comments with reference to the CA Act, 1949 & Schedules thereto. (5 Marks)

ANSWER : 2 (c)

Clause (1) of Part I of the First Schedule to the CA Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he

allows any person to practice in his name as a chartered accountant unless such person is also a chartered accountant in practice & is in partnership with or employed by him.

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

In the instant case, CA Subahu allowed CA Bahu (who is a newly qualified CA professional with COP) to sit in his office for 6 months, & allowed him to provide tax consultancy independently to his firm's clients, filing of some IT & GST Returns. He also allowed him to appear before various tax authorities on behalf of his firm. CA Bahu was only reimbursed with his usual expenses & was not paid any salary or share of profit for the same. However, after the end of agreed period he was given a lump-sums of ₹ 2,50,000 for his association out of gratitude.

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

QUESTION : 3 (a)

You have been appointed to carry out the audit of Blue Heaven Life Insurance Company Ltd. for the year 2021-22. During the course of audit, you observed that the commission payable to agents constituted a major expense in operating expenses of the Company. Enumerate the audit concerns that address to the assertions required for the Auditor to ensure the continued existence of internal control as well as fairness of the amounts in accounting of commission payable to agents. (5 Marks)

ANSWER : 3 (a)

Commission payable to Agents: Insurance business is generally solicited by the Insurance agents. The remuneration of agent is paid by way of commission which is calculated by applying percentage to premium collected by him. Agency commission contributes towards significant portion of expenses incurred by the Insurance Commission. Commission is payable towards generation of new business & towards settlement of renewal premium

Role of Auditor: The Auditor during his review of Commission paid to Agents should mainly consider the following:

- Review the system established by the Insurer with respect to calculation of commission to eligible agents accurately & processing the same in timely manner.
- Review the commission payment system is in sync with the premium collection system.
- Check whether commission paid is within the limit prescribed under Insurance Act.
- Check whether commission is clawed-back on the cancelled policies.

QUESTION : 3 (b)

Mr. Yuvi is a contractor dealing in food catering, flower decorating & light decorating activities. He has received contract in respect of food catering & flower decorating from one NGO for holding Annual Talent evening event to celebrate completion of 25 years of their establishment. For the said event Mr. Yuvi has received in cash ₹ 1,75,000 for food catering & ₹ 1,35,000 for flower decoration. As a tax auditor how would you deal & report on the above? (5 Marks)

ANSWER : 3 (b)

Section 269ST provides that no person shall receive sum of ₹ 2 lakh or more a) in aggregate from a person in a day; or b) in respect of a single transaction; or c) in respect of transactions relating to one event or occasion from a person otherwise than by an account payee cheque or an account payee demand draft or by use of electronic clearing system through a bank account.

Further, the tax auditor has the responsibility to verify the compliance with the provisions of 269T of the Income Tax Act.

Furthermore, the tax auditor is required to report under Clause 31 (ba) particulars of each receipt in an amount exceeding the limit specified in section 269ST, in aggregate from a person in a day or in respect of a single transaction or in respect of transactions relating to one event or occasion from a person, during the previous year, where such receipt is otherwise than by a cheque or bank draft or use of electronic clearing system through a bank account:-

- (i) Name, address & Permanent Account Number (if available with the assessee) of the payer;
- (ii) Nature of transaction;
- (iii) Amount of receipt (in ₹);
- (iv) Date of receipt;

In the present case, Mr. Yuvi, contractor dealing in food catering, flower decorating & light decorating activities, received in cash ₹ 1,75,000 for food catering & ₹ 1,35,000 for flower decoration from one NGO for holding one event, by way of cash which is exceeding prescribed amount of ₹ 2,00,000. Thus, tax auditor is required to report the same in compliance with Clause 31 (ba) of Form 3CD.

QUESTION : 3 (c)

CA. Vardhman, a Chartered Accountant in practice, empanelled as an Insolvency Professional (IP) has mentioned the same on his visiting cards, letter heads & other communications also. Mr. Tapas residing in his neighbourhood, has filed a complaint for professional misconduct against the said member for such mention of IP. You are required to examine the same with reference to the CA Act, 1949 & Schedules thereto. (4 Marks)

ANSWER : 3 (c)

Using Designation of Insolvency Professional: As per Clause (7) of Part I of First Schedule to the CA Act, 1949, a CA in practice is deemed to be guilty of professional misconduct if he (i) advertises his professional attainments or services or (ii) uses any designation or expressions other than 'Chartered Accountant' on professional documents, visiting cards, letter heads or sign boards unless it be a degree of a university established by law in India or recognized by the Central Government or a title indicating membership of the ICAI or of any other institution that has been recognized by the Central Government or may be recognized by the council.

In the given situation, CA. Vardhman is a Chartered Accountant in practice. He is also empanelled as an Insolvency Professional (IP), accordingly, has mentioned the same on his visiting cards, letter heads & other communications also. As per Clause (7) of Part I of First Schedule to the CA Act, 1949, a Chartered Accountant empaneled as IP (Insolvency Professional) can mention "Insolvency Professional" on his visiting cards, letter heads & other communication, as this is a title recognised by the Central Government in terms of Clause 7 of Part 1 of First Schedule to the CA Act, 1949. Thus, complaint of neighbour Mr. Tapas is not enforceable/valid.

QUESTION : 4 (a)

CA Sheetal is conducting the statutory audit of Kunthu Ltd., a non-banking financial company. It has branches in various parts of India. The company with a focus on housing finance, has outstanding non-convertible debentures worth ₹ 170 crore. The company reportedly missed interest payments of ₹ 17 crore on its debts because of inadequate liquidity. As a result, Kunthu Ltd. faced a series of downgrades by rating agencies on its debts over the past two months. Rating was cut to D from A4 implying that the company was in default or expected to be in default soon. What aspects CA Sheetal should look into in relation to the activity of mobilization of public deposits (particularly in relation to downgrading of credit facilities) by Kunthu Ltd

(5 Marks)

ANSWER : 4 (a)

CA Sheetal has to ascertain whether the company has complied with the following aspects in relation to the activity of mobilization of public deposits:-

- (i) The ceiling on quantum of public deposits has been linked to its credit rating as given by an approved credit rating agency. In the event of a upgrading/downgrading of credit rating, the auditor should bear in mind that the NBFC will have to increase/reduce its public deposits in accordance with the revised credit rating assigned to it within a specified time frame & should ensure that the NBFC has informed about the same to the RBI inwriting.
- (ii) In the event of downgrading of credit rating below the minimum specified investment grade, a non-banking financial company, being an investment & credit company or a factor, shall regularise the excess deposit as provided hereunder:
- with immediate effect, stop accepting fresh public deposits & renewing existing deposits;
 - all existing deposits shall run off to maturity; &
 - report the position within 15 working days, to the concerned Regional Office of the RBI where the NBFC is registered.
 - No matured public deposit shall be renewed without the express & voluntary consent of the depositor.

QUESTION : 4 (b)

Moksh Ltd. is a manufacturing company & started its business in the year 2000. The net profit after tax of the company was 15% up to the financial year 2019-20, but for the financial year 2020-21 & 2021-22 the company's profit declined even when there was increase in the sales & production of goods by the company. So, the management of AS Ltd. felt a need to get the management audit conducted with the objective of detecting & overcoming current managerial deficiencies. Briefly discuss the steps to prepare the management audit report. (5 Marks)

ANSWER : 4 (b)**Steps to Prepare the Management Audit Report:**

Planning the Audit Report - Before starting the report, the auditor should ask himself, "What do I want to tell the reader about this audit?" The answer will enable him to communicate effectively.

Supporting information - The management auditor should supplement his report with appropriate audit evidence which sufficiently & convincingly supports the conclusions.

Preparing draft report - Before writing the final report, the auditor should prepare a draft report. This would help him in finding out the most effective manner of presenting his report. It would also indicate whether there is any superfluous information or a gap in reasoning.

Writing & issuing the final report - The final report should be written only when the auditor is completely satisfied with the draft report. The head of the management auditing department may review & approve the final report. Before issuing the final report, the auditor should discuss conclusions & recommendations at appropriate levels of management. The report should be duly signed & dated.

Follow-up of the audit report - The management auditor should review whether follow-up action is taken by management on the basis of his report. If no action is taken within a reasonable time, he should draw management's attention to it.

Action / Response of Management on Audit Report: Where management has not acted upon his suggestions or not implemented his recommendations, the auditor should ascertain the reasons thereof. In cases where he finds that non-implementation is due to a gap in communication, he should initiate further discussions to bridge such gaps. The actions & responses to the Management Audit Report reflect management's attitude to the audit. In any case, the auditor to retain the usefulness of the audit function should ascertain from the management, preferably in writing, the reasons for non- implementation. It is possible that because of change in circumstances, the audit observation did not require any action on the part of the management. The auditor should satisfy himself on the appropriateness of such reasons as well to close the issue.

QUESTION : 4 (c)

Mr. Shanti, a Chartered Accountant, employed as a paid Assistant with a Chartered Accountant firm, leaves the services of the firm on 31st December, 2020. Despite many reminders from ICAI he fails to reply

regarding the date of leaving the services of the firm. Comment with reference to the CA Act, 1949, & Schedules thereto. (4 Marks)

ANSWER : 4 (c)

Failed to Supply Information Called For: As per Clause (2) of Part III of the First Schedule to the CA Act, 1949, a member, whether in practice or not, will be deemed to be guilty of professional misconduct if he does not supply the information called for, or does not comply with the requirements asked for, by the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate authority.

Thus, in the given case, Mr. Shanti has failed to reply to the letters of the Institute asking him to confirm the date of leaving the service as a paid assistant. Therefore, he is held guilty of professional misconduct as per Clause (2) of Part III of the First Schedule to the CA Act, 1949.

QUESTION : 5 (a)

Mr. Shripal, a practising Chartered Accountant, has been appointed as an auditor of Rani Ltd on 12th June, 2021 for the year ended 31st March, 2022. The following persons have done following transactions in securities of Rani Ltd.:

- Daughter of Mr. Shripal Purchase of Securities on 10th September, 2021 of face value of ₹ 45,000 (market value ₹ 90,000).
- Husband of daughter of Mr. Shripal: Purchase of Securities on 10th December, 2021 of face value of ₹ 90,000 (market value ₹ 1,90,000).

All the above securities were sold on 18th February, 2022 for ₹ 3,00,000. Discuss the implications of the above on the appointment of Mr. Shripal. (5 Marks)

ANSWER : 5 (a)

Implications of relatives' securities holding on the Appointment of the Auditor: According to Section 141 (3)(d)(i) of the Companies Act, 2013, read with Rule 10, an auditor is disqualified to be appointed as an auditor if the auditor or his relative holds securities or interest in the company of face value exceeding ₹ 100,000.

Further the definition of relative also includes daughter & a daughter's husband. Both are covered in the definition of relative as defined by the Companies Act 2013.

Thus, the disqualifications will be applicable as the relative/s are holding securities of face value of more than ₹ 100,000 & market value is not important.

It is also to note that in the event of acquiring any security or interest by a relative above the threshold prescribed, the corrective action to maintain the limits as specified above can be taken by the auditor within 60 days of such acquisition or interest. The same has however not been done.

In the instant case, Daughter of Mr. Shripal purchased the securities on 10th September 2021 of face value of ₹ 45,000 & husband of daughter of Mr. Shripal purchased the securities on 10th of December, 2021 of face value of ₹ 90,000. Aggregating the value of holding of securities exceeds the limits mentioned in proviso to section 141 (3)(d)(i) i.e. ₹ 1,00,000.

Further, corrective action taken by Husband of Daughter of Mr. Shripal on 18th February, is also not in accordance with prescribed grace period of 60 days.

Therefore, CA. Shripal will be disqualified for appointment as an auditor of Raja Ltd. as per section 141 (3)(d)(i) & he shall vacate his office.

QUESTION : 5 (b)

EROS, a movie theatre complex, is the foremost theatre located in Bangalore. Along with the sale of tickets over the counter & online booking, the major proportion of income is from the cafe, shops, pubs etc. located in the complex. Its other income includes advertisements exhibited within/outside the premises such as hoardings, banners, slides, short films etc. The facility for parking of vehicles is also provided in the basement of the premises.

EROS appointed your firm as the auditor of the entity. Being the head of the audit team, you are, therefore, required to draw an audit programme initially in respect of its revenue & expenditure considering the above mentioned facts along with other relevant points relating to a complex. (5 Marks)

ANSWER : 5 (b)

Audit Programme of Movie Theatre Complex:

- (i) Peruse the Memorandum of Association & Articles of Association of the entity.
- (ii) Ensure the object clause permits the entity to engage in this type of business.
- (iii) In the case of income from sale of tickets:
 - (1) Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly accounted.
 - (2) Verify the system of relating to online booking of various shows & the system of realization of money.
 - (3) Check that there is overall system of reconciliation of collections with the number of seats available for different shows on a day.
- (iv) Verify the **internal control system** & its effectiveness relating to the income from cafe, shops, pubs, game zone etc., located within the multiplex.
- (v) Verify the system of control exercised relating to the **income receivable from advertisements** exhibited within the premises & inside the hall such as hoarding, banners, slides, short films etc.
- (vi) Verify the system of collection from the **parking areas** in respect of the vehicles parked by the customers.
- (vii) In the case of **payment to the distributors** verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement any payment of advance made to the distributor is also adjusted against the amount due.
- (viii) Verify the system of payment of salaries & other benefits to the employees & ensure that statutory requirements are complied with.
- (ix) Verify the payments effected in respect of the **maintenance of the building** & ensure the same is in order.
- (x) Verify the insurance premium paid & ensure it covers the entire assets.

QUESTION : 5 (c)

HSDC Bank Ltd., received an application from a pharmaceutical company for take over of their outstanding term loans secured on its assets, availed from & outstanding with a nationalised bank. HSDC Bank Ltd., requires you to make a due diligence audit in the areas of assets of pharmaceutical company especially with reference to valuation aspect of assets. State what may be your areas of analysis in order to ensure that the assets are not stated at overvalued amounts. (4 Marks)

ANSWER : 5 (c)

Over-Valued Assets: In case of due diligence exercise, the area of analysis in order to ensure that the assets are not stated at over-valued amounts are:

- Uncollected/uncollectable receivables.
- Obsolete, slow non-moving inventories or inventories valued above NRV; huge inventories of packing materials etc. with name of company.
- Underused or obsolete Plant & Machinery & their spares; asset values which have been impaired due to sudden fall in market value etc.
- Assets carried at much more than current market value due to capitalization of expenditure/foreign exchange fluctuation, or capitalization of expenditure mainly in the nature of revenue.
- Litigated assets & property.
- Investments carried at cost though realizable value is much lower.
- Investments carrying a very low rate of income / return.
- Infertuous project expenditure/deferred revenue expenditure etc.
- Group Company balances not reconciled.
- Intangibles having no reliable value.

QUESTION : 6 (a)

Bahubali & Co., a CA. firm was appointed by C&AG to conduct comprehensive audit of Brahmi Ltd., a public sector undertaking. C&AG advised Bahubali & Co. to cover areas such as investment decisions, project formulation, organisational effectiveness, capacity utilisation, management of equipment, plant & machinery, production performance, use of materials, productivity of labour, idle capacity, costs & prices, materials management, sales & credit control, budgetary & internal control systems, etc. Discuss stating the issues examined in comprehensive audit. (5 Marks)

ANSWER : 6 (a)

Issues examined in Comprehensive Audit: Some of the issues examined in comprehensive audit are-

- How does the overall capital cost of the project compare with the approved planned costs? Were there any substantial increases &, if so, what are these & whether there is evidence of extravagance or unnecessary expenditure?
- Have the accepted production or operational outputs been achieved? Has there been under utilisation of installed capacity or shortfall in performance &, if so, what has caused it?
- Has the planned rate of return been achieved?
- Are the systems of project formulation & execution sound? Are there inadequacies? What Has been the effect on the gestation period & capital cost?
- Are cost control measures adequate & are there inefficiencies, wastages in raw materials consumption, etc.?
- Are the purchase policies adequate? Or have they led to piling up of inventory resulting in redundancy in stores & spares?
- Does the enterprise have research & development programmes? What has been the performance in adopting new processes, technologies, improving profits & in reducing costs through technological progress?
- If the enterprise has an adequate system of repairs & maintenance?
- Are procedures effective & economical?
- Is there any poor or insufficient or inefficient project planning?

QUESTION : 6 (b)

The Auditor of Rapid Limited succumbed to the pressure of the management in certifying the financials with an over stated figure of turnover by not adhering to the cut-off principles of the time scale for the transactions of the year. On taking cognizance of this act of the auditor, the Tribunal under the Companies Act, 2013 initiated the proceedings against him. Briefly list the powers of the Tribunal in this respect including those relating to making orders against the Auditor found to be guilty. (5 Marks)

ANSWER : 6 (b)

Power of Tribunal in case Auditor acted in a Fraudulent Manner: As per sub-section (5) of the section 140 of the Companies Act, 2013, the Tribunal either suo motu or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors.

However, if the application is made by the Central Government & the Tribunal is satisfied that any change of the auditor is required, it shall within fifteen days of receipt of such application, make an order that he shall not function as an auditor & the Central Government may appoint another auditor in his place.

It may be noted that an auditor, whether individual or firm, against whom final order has been passed by the Tribunal under this section shall not be eligible to be appointed as an auditor of any company for a period of five years from the date of passing of the order & the auditor shall also be liable for action u/s 447 of the said Act. It is hereby clarified that in the case of a firm, the liability shall be of the firm & that of every partner or

partners who acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its director or officers.

QUESTION : 6 (c)

CA Rajul has been appointed as Forensic Auditor by BMY Bank Limited for one of its borrowal accounts AMISS Ltd. CA Rajul started the audit by first reviewing the transactions of the borrower in Bank statement as per Bank records to identify any hidden patterns in that information. She had to review huge volume of data, as the number of transactions per day were in hundreds & the data was to be reviewed for the last three years. So, she was stuck up as to how to proceed further to identify any hidden patterns in information, if any. Guide CA Rajul, suggesting which technique to be used for identifying any hidden patterns in the information. (4 Marks)

ANSWER : 6 (c)**Data Mining Techniques:**

- (i) Data mining technique is a set of assisted techniques designed to automatically mine large volumes of data for new, hidden or unexpected information or patterns.
- (ii) It discovers the usual knowledge or patterns in data, without a predefined idea or hypothesis about what the pattern may be, i.e. without any prior knowledge of fraud.
- (iii) It explains various affinities, association, trends & variations in the form of conditional logic.
- (iv) Data mining techniques are categorized in three ways: Discovery, Predictive modeling & Deviation & Link analysis.

In the given case of BMY Bank Ltd., CA Rajul appointed as forensic auditor for its borrower, AMISS Ltd, shall use above stated data mining techniques to identify any hidden patterns of information.

OR

QUESTION : 6 (c)

While assigning the quality review work to the respective Technical Reviewers, in order to ensure independence & avoid conflict of interest, certain eligibility conditions were specified for carrying out the specified quality review assignment to the Technical Reviewers who were required to submit a declaration of eligibility before starting the assignment. In view of above, briefly discuss those eligibility conditions prescribed for Technical Reviewer. (4 Marks)

ANSWER : 6 (c)

While assigning the quality review work to the respective Technical Reviewers, in order to ensure independence & avoid conflict of interest, the following eligibility conditions were specified for carrying out the specified quality review assignment to the Technical Reviewers who were required to submit a declaration of eligibility before starting the assignment.

For being a technical reviewer (TR):

- He should not have disciplinary proceeding under the CA Act, 1949 pending against him/her or any disciplinary action under the CA Act, 1949 / penal action under any other law taken/pending against him during last three financial years &/or thereafter.
- He or his/her firm or any of the network firms or any of the partners of the firm or that of the network firms should not have been the statutory auditor of the company, as specified, or have rendered any other services to the said entity during last three financial years & /or thereafter.
- He or his/her firm or any of the network firms or any of the partners of the firm or that of the network firms should not have had any association with the specified AFUR, during the last three financial years & /or thereafter.
- He should comply with all the eligibility conditions laid down for appointment as an auditor of a company u/s 141(3) of the Companies Act, 2013 which apply mutatis mutandis in respect of the review of the quality of statutory audit of the entity, as specified, so far as applicable.
- He does not belong to the city/region of head office of the AFUR.

CA FINAL – ADVANCED AUDITING & PROFESSIONAL ETHICS

SUGGESTED ANSWERS - May 2022

ANSWER THE FOLLOWING QUESTIONS

QUESTION : 1(a)

PQR & Associates, Chartered Accountants, is a partnership firm having 3 partners CA P, CA Q & CA R. PQR & Associates are appointed as Statutory Auditors of ABC Limited, a listed entity for the financial year 2021-22 & CA P is appointed as Engagement Partner for the audit of ABC Limited. Before issuing the Audit Report of ABC Limited, CA P asked CA R to perform Engagement Quality Control Review & is of the view that his responsibility will be reduced after review by CA R. Whether the contention of CA P is correct? What are the aspects that need to be considered by CA R while performing Engagement Quality Control Review for audit of financial statements of ABC Limited? (5 Marks)

ANSWER : 1(a)

As per SQC 1, "Quality Control for Firms that Perform Audit & Reviews of Historical Financial Information, & other Assurance & Related Services Engagements", the review does not reduce the responsibilities of the engagement partner. Hence, contention of CA. P that after engagement quality control review by CA. R, his responsibility will be reduced, is not correct.

However, CA. R needs to consider the following aspect while performing Engagement Quality Control Review for audit of financial statements of a listed entity ABC Ltd.:

1. The engagement team's evaluation of the firm's independence in relation to the specific engagement.
2. Significant risks identified during the engagement & the responses to those risks.
3. Judgments made, particularly with respect to materiality & significant risks.
4. Whether appropriate consultation has taken place on matters involving differences of opinion or other difficult or contentious matters, & the conclusions arising from those consultations.
5. The significance & disposition of corrected & uncorrected misstatements identified during the engagement.
6. The matters to be communicated to management & those charged with governance &, where applicable, other parties such as regulatory bodies.
7. Whether working papers selected for review reflect the work performed in relation to the significant judgments & support the conclusions reached.
8. The appropriateness of the report to be issued.

Engagement quality control reviews for engagements other than audits of financial statements of listed entities may, depending on the circumstances, include some or all of these considerations.

QUESTION : 1(b)

JKL Limited is engaged in the business of Construction & real estate having various projects across states. M/s YT & Co, Chartered Accountants have been appointed as Statutory Auditors, Audit Team from M/s YT & Co for audit of JKL Limited comprises of CA Z - Engagement Partner, CA Q, a paid assistant & 3 Articled Assistants. During preliminary verification, CA Z observed that huge amount of sub-contract payments were made to M/s JB Associates, a partnership firm in which Director of JKL Limited is a managing partner. The engagement team discussed that SA 315 & SA 240 shall include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the JKL Limited's related party relationships & transaction. Highlight the matters that are to be addressed in the discussion by CA Z with engagement team members with reference to the relevant standard on Auditing. (5 Marks)

ANSWER : 1(b)

As per SA 550 "Related Parties", the engagement team discussion that SA 315 & SA 240 require shall

include specific consideration of the susceptibility of the financial statements to material misstatement due to fraud or error that could result from the entity's related party relationships & transactions. Accordingly matters that are to be addressed in the discussion by CA Z among the engagement team include:

1. The nature & extent of the entity's relationships & transactions with related parties (using, for example, the auditor's record of identified related parties updated after each audit).
2. An emphasis on the importance of maintaining professional skepticism throughout the audit regarding the potential for material misstatement associated with related party relationships & transactions.
3. The circumstances or conditions of the entity that may indicate the existence of related party relationships or transactions that management has not identified or disclosed to the auditor (e.g., a complex organisational structure, use of special- purpose entities for off-balance sheet transactions, or an inadequate information system).
4. The records or documents that may indicate the existence of related party relationships or transactions.
5. The importance that management & those charged with governance attach to the identification, appropriate accounting for, & disclosure of related party relationships & transactions (if the applicable financial reporting framework establishes related party requirements), & the related risk of management override of relevant controls.
6. In addition, the discussion in the context of fraud may include specific consideration of how related parties may be involved in fraud. For example:
 - (a) how special-purpose entities controlled by management might be used to facilitate earnings management.
 - (b) how transactions between the entity & a known business partner of a key member of management could be arranged to facilitate misappropriation of the entity's assets.

QUESTION : 1(c)

Beta Hotel operates in an automated environment & uses application softwares for front desk, Guest reservations, Restaurant & kitchen orders, & billing for which CA Anil has been appointed as an auditor. Guide CA Anil the various key aspects that needs to be considered by him while understanding of the automated environment of the Company in accordance with SA 315, Is he required to document the same? If yes, illustrate by giving one example. (4 Marks)

ANSWER : 1(c)

Understanding & Documenting Automated Environment: Understanding of the automated environment of a company is required as per SA 315. The auditor's understanding of the automated environment should include the following:

1. The applications that are being used by the company;
2. Details of the IT infrastructure components for each of the application;
3. The organisation structure & governance;
4. The policies, procedures & processes followed;
5. IT risks & controls.

The auditor is required to document the understanding of a company's automated environment as per SA 230. The illustration below is an example of how an auditor can document details of an automated environment:

Application	Used for	Database	Operating System	Network	Server & Storage
SAP ECC/ HANA	Integrated Application software	Oracle 19c	HP-UX	LAN, WAN	HP Server & NAS
REVS	Front Desk, Guest	MS-SQL	Windows	In-house	HP Server Internal

	Reservations	Server 2018	2016 Server	developed	HDD
KOTS	Restaurant & Kitchen Orders	MS-SQL Server 2018	Windows 2016 Server	In-house developed	HP Server Internal HDD
BILLSYS	Billing	Oracle	Windows	Packaged	HP Server
		12c	2016 Server	Software	Internal HDD

QUESTION : 2 (a)

Mr. K has been appointed as statutory auditor of SK Limited for issuing an audit opinion on financial statements & internal controls over financial reporting (ICFR) for the year ended March 31, 2022 under the Companies Act, 2013. Guide Mr. K to prepare a checklist in the form of questions for testing internal control over cash & bank balances. When forming an opinion on ICFR is it necessary for Mr. K to test the transactions only at the balance sheet date ? (5 Marks)

ANSWER : 2(a)

In the given case of SK Limited, the appointed auditor Mr. K would prepare checklist for testing internal control over cash & bank balances. An illustrative set of questions to be answered by the audit staff is as follows:

Have you checked that the cashier -

- (i) is not responsible for opening the incoming mails;
- (ii) does not authorise any of the ledgers;
- (iii) does not authorise any expenditure or receipt;
- (iv) does not sign cheques;
- (v) takes his annual leave regularly;
- (vi) inks & balances the cash book every day;
- (vii) verifies physical cash balance with the book figure daily at the end of the day;
- (viii) prepares monthly bank reconciliation statement;
- (ix) holds no other funds or investment;
- (x) holds no unnecessary balance in hand;
- (xi) does not pay money without looking into compliance with proper procedure & due authorisation; &
- (xii) has tendered proper security or has executed a fidelity bond?

In the given situation, Mr. K is Statutory Auditor of SK Limited for issuing opinion on financial statements & internal control over financial reporting. He should surely test transactions during the financial year & not just as at the balance sheet date, though the extent of testing at or near the balance sheet date may be higher. From the discussion given above, it can be concluded that it would not be necessary for Mr. K to test the transactions only at the balance sheet date.

QUESTION : 2(b)

Jam Private Limited was engaged in business of manufacture of Cycles. CA Roy was appointed as a Statutory Auditor of the Company for the financial year 2021-22. During the year under audit, Jam Private Limited obtained working capital facilities from ABC Bank Limited for ₹ 10 crore hypothecating the Stock of goods as primary security. On inquiry CA Roy was informed by management that stock statements are furnished periodically to ABC Bank Limited & the details of submission of quarterly stock statement are as follows:

Period of Quarter	Stock Value as per Books of Account as at the end of the quarter (₹ in crore)	Stock Value as per quarterly statement submitted to ABC Bank Limited as at the end of quarter (₹ in crores)
Q1-2021-22	11.50	14.00
Q2-2021-22	14.75	17.00

Q3-2021-22	11.50	14.00
Q4-2021-22	15.25	15.25

The management of Jam Private Limited did not disclose the above variations in Notes to accounts forming part financial Statements of the Company for the year 2021-22. The management replied that there are no variations as on the Balance sheet date & further they are of the view that stock statement furnished to bank is only a formality & computed arbitrarily only for the purpose of securing higher drawing power & hence statutory auditors need not be bothered.

Is the contention of the management valid? As a Statutory Auditor how CA Roy should deal & discuss the disclosure/reporting requirements if any, as per the Companies Act, 2013 & CARO, 2020. (5 Marks)

ANSWER : 2(b)

As per clause (vii) of point Y of Schedule III to the Companies Act, 2013 - Division I - Financial Statements for a company whose financial statements are required to comply with the Companies (Accounting Standard) Rules, 2006, "where the company has borrowings from banks or financial institutions on the basis of security of current assets, it shall disclose the following :

- whether quarterly returns or statements of current assets filed by the company with banks or financial institutions are in agreement with the books of accounts.
- if not, summary of reconciliation & reasons of material discrepancies, if any to be adequately disclosed.

Further, as per para 3(ii) (b) of CARO 2020, the auditor is required to report whether during any point of time of the year, the company has been sanctioned working capital limits in excess of ₹ 5 crores, in aggregate, from banks or financial institutions on the basis of security of current assets; whether the quarterly returns or statements filed by the company with such banks or financial institutions are in agreement with the books of account of the Company, if not, give details.

The above clause requires CA Roy to comment on whether during any point of time of the year, the company has been sanctioned working capital limits in excess of ₹ 5 crores in aggregate. Jam (P) Ltd. has been sanctioned working capital facilities/limit of ₹ 10 crores which is apparently in excess of ₹ 5 crores.

Secondly, whether the quarterly returns filed by the Jam (P) Ltd. company with ABC Bank Ltd. are in agreement with the book of accounts of the company.

According to the data given in the instant situation, it is clear that there are variations in Quarter 1, Quarter 2 & Quarter 3 requiring reporting under this clause because of difference in stock value as per Book of Accounts & Stock Value as per Quarterly returns submitted to ABC Bank Ltd.

Therefore, Contention of the management is not valid.

CA. Roy should report the differences as per the Companies Act, 2013 & CARO 2020 as follows:

	Stock value as per Book Accounts (₹ in Crore)	Stock value as per quarterly statement Submitted to ABC Bank Ltd. (₹ in Crore)	Variation
Q - 1	11.50	14.00	Excess reporting of stock to Bank by 2.50 crore
Q - 2	14.75	17.00	Excess reporting of stock to Bank by 2.25 Crore
Q - 3	11.50	14.00	Excess reporting of stock to bank by 2.50 crore

QUESTION : 2(c)

CA Ravi, a practising Chartered Accountant, was proprietor of M/s. Ravi & Associates. CA Ravi died on 15th September, 2020 due to cardiac arrest. Only family member left behind CA Ravi was his wife, A) Roohi. On 30th September, 2021, Roohi sold the practice of her husband to CA Balwan for ₹ 25 Lacs along

with right to use the firm name i.e., M/s. Ravi & Associates & requested the Institute to consider the effect of such sale. Give your comments on the following ; issues with reference to the CA Act, 1949 & schedules thereto:

- (i) Whether Roohi can sell the practice to CA Balwan?
- (ii) Can CA Balwan continue to practice as proprietor in name of M/s. Ravi & Associates ? (4 Marks)

ANSWER : 2(c)

Sale of Goodwill: With reference to Clause (2) of Part I to the First Schedule to CA' Act, 1949, the Council of the ICAI considered whether the goodwill of a proprietary concern of chartered accountant can be sold to another member who is otherwise eligible, after the death of the proprietor.

It is being resolved that the legal heir of the deceased member has to obtain the permission of the Council within a year of the death of the proprietor concerned.

It further lays down that the sale is permitted subject to certain conditions like such a sale is completed/effectuated in all respects & the Institute's permission to practice in deceased's proprietary firm name is sought within a year of the death of such proprietor concerned. In respect of these cases, the name of the proprietary firm concerned would be kept in abeyance (i.e. not removed on receipt of information about the death of the proprietor as is being done at present) only upto a period of one year from the death of proprietor concerned as aforesaid.

In the given case, Mrs. Roohi, widow of Mr. Ravi, proprietor of M/s. Ravi & Associates, has sold the practice along with right to use the firm name after one year of his death for ₹ 25 lakhs. This sale is in effect the sale of goodwill.

From the discussion given above it can be concluded that:

- (i) Mrs. Roohi cannot sell the practice of CA. Balwan with right to use the firm name.
- (ii) CA Balwan cannot continue to practice in the name of the firm M/s. Ravi & Associates as a proprietor because the name of the firm M/s. Ravi & Associates would be kept in abeyance only up to a period of one year from the death of the proprietor.

QUESTION : 3 (a)

M/s. PQR Auto, a partnership firm, is engaged in manufacture of automobile spare parts having factory at Surat. CA S was appointed as the Tax Auditor of M/s. PQR Auto for the Assessment year 2022- 2023.

While carrying out the Tax Audit u/s 44AB of the Income Tax Act, 1961 CA S observed following :

- (i) Interest of ₹ 50,000 paid to Vendor X who was registered under MSME Act, 2006.
- (ii) Interest payment ₹ 10,000 was incurred in relation to earning exempt interest income from Tax Relief bonds.
- (iii) Sum of ₹ 1,00,000 was received from Mr. X, for sale of one plant & machinery. But due to non-compliance of one of the conditions as specified in the contract with Mr. X, M/s. PQR Auto forfeited ₹ 1,00,000 during AY 2022-23 as per forfeiture clause mentioned in the contract.

Guide CA S in reporting the above transactions under the relevant clauses in Form No. 3CD. (5 Marks)

ANSWER : 3(a)

- (i) As per Clause 22 of Form 3CD of the Income-tax Act, 1961, the tax auditor is required to state the amount of interest inadmissible u/s 23 of the Micro, Small & Medium Enterprises Development Act, 2006. Section 23 of the MSME Act lays down that an interest payable or paid by the buyer, in accordance with the provisions of this Act, shall not be allowed as a deduction for the purposes of the computation of income under the Income-tax Act, 1961.

Accordingly, the CA. S is required to report the payment of interest of ₹ 50,000 to Vendor X who was registered under MSME Act, 2006 under clause 22 of Form 3CD of the Income-tax Act, 1961.

- (ii) As per Clause 21(h) of Form 3CD of the Income-tax Act, 1961, the tax auditor is required to report about the amount of deduction inadmissible in terms of section 14A Income-tax Act, 1961, in respect of the expenditure incurred in relation to income which does not form part of the total

income.

Therefore, CA. S, the auditor is required to scrutinize expense accounts particularly interest account to check whether there is included any expense which is relatable to exempt income. He is also required to note down the amount & mention against the clause.

Thus, in the given situation, CA. S is required to report the same as per clause 21 (h) of Form 3CD of the Income-tax Act, 1961.

(iii) As per Clause 29(A) of Form 3CD of the Income-tax Act, 1961 of the Income-tax Act, 1961, the auditor is required to report,

(a) whether any amount is to be included as income chargeable under the head 'income from other sources' as referred to in clause (ix) of sub section (2) of section 56 the Income-tax Act, 1961.

(b) If yes, to provide the nature of income & amount thereof.

The auditor is also required to obtain a certificate from the assessee regarding all such advances received towards transfer of capital assets which have forfeited during the year & examine whether any amount of such advances has been written back during the year & examine the basis of such write back to determine whether such write back was on account of an act of forfeiture. Further, the auditor is also required to verify the terms of contract to check the conditions to forfeit of such advance & such conditions have occurred, then should verify whether the amount has been actually forfeited.

Thus, same is required to be reported under clause 29(A) of Form 3CD of the Income-tax Act, 1961.

QUESTION : 3 (b)

TQR Limited is engaged in the business of garment manufacturing having registered office at Mumbai & branches across India. Mr. Shyam, one of the senior Managers was involved in creating false documents & legitimate documents were altered to support fictitious transactions. Consequently, the management appointed you to get forensic audit done based on the digital foot-print of transactions handled by Mr. Shyam. The use of sound techniques will enable to discover the defalcations on a timely basis. As a forensic auditor how will you deal & suggest Technology based/Digital forensic techniques. (5 Marks)

ANSWER : 3(b)

Technology based /Digital Forensics Techniques: Every transaction leaves a digital footprint in today's computer-driven society. Close scrutiny of relevant emails, accounting records, phone logs & target company hard drives is a requisite facet of any modern forensic audit.

Before taking steps such as obtaining data from email etc. the forensic auditor should take appropriate legal advice so that it doesn't amount to invasion of privacy.

Digital investigations can become quite complex & require support from trained digital investigators.

Many open-source digital forensics tools are now available to assist you in this phase of the investigation.

- (i) Cross Drive Analysis
- (ii) Live Analysis
- (iii) Deleted Files
- (iv) Stochastic Forensics
- (v) Steganography
- (vi) EnCase
- (vii) MD5
- (viii) Tracking Log Files
- (ix) PC System Log
- (x) Free Log Tools

QUESTION : 3(c)

CA K qualified as Chartered Accountant & started practice as proprietor in the name of M/s. K & Associates in the year 2015-16. LST Limited, a listed entity, appointed M/s. K & Associates as Statutory Auditor for the year ended 31st March, 2022. CA K signed the balance sheet of LST Limited for the year ended 31st March, 2022 on 14th May, 2022. M/s. K & Associates never subjected themselves to the Peer Review process of the Institute since its inception of practice. Comment with reference to the CA Act, 1949 & schedules thereto. (4 Marks)

ANSWER : 3(c)

Clause (9) of Part I of the Second Schedule to the CA Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he fails to invite attention to any material departure from the generally accepted procedure of audit applicable to the circumstances.

This clause implies that the audit should be performed in accordance with "generally accepted procedure of audit applicable to the circumstances" & if for any reason the auditor has not been able to perform the audit in accordance with such procedure, his report should draw attention to the material departures from such procedures. What constitutes "generally accepted audit procedure" would depend upon the facts & circumstances of each case, but guidance is available in general terms from the various pronouncements of the Institute is issued by way of Engagement & Quality Control Standards, Statements, General Clarifications, Guidance Notes Technical Guides, Practice Manuals, Studies & Other Papers.

Audit of Listed Companies: Pursuant to SEBI Notification, statutory audit of listed companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, & hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s. K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, CA K, the proprietor signed the balance sheet on

but never subjected the firm to the Peer Review process of the Institute. CA K would be held guilty of professional misconduct under clause (9) of Part I of Second Schedule of the CA Act, 1949. Also, CA K did not comply with the SEBI Notification which was required to be complied with.

Alternative Answer

Clause (1) of Part II of the Second Schedule to the CA Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of misconduct if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council. It requires every member of the institute to act within the framework of the CA Act, 1949 & the regulations & guidelines made by Council thereunder.

The Statement on Peer Review shall be deemed to be a guideline of the Council under Clause (1) of Part II of Second Schedule to the Act & it is obligatory for the Practice Unit to comply with the provisions contained in this Statement.

As per the Statement every Practice Unit including its branches who has conducted Statutory Audit of Enterprises whose equity or debt securities are listed in India or abroad as defined under SEBI(LODR) regulations, 2015, will be subject to Peer Review in accordance with this statement.

Audit of Listed Companies: Pursuant to SEBI Notification, Statutory Audit of Listed Companies under the Companies Act, 2013 shall be done by only those auditors who have subjected themselves to the Peer Review process of the Institute, & hold a valid certificate issued by the Peer Review Board of the ICAI.

In the given case of M/s K & Associates, who is appointed auditor of a listed entity LST Limited for the year ended 31.03.2022, Mr K, the proprietor signed the Balance sheet on

but never subjected the firm to the Peer Review process of the Institute. Hence, CA K would be held guilty of professional misconduct under clause (1) of Part II of Second Schedule of the CA Act, 1949.

QUESTION : 4 : (a)

Comment on the following in the light of certificate of compliance of conditions of Corporate governance to be issued under SEBI (LODR) Regulations 2015, for a Listed company (one among the top 1000 listed companies) where the Board consists of 20 directors with a Nonexecutive director as its Chairman & further -

- (i) One Non-executive Director has attained the age of 70 years;
- (ii) One of the Directors is a Director in eight other listed entities;
- (iii) The Managing Director is serving as Independent Director in four listed entities of which one entity's equity shares are not listed on a Stock exchange;
- (iv) The Nonexecutive Chairman is the promoter of the Listed entity which has Nine Independent Directors;
- (v) One Independent Director has been serving as Independent Director in Eight listed entities of which Equity shares are listed on a Stock exchange. (5 Marks)

ANSWER : 4(a)

- (i) **One non-executive director has attained the age of 70 years:** The auditor should ensure that no listed entity shall appoint a person or continue the directorship of any person as a non-executive director who has attained the age of seventy-five years. In the given situation, there is no violation of LODR 2015 for Non-executive director who has attained the age of 70 years.
- (ii) **One of the Directors is a Director in eight other Listed Entities:** As per LODR 2015, a person shall not be a director in more than seven listed entities. In the given situation, there is non-compliance as one of the Directors is a Director in eight other listed entities which is exceeding the prescribed limit of seven entities.
- (iii) **The Managing Director is serving as Independent Director in Four listed entities of which one entity's equity shares are not listed on a Stock Exchange:** Any person who is serving as a whole-time director / managing director in any listed entity shall serve as an independent director in not more than three listed entities. For the purpose of above mentioned provision, the count for the number of listed entities on which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange. In the given situation, Managing Director has been serving as Independent Director in four listed entities of which one entity's equity shares are not listed on a stock exchange. So it is not exceeding the prescribed limit of three entities, hence there is no violation of LODR 2015.
- (iv) **The Non-executive Chairman is the Promoter of the Listed Entity which has nine Independent Directors:** The auditor should also verify that if the regular nonexecutive Chairperson is a promoter of the listed entity or is related to any promoter or person occupying management positions at the Board level or at one level below the Board, at least one-half of the Board of the listed entity shall consist of independent directors. In the given situation, Board consist of 20 directors with a Non-executive Director as its Chairman has 9 independent directors i.e., less than half of Board is not in compliance with the requirement of LODR, 2015.
- (v) **One Independent Director has been serving as Independent Director in Eight Listed Entities of which Equity Shares are listed on a Stock Exchange:** A person shall not serve as an independent director in more than seven listed entities in case its equity shares are listed on a Stock Exchange. It may be noted that the count for the number of listed entities on which a person is a director / independent director shall be only those whose equity shares are listed on a stock exchange. In the given situation, there is non-compliance as one of the Independent Director has been serving as Independent Director in eight listed entities which is exceeding the prescribed limit of seven entities.

QUESTION : 4 : (b)

Your firm has been appointed as Central Statutory Auditors of a Nationalised Bank for the financial year 2021-22. During the course of audit your audit team observed that a lump sum amount has been

disclosed as Contingent liability collectively though the components are correctly identified. In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all the contingent liabilities are identified & properly valued & the audit firm intend to obtain a representation from the management. Highlight the point's checklists that are to be covered in the management representation.

(5 Marks)

ANSWER : 4(b)

Contingent Liabilities: In respect of contingent liabilities, the auditor is primarily concerned with seeking reasonable assurance that all contingent liabilities are identified & properly valued. The auditor should obtain representation from management that: -

- (i) all off-balance sheet transactions have been accounted in the books of accounts as & when such transaction has taken place;
- (ii) all off balance sheet transactions have been entered into after following due procedure laid down;
- (iii) all off balance sheet transactions are supported by the underlying documents;
- (iv) all year end contingent liabilities have been disclosed;
- (v) the disclosed contingent liabilities do not include any crystallised liabilities which are of the nature of loss/ expense & which, therefore, require creation of a provision/adjustment in the financial statements;
- (vi) the estimated amounts of financial effect of the contingent liabilities are based on the best estimates in terms of Accounting Standard 29, including consideration of the possibility of any reimbursement;
- (vii) in case of guarantees issued on behalf of the bank's directors, the bank has taken appropriate steps to ensure that adequate & effective arrangements have been made so that the commitments would be met out of the party's own resources & that the bank will not be called upon to grant any loan or advances to meet the liability consequent upon the invocation of the said guarantee(s) & that no violation of section 20 of the Banking Regulation Act, 1949 has arisen on account of such guarantee; &
- (viii) such contingent liabilities which have not been disclosed on account of the fact that the possibility of their outcome is remote include the management's justification for reaching such a decision in respect of those contingent liabilities.

Note: Students may be given due credit for any other relevant point quoted.

QUESTION : 4 : (c)

XYZ Limited is manufacturer of soaps & cosmetics having business operations in Delhi, XYZ Limited is planning to expand its operations across India. Be tore expansion, the top management of XYZ Limited is willing to appoint CA T for conducting Management Audit of XYZ Limited, However, the top management of XYZ Limited is afraid that Management Audit may lead to the breeding of antagonism on the part of the Company. The top management of XYZ Limited approached CA T & requested to explain them the causes of antagonism. Help CA T.

(5 Marks)

ANSWER : 4(c)

CA. T as the management auditor, is expected to evaluate the effectiveness of controls, the auditees might fear that the management audit report may create their incompetent impression on the top management of XYZ Limited. Therefore, the management audit may lead to the breeding of antagonism on the part of the auditees. Causes of antagonism are as under:

- (i) Fear of criticism stemming from adverse audit findings.
- (ii) Fear of changes in day-to-day working habits because of changes resulting from audit recommendations.
- (iii) Punitive action by superiors prompted by reported deficiencies.
- (iv) Insensitive audit practices - reports which are overly critical, reports which focus on deficiencies

only, the air of mystery cloaking some audits, & the perception that auditors gain personally from reporting deficiencies.

- (v) Hostile audit style - a cold & distant aspect is a lack of understanding of the auditee's problems, an absence of empathy, an air of smugness or superiority, an excessive concentration on insignificant errors, a prosecutorial tone when asking questions, & a greater concern with parading defects than helping constructively to improve conditions.

QUESTION : 5(a)

You have been appointed as an auditor of Safe Life Insurance 5 Company Limited, During the course of audit you come across several cases of lapsed policies. Management is flooded with complaints from Agents & Life Assured regarding Policy lapses & Revival. The policy lapsation is tracked over the PMS software. You are requested by the Management to explain in clear terms about Policy lapses & Revival. Also state your role as an auditor in verifying the same. (5 Marks)

ANSWER : 5(a)

Policy Lapse & Revival: "Lapse" is the discontinuance of the policy owing to non - payment of premium dues. In order to keep a life insurance policy "in force" the policy holder is required to pay premiums when due (either monthly/ quarterly/annual/bi-annual). If payment is missed, the insurer allows a period of 15/30 days from the premium due date for making the payment. This period is termed as "grace period". If the policy holder does not make the payment within the grace period, the policy gets "lapsed". Thus, a payment within the grace period is deemed to be a payment on the due date.

The terms & conditions of the policy stipulate that where the premium is not paid within the grace period, the policy lapses but may be revived during the lifetime of the life assured. Some insurers do not allow revival, if the policy has remained in lapsed condition for more than five years. This is because of the possibility that the arrears of premiums on such a policy would be too heavy & that it would be better to take out a fresh policy.

The insurer should have taken persistent measures for monitoring receipt of renewal premium within the due dates. In case of most of insurers, policy lapsation is tracked over the PMS, wherein premium due dates are monitored by the system once initial data of the policy is entered in the system.

Role of Auditor: The primary objective of the audit is to check & confirm that due dates are recorded & monitored properly & policies are marked as "lapsed" on non-receipt of renewal premium within due dates/grace period. In case of revival request, whether adequate checks are in place for receipt of outstanding amounts & adequate documents are obtained before reviving the policy.

QUESTION : 5(b)

In exercise of the powers conferred by clauses (f) & (g) of Sub- section (2) of Section 29A read with Section 28C & Sub -section (1) of Section 28D of the CA Act, 1949 (38 of 1949), the Central Government has made 'Chartered Accountants (Procedures of Meetings of Quality Review Board, & Terms & Conditions of Service & Allowances of the Chairperson & Members of the Board) Rules, 2006'. Elucidate the powers of Quality Review Board in discharging its functions. How the Quality Review Board would proceed in case it does not receive the information called for by it from any Company ? (5 Marks)

ANSWER : 5(b)

Powers of Quality Review Board : The Government of India has, in exercise of the powers conferred by clauses (f) & (g) of Sub-section (2) of Section 29A read with Section 28C & Sub-section (1) of Section 28D of the CA Act, 1949 (38 of 1949), the Central Government has made 'Chartered Accountants (Procedures of Meetings of Quality Review Board, & Terms & Conditions of Service & Allowances of the Chairperson & Members of the Board) Rules, 2006'. To facilitate the discharge of its functions, Rule 6 of aforesaid rules provides:

- (i) on its own or through any specialized arrangement set up under the Institute, evaluate & review the quality of work & services provided by the members of the Institute in such manner as it may decide;
- (ii) lay down the procedure of evaluation criteria to evaluate various services being provided by the

members of the Institute & to select, in such manner & form as it may decide, the individuals & firms rendering such services for review;

- (iii) call for information from the Institute, the Council or its Committees, Members, Clients of members or other persons or organizations, in such form & manner as it may decide, & may also give a hearing to them;
- (iv) invite experts to provide expert/technical advice or opinion or analysis on any matter or issue which the Board may feel relevant for the purpose of assessing the quality of work & services offered by the members of the Institute;
- (v) make recommendations to the Council to guide the members of the Institute to improve their professional competence & qualifications, quality of work & services offered & adherence to various statutory & other regulatory requirements & other matters related thereto.

In case, the Board does not receive the information called for by it from any company registered under the Companies Act, 2013, the Board may request the Central Government in the Ministry of Corporate Affairs for assistance in obtaining the information.

QUESTION : 5(c)

CA Harry is appointed as a Statutory Auditor of Delist Limited for the financial year 2021-22. M/s. Delist Limited is a listed entity at National Stock Exchange & the financial statements are to be drawn up in compliance with Ind AS. M/s. Delist Limited made certain fair value accounting estimates on complex financial instruments which are not traded in an active & open market. CA Harry is concerned with identification & assessment of the risks of material misstatement for accounting estimates. Guide him with regard to the estimation making process adopted by management with reference to the relevant standard on Auditing. **(5 Marks)**

ANSWER : 5(c)

As per SA 540 "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, & Related Disclosures", CA. Harry shall obtain an understanding of the following in order to provide a basis for the identification & assessment of the risks of material misstatements for accounting estimates:

The estimation making process adopted by the management including-

1. The method, including where applicable the model, used in making the accounting estimates.
2. Relevant controls.
3. Whether management has used an expert?
4. The assumption underlying the accounting estimates.
5. Whether there has been or ought to have been a change from the prior period in the methods for making the accounting estimates, & if so, why; &
6. Whether &, if so, how the management has assessed the effect of estimation uncertainty.

QUESTION : 6 (a)

CA H was appointed as a Statutory Auditor of MNL Limited, a listed company, which has three subsidiaries namely M Ltd., N Ltd., L Ltd. & also 15 branches across India. Auditors are duly appointed for the subsidiaries & branches as well. With regard to the determination of materiality during the audit of consolidated financial statements what should be the considerations of CA H? How he should deal in his report if there are observations (for instance modification &/or emphasis of matter in accordance with SA 705/706) made by component auditors? **(5 Marks)**

ANSWER : 6(a)

CA. H should consider the requirement of SA 600, "Using the Work of Another Auditor", if he decides to use the work of another auditor in relation to the audit of consolidated financial statements & he should comply with the requirements of SA 600.

In carrying out the audit of the standalone financial statements, the computation of materiality for the purpose of issuing an opinion on the standalone financial statements of each component would be done component-wise on a standalone basis.

However, with regard to determination of materiality during the audit of consolidated financial statements (CFS), the auditor should consider the following:

- (i) The auditor is required to compute the materiality for the group as a whole. This materiality should be used to assess the appropriateness of the consolidation adjustments (i.e. permanent consolidation adjustments & current period consolidation adjustments) that are made by the management in the preparation of CFS.
- (ii) The parent auditor can also use the materiality computed on the group level to determine whether the component's financial statements are material to the group to determine whether they should scope in additional components, & consider using the work of other auditors as applicable.
- (iii) The principal auditor also computes materiality for each component & communicates to the component auditor, if he believes is required for true & fair view on CFS.

However, while considering the observations (for instance modification & /or emphasis of matter in accordance with SA 705/706) of the component auditor in his report on the standalone financial statements, the principles of SA 600 needs to be considered i.e. the parent auditor should comply with the requirements of SA 600, "Using the Work of Another Auditor".

QUESTION : 6 (b)

You are the team leader of 10 members for an audit of a Multinational company. All the team members are concerned about Audit documentation in order to provide evidence that the audit complies with SAs. Hence, the team members wish to document every matter concerned. In your opinion it is neither necessary nor practicable for the auditor to document every matter considered or professional judgement made in an audit. Further you feel that it is unnecessary for the auditor to document separately compliance with matters for which compliance is demonstrated by documents included within the audit file. Illustrate by giving examples with reference to relevant Standard Auditing. (5 Marks)

ANSWER : 6(b)

SA 230, "Audit Documentation", provides evidence that the audit complies with SAs. However, it is neither necessary nor practicable for the auditor to document every matter considered, or professional judgment made, in an audit.

For example,

- (i) the existence of an adequately documented audit plan demonstrates that the auditor has planned the audit.
- (ii) the existence of a signed engagement letter in the audit file demonstrates that the auditor has agreed the terms of the audit engagement with management, or where appropriate, those charged with governance.
- (iii) An auditor's report containing an appropriately qualified opinion demonstrates that the auditor has complied with the requirement to express a qualified opinion under the circumstances specified in the SAs.
- (iv) In relation to requirements that apply generally throughout the audit, there may be a number of ways in which compliance with them may be demonstrated within the audit file:
 - For example, there may be no single way in which the auditor's professional skepticism is documented. But the audit documentation may nevertheless provide evidence of the auditor's exercise of professional skepticism in accordance with SAs. Such evidence may include specific procedures performed to corroborate management's responses to the auditor's inquiries.
 - Similarly, that the engagement partner has taken responsibility for the direction, supervision & performance of the audit in compliance with the SAs may be evidenced in a number of ways within the audit documentation. This may include documentation of the engagement partner's timely involvement in aspects of the audit, such as participation in the team discussion required by SA 315, "Identifying & Assessing the Risks of Material Misstatement through Understanding the Entity & Its Environment".

QUESTION : 6 (c)

Sirish, a Chartered Accountant in practice, delivered a speech in a national conference organized by the Ministry of Information Technology. While delivering the speech, he told to the audience that he is a Cybersecurity expert & his firm provides services of cloud accounting, IT governance, risk compliance, & information security at reasonable rates. He also requested the audience to approach his firm of chartered accountants for these services & at the request of the audience he also distributed his business cards & telephone number of his firm to those in the audience.

Comment in the light of professional Code of Ethics.

(5 Marks)

ANSWER : 6(c)

Using Designation Other Than a CA & Providing Details of Services Offered: Clause (6) of Part I of the First Schedule to the CA Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. Such a restraint has been put so that the members maintain their independence of judgment & may be able to command respect from their prospective clients.

Section 7 of the CA Act, 1949 read with Clause (7) of Part I of the First Schedule to the said Act prohibits advertising of professional attainments or services of a member. It also restrains a member from using any designation or expression other than that of a chartered accountant in documents through which the professional attainments of the member would come to the notice of the public. Under the clause, use of any designation or expression other than chartered accountant for a chartered accountant in practice, on professional documents, visiting cards, etc. amounts to a misconduct unless it be a degree of a university or a title indicating membership of any other professional body recognised by the Central Government or the Council.

In view of above, it is improper to use designation "Cybersecurity Expert" since neither it is a degree of a University established by law in India or recognised by the Central Government nor it is a recognised professional membership by the Central Government or the Council. Therefore, he is deemed to be guilty of professional misconduct under both Clause (6) & Clause (7) as he has used the designation "Cybersecurity Expert" in his speech & also he has made reference to the services provided by his firm of Chartered Accountants at reasonable rates. Distribution of cards to audience is also misconduct in terms of Clause (6).

OR

QUESTION : 6 (c)

CA K, a Practising Chartered Accountant, was appointed as Authorized Representative by GKR Limited to appear before National e-assessment centre in the matter of its Faceless Income - tax proceedings for the Assessment year 2020-21. While preparing a reply in response to the notice for the Scrutiny Assessment, CA K observed that there were certain trade payables & loan creditors which were not in existence but was fabricated by the management of, GKR Limited. Though CA K knew these accounts were fabricated, he still submitted those false accounts to the National faceless e-assessment centre. What are the liabilities of CA K under the Income Tax Act, 1961?

(4 Marks)

ANSWER : 6(c)

False Declaration as Authorized Representative: In connection with proceedings under the Income-tax Act 1961, a Chartered Accountant often acts as the authorized representative of his clients & attends before an Income-tax Authority or the appellate tribunal.

Any person who acts or induces, in any manner another person to make & deliver to the Income-tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable u/s 278 of the Income-tax Act 1961.

Further, in case of submission of any information which is false & which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) &/or to a fine.

In the instant case, Mr. K, a chartered accountant was appointed as authorize representative by GKR Limited to appear before National E-Assessment Centre in the matter of its faceless Income-tax proceeding. While preparing a reply in response to the notice for the scrutiny assessment, CA. K, submitted false accounts to the National Faceless E-Assessment Centre, knowingly that certain trade payables & loan creditors accounts were not in existence & were fabricated by Management.

In view of above, CA. K would be liable u/s 278 of the Income-tax Act, 1961.



CA FINAL – ADVANCED AUDITING & PROFESSIONAL ETHICS

SUGGESTED ANSWERS - Nov 2021

QUESTION : 1 (a)

M/s Kumar & Co., Chartered Accountants were appointed as statutory auditors of PC limited for the financial year 2020-21. During the course of audit, one of the partners CA. Kumar observed that there is misappropriation of assets in the form of theft of entity's inventory & is perpetrated by employees in relatively small & immaterial amounts, CA. Kumar is concerned with the existence of certain circumstances for increasing the susceptibility of assets to misappropriation.

Guide CA, Kumar with respect to Risk factors related to misstatements arising from misappropriation of assets with reference to relevant Standard on Auditing. (5 Marks)

ANSWER : 1 (a)

Guidance to CA Kumar with respect to risk factors that relate to misstatements arising from misappropriation of assets as per SA 240 is:

As per SA 240, "The Auditor's Responsibilities Relating to Fraud in an audit of Financial Statements", misappropriation of assets involves the theft of entity's assets & is often perpetrated by employees in relatively small & immaterial amounts. However, it can also involve management who are usually more able to disguise or conceal misappropriations in ways that are difficult to detect.

Misappropriation of assets can be accomplished in a variety of ways including stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).

Risk factors that relate to misstatements arising from misappropriation of assets are also classified according to the three conditions generally present when fraud exists: incentives/pressures, opportunities, & attitudes/rationalization.

Incentives/Pressures

Personal financial obligations may create pressure on management or employees with access to cash or other assets susceptible to theft to misappropriate those assets.

Adverse relationships between the entity & employees with access to cash or other assets susceptible to theft may motivate those employees to misappropriate those assets. For example, adverse relationships may be created by the following:

- (i) Known or anticipated future employee layoffs.
- (ii) Recent or anticipated changes to employee compensation or benefit plans.
- (iii) Promotions, compensation, or other rewards inconsistent with expectations.

Opportunities

Certain characteristics or circumstances may increase the susceptibility of assets to misappropriation. For example, opportunities to misappropriate assets increase when there are the following:

- (i) Large amounts of cash on hand or processed.
- (ii) Inventory items that are small in size, of high value, or in high demand.
- (iii) Easily convertible assets, such as bearer bonds, diamonds, or computer chips.
- (iv) Fixed assets which are small in size, marketable, or lacking observable identification of ownership.

Inadequate internal control over assets may increase the susceptibility of misappropriation of those assets. For example, misappropriation of assets may occur because there is the following:

- (i) Inadequate segregation of duties or independent checks.
- (ii) Inadequate oversight of senior management expenditures, such as travel & other reimbursements.
- (iii) Inadequate management oversight of employees responsible for assets, for example, inadequate supervision or monitoring of remote locations.
- (iv) Inadequate job applicant screening of employees with access to assets.
- (v) Inadequate record keeping with respect to assets.

- (vi) inadequate system of authorization & approval of transactions (for example, in purchasing).
- (vii) Inadequate physical safeguards over cash, investments, inventory, or fixed assets.
- (viii) Lack of complete & timely reconciliations of assets.
- (ix) Lack of timely & appropriate documentation of transactions, for example, credits for merchandise returns.
- (x) Lack of mandatory vacations for employees performing key control functions.
- (xi) Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation.
- (xii) Inadequate access controls over automated records, including controls over & review of computer systems event logs.

Attitudes/Rationalizations

- (i) Disregard for the need for monitoring or reducing risks related to misappropriations of assets.
- (ii) Disregard for internal control over misappropriation of assets by overriding existing controls or by failing to take appropriate remedial action on known deficiencies in internal control.
- (iii) Behaviour indicating displeasure or dissatisfaction with the entity or its treatment of the employee.
- (iv) Changes in behaviour or lifestyle that may indicate assets have been misappropriated.
- (v) Tolerance of petty theft.

QUESTION : 1 (b)

In the course of audit of Tech limited you observed that processing of accounting data was given to a third party on account of certain considerations like cost reduction, own computer working to full capacity. Tech Limited used a service organisation to record transactions & process related data. As an auditor, what would be your considerations regarding the nature & extent of activities undertaken by service organisation so as to determine whether those activities are relevant to the audit &, if so, to assess their effect on audit risk.

Discuss with reference to relevant Standard on Auditing.

(5 Marks)

ANSWER : 1 (b)

As per SA 402 "Audit Considerations relating to an Entity using a Service Organization", 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 & the significance of those services to the user entity, including the effect thereof on the user entity's internal control;
- (ii) The nature & materiality of the transactions processed or accounts or financial reporting processes affected by the service organisation;
- (iii) The degree of interaction between the activities of the service organisation & those of the user entity; &
- (iv) The nature of the relationship between the user entity & the service organisation, including the relevant contractual terms for the activities undertaken by the service organization.

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

QUESTION : 1 (c)

CA Madhu is the statutory auditor of Lakshmi Ltd. for the Financial year 2020-21. In respect of loans & advances of ₹ 75 Lakh given to Sriman Pvt. Ltd., the Company has not furnished any agreement to CA Madhu & in absence of the same, he is unable to verify the terms of repayment, chargeability of interest & other terms.

Justify the type of opinion which CA Madhu should give in such situation. Also, Draft an appropriate Opinion paragraph & Basis of opinion paragraph.

(4 Marks)

ANSWER : 1 (c)

In the present case, with respect to loans & advances of ₹ 75 Lacs given to Sriman Pvt. Limited, the Company has not furnished any agreement to CA Madhu. In the absence of such an agreement, CA Madhu is unable to verify the terms of repayment, chargeability of interest & other terms. For an auditor, while verifying any loans & advances, one of the most important audit evidence is the loan agreement. Therefore, the absence of such document in the present case, tantamount to a material misstatement in the financial statements of the company. However, the inability of CA Madhu to obtain such audit evidence is though material but not pervasive so as to require him to give a disclaimer of opinion.

Thus, in the present case, CA Madhu should give a qualified opinion

The relevant extract of the Qualified Opinion Paragraph & Basis for Qualified Opinion paragraph is as under:

Qualified Opinion

In our opinion & to the best of our information & according to the explanations given to us, except for the effects of the matter described in the Basis for Qualified Opinion section of our report, the financial statements of Lakshmi Limited give a true & fair view in conformity with the accounting principles generally accepted in India, of the state of affairs of the Company as on 31.03.2021 & profit/ loss for the year ended on that date.

Basis for Qualified Opinion

The Company is unable to furnish the loan agreement with respect to loans & advances of ₹ 75 Lacs given to Sriman Pvt Limited. Consequently, in the absence of such an agreement, we are unable to verify the terms of repayment, chargeability of interest & other terms.

QUESTION : 2 (a)

During the course of audit of Fortune Ltd., CA Prasad is concerned with the quality & effectiveness of internal control. Towards achieving his objective he wants to assess & evaluate the control environment. Guide CA Prasad with well-defined set of the Standard Operating Procedures in the assessment & evaluation of control. (5 Marks)

ANSWER : 2 (a)

Guidance to CA Prasad with well defined set of Standard Operating Procedure is given hereunder:

- (i) **Standard Operating Procedures (SOPs):** A well defined set of SOPs helps define role, responsibilities, process & controls & thus helps clearly communicate the operating controls to all touch points of a process. The controls are likely to be clearly understood & consistently applied even during employee turnover.
- (ii) **Enterprise Risk Management:** An organization which has robust process to identify & mitigate risks across the enterprise & its periodical review will assist in early identification of gaps & taking effective control measures. In such organizations, surprises of failures in controls is likely to be few.
- (iii) **Segregation of Job Responsibilities:** A key element of control is that multiple activities in a transaction/decision should not be concentrated with one individual. Segregation of duties is an important element of control such that no two commercial activities should be conducted by the same person.
- (iv) **A buyer should not be involved in receiving of materials or passing of bills.** Similarly bank reconciliation should be prepared by a person other than the one who maintains bank book
- (v) **Job Rotation in Sensitive Areas:** Any job carried out by the same person over a long period of time is likely to lead to complacency & possible misuse in sensitive areas. It is therefore important that in key commercial functions, the job rotation is regularly followed to avoid degeneration of controls. For example, if the same buyer continues to conduct purchase function for long period, it is likely that he gets into comfort zone with existing vendors & hence does not exercise adequate controls in terms of vendor development, competitive quotes etc.
- (vi) **Delegation of Financial Powers Document:** As the organization grows, it needs to delegate the financial & other powers to their employees. A clearly defined document on delegation of powers allows controls to be clearly operated without being dependent on individuals.

- (vii) Information Technology based Controls: With the advent of computers & enterprise resource planning (ERP) systems, it is much easier to embed controls through the system instead of being human dependent. The failure rate for IT embedded controls is likely to be low, is likely to have better audit trail & is thus easier to monitor. For example at the stage of customer invoicing, application of correct rates in invoices or credit control can all be exercised directly through IT system improving control environment.

QUESTION : 2 (b)

Mr. Khanna has been appointed as statutory auditor of RST Ltd. for the financial year ended 31st March, 2021. The financial statements of RST Ltd. are to be drawn up in compliance of the Companies (Indian Accounting Standards) Rules, 2015. The Chief financial officer is of the view that the disclosure requirements specified under Division II of Schedule III of the Companies Act, 2013 are complete & no other additional disclosures shall be made in the Notes or by way of additional statements. Advise on the General instructions to be considered by RST Ltd. while preparing its financial statements. (5 Marks)

ANSWER : 2 (b)

General Instructions for Preparation of Financial Statement of a Company required to comply with Ind-AS:

- (1) Every company to which Indian Accounting Standards apply, shall prepare its financial statements in accordance with this Schedule or with such modification as may be required under certain circumstances.
- (2) Where compliance with the requirements of the Act including Indian Accounting Standards (except the option of presenting assets & liabilities in the order of liquidity as provided by the relevant Ind AS) as applicable to the companies require any change in treatment or disclosure including addition, amendment substitution or deletion in the head or sub-head or any changes inter se, in the financial statements or statements forming part thereof, the same shall be made & the requirements under this Schedule shall stand modified accordingly.
- (3) The disclosure requirements specified in this Schedule are in addition to & not in substitution of the disclosure requirements specified in the Indian Accounting Standards. Additional disclosures specified in the Indian Accounting Standards shall be made in the Notes or by way of additional statement or statements unless required to be disclosed on the face of the Financial Statements. Similarly, all other disclosures as required by the Companies Act, 2013 shall be made in the Notes in addition to the requirements set out in this Schedule.
- (4)
 - (i) Notes shall contain information in addition to that presented in the Financial Statements & shall provide where required- narrative description or disaggregation of items recognised in those statements; & information about items that do not qualify for recognition in those statements.
 - (ii) Each item on the face of the Balance Sheet, Statement of Changes in Equity & Statement of Profit & Loss shall be cross-referenced to any related information in the Notes. In preparing the Financial Statements including the Notes, a balance shall be maintained between providing excessive detail that may not assist users of Financial Statements & not providing important information as a result of too much aggregation.
- (5) Financial Statements shall contain the corresponding amounts (comparatives) for the immediately preceding reporting period for all items shown in the Financial Statement including Notes except in the case of first Financial Statements laid before the company after incorporation.
- (6) Financial Statements shall disclose all 'material' items, i.e. the items if they could. Individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size or nature of the item or a combination of both, to be judged in the particular circumstances.
- (7) Where any Act or Regulation requires specific disclosure to be made in the standalone financial statement of a company, the said disclosure shall be made in addition to those required under this Schedule.

QUESTION : 2 (c)

The Cashier of a company committed a fraud & absconded with the proceeds thereof. The Chief Accountant of the company also did not know when the fraud had occurred. In the course of the audit, the auditor failed to discover the fraud. After the audit was completed, however, the fraud was discovered by the Chief Accountant. Investigation made at that time indicates that the auditor did not exercise proper skill & care & performed his work in a desultory & haphazard manner. With this background, the Directors of the company intend to file disciplinary proceedings against the auditor. Comment with reference to the CA Act, 1949 & schedules thereto. (4 Marks)

ANSWER : 2 (c)

In the given case, in the course of audit, auditor failed to discover the fraud. It is clearly given that investigation indicated that the auditor did not exercise reasonable skill & care & performed his work in a casual & unmethodical manner.

According to Clause (7) of Part I of Second Schedule of CA Act, 1949, a Chartered Accountant in practice is 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".

As per SA 240, "The auditor's responsibilities relating to fraud in an audit of financial statements", it can be concluded that the auditor did not plan & perform the audit with an attitude of professional skepticism. Thus, having regard to this & a fraud has actually taken place during the year, committed by the absconding cashier, it is reasonable to think that prima facie there is a case against the auditor for gross negligence.

From the facts given in the case & by applying Clause (7) & SA 240, it is clear that the auditor is guilty of professional misconduct & the directors can file disciplinary proceedings against the auditor.

QUESTION : 3 (a)

The reports of the Comptroller & Auditor General of India on the audit of PS Us are presented to the Parliament & to various state legislatures to facilitate a proper consideration. Enumerate the contents of Audit Report presented by C & AG. (5 Marks)

ANSWER : 3 (a)

To facilitate a proper consideration, the reports of the C&AG on the audit of PSUs are presented to the Parliament in several parts consisting of the following:

- (i) Introduction containing a general review of the working results of Government companies, deemed Government companies & corporations;
- (ii) Results of comprehensive appraisals of selected undertakings conducted by the Audit Board;
- (iii) Resume of the company auditors' reports submitted by them under the directions issued by the C&AG & that of comments on the accounts of the Government companies; &
- (iv) Significant results of audit of the undertakings not taken up for appraisal by the Audit Board.

For certain specified states, the C&AG submits a separate audit report (commercial) to the legislature, while for other States/Union Territories with legislature, there is a commercial chapter in the main audit report. The State audit reports, contains both the results of audit appraisal of performance of selected companies/corporations as well as important individual instances of financial irregularities, wasteful expenditure, system deficiencies noticed by the statutory auditors, & a general review of the working results of Government companies & corporations.

QUESTION : 3 (b)

You have been appointed as Concurrent auditor of one of the branches of Coin Bank Ltd. This branch is dealing mainly in foreign exchange.

State the suggested audit procedures to be covered by you to check the foreign exchange transactions of this branch while doing Concurrent audit. (5 Marks)

ANSWER : 3 (b)

Suggested audit procedure to be covered by the Concurrent Auditor to check the foreign exchange transactions of one of the branches of Coin Bank Ltd is given hereunder:

- Check foreign bills negotiated under letters of credit.
- Check FCNR & other non-resident accounts whether the debits & credits are permissible under rules.
- Check whether inward/outward remittance have been properly accounted for.
- Examine extension & cancellation of forward contracts for purchase & sale of foreign currency. Ensure that they are duly authorized & necessary charges have been recovered.
- Ensure that balances in Nostro accounts in different foreign currencies are within the limit as prescribed by the bank.
- Ensure that the overbought/oversold position maintained in different currencies is reasonable, considering the foreign exchange operations.
- Ensure adherence to the guidelines issued by RBI/HO of the bank about dealing room operations.
- Ensure verification/reconciliation of Nostro & Vostro account transactions/ balances.

QUESTION : 3 (c)

CA Mehta was appointed as the Auditor of CS Ltd. for the year 2020-21 in the place of retiring auditor CA Gupta. CA Mehta accepted the appointment after obtaining a certificate from the management that the provisions of the Sections 139 & 140 of the Companies Act, 2013 have been complied with.

Comment with reference to the CA Act, 1949 & schedules thereto. (4 Marks)

ANSWER : 3 (c)

In the given case, CA Mehta accepted the appointment in place of retiring auditor after obtaining a certificate from the management that the provisions of the Sections 139 & 140 of the Companies Act, 2013 have been complied with.

Clause (9) of Part I of the First Schedule to CA Act, 1949 provides that a member in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a Company without first ascertaining from it whether the requirements of Sections 139 & 140 of the Companies Act, 2013, in respect of such appointment have been duly complied with.

Under this clause it is obligatory on the incoming auditor to ascertain from the Company that the appropriate procedure in the matter of his appointment has been duly complied with so that no shareholder or retiring auditor may, at a later date, challenge the validity of such appointment.

Under Clause (9) of Part I of the First Schedule to the CA Act, 1949, the incoming auditor has to ascertain whether the Company has complied with the provisions of the above sections. The word "ascertain" means "to find out for certain". This would mean that the incoming auditor should find out for certain as to whether the Company has complied with the provisions of Sections 139 & 140 of the Companies Act, 2013. In this respect, it would not be sufficient for the incoming auditor to accept a certificate from the management of the Company that the provisions of the above sections have been complied with. It is necessary for the incoming auditor to verify the relevant records of the Company & ascertain as to whether the Company has, in fact, complied with the provisions of the above sections. If the Company is not willing to allow the incoming auditor to verify the relevant records in order to enable him to ascertain as to whether the provisions of the above sections have been complied with, the incoming auditor should not accept the audit assignment.

Applying the above clause to the given case, the Company is not willing to allow the incoming auditor to verify the relevant records in order to enable him to ascertain as to whether the provisions of the above sections have been complied with, the incoming auditor, CA Mehta should not have accepted the audit assignment. But on the other hand, CA Mehta accepted the appointment in place of retiring auditor after obtaining a certificate from the management which is not enough & hence CA Mehta is deemed to be guilty of professional misconduct.

QUESTION : 4 (a)

M & B Investments Ltd. is a company having paid up share capital of ₹ 1 Crore. It has a subsidiary, Investors Fund Management Ltd. Major business of M & B Investments Ltd. is to pool money from investors on a collective basis & invest this money in various funds. This company pooled ₹ 10 Crore from a number of clients, which represent the Company's shareholders.

While auditing books of accounts of M & B Investments Ltd. CA. X observed that whole amount of ₹ 10 crore pooled has been invested in shares & debentures of various companies & profit earned due to appreciation of the prices of these shares has been distributed to various shareholders of the company.

Now, CA X raised an issue while auditing financial statements of M & B Investments Ltd. whether the consolidated financial statements are required as per Section 129(3) of the Companies Act, 2013 ?

Analyse the above issue & give your opinion.

(5 Marks)

ANSWER : 4 (a)

According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company & joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the company & of all the subsidiaries in the same form & manner as that of its own.

As per sub-section 6 of the section 129 of the Companies Act, 2013, the Central Government may, on its own or on an application by a class or classes of companies, by notification, exempt any class or classes of companies from complying with any of the requirements of section 129 or the rules made thereunder.

An investment entity is an entity that:

- (a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
- (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; &
- (c) measures & evaluates the performance of substantially all of its investments on a fair value basis.

An investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of Ind AS 110, to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

However, as per paragraph 33 of Ind AS 110, parent of an investment entity shall consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

Applying the above to the given case of M&B Investment Ltd, which fulfils all the conditions stated above, it is an investment entity. By applying Para 31 & 33 of Ind AS 110, it can be concluded that M&B Investment Ltd is not required to consolidate as per Section 129 (3) of the Companies Act, 2013.

QUESTION : 4 (b)

ACT Silk Industries is a leading textile manufacturing listed company.

In the course of evidence collection & analysis, it was observed that the company is involved in siphoning of funds through payments to shell companies. Hence, SEBI appointed B & S Associates, Chartered Accountants, as forensic auditors of the company. Enumerate in brief the steps to be taken by B & S Associates in forensic audit process.

(5 Marks)

ANSWER : 4 (b)

Each Forensic accounting assignment is unique. Accordingly, the actual approach adopted & the procedures performed will be specific to it. Steps to be taken by B & S Associates, as Forensic auditors of the company are:

Step 1. Initialization

It is vital to clarify & remove all doubts as to the real motive, purpose & utility of the assignment. It is helpful to meet the client to obtain an understanding of the important facts, players & issues at hand. A conflict check should be carried out as soon as the relevant parties are established. It is often useful to carry out a

preliminary investigation prior to the development of a detailed plan of action. This will allow subsequent planning to be based upon a more complete understanding of the issues.

Step 2. Develop Plan

This plan will take into account the knowledge gained by meeting with the client & carrying out the initial investigation & will set out the objectives to be achieved & the methodology to be utilized to accomplish them.

Step 3. Obtain Relevant Evidence

Depending on the nature of the case, this may involve locating documents, economic information, assets, a person or company, another expert or proof of the occurrence of an event. In order to gather detailed evidence, the investigator must understand the specific type of fraud that has been carried out, & how the fraud has been committed. The evidence should be sufficient to ultimately prove the identity of the fraudster(s), the mechanics of the fraud scheme, & the amount of financial loss suffered. It is important that the investigating team is skilled in collecting evidence that can be used in a court case within the stipulated time period, & in keeping a clear chain of custody until the evidence is presented in court. If any evidence is inconclusive or there are gaps in the chain of custody, then the evidence may be challenged in court, or even become inadmissible. Investigators must be alert to documents being falsified, damaged or destroyed by the suspect(s).

Step 4. Perform the analysis

The actual analysis performed will be dependent upon the nature of the assignment & may involve:

- calculating economic damages;
- summarizing a large number of transactions;
- performing a tracing of assets;
- performing present value calculations utilizing appropriate discount rates;
- performing a regression or sensitivity analysis;
- utilizing a computerized application such as a spread sheet, data base or computer model; &
- Utilizing charts & graphics to explain the analysis.

Step 5. Reporting

Issuing an audit report is the final step of a fraud audit. Auditors will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence, a conclusion as to the amount of loss suffered as a result of the fraud & to identify those involved in fraud. The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope & findings &/or opinions. The report will include schedules & graphics necessary to properly support & explain the findings.

The report will also discuss how the fraudster set up the fraud scheme, & which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

The forensic auditor should have active listening skills which will enable him to summarize the facts in the report. It should be kept in mind that the report should be based on the facts assimilated during the process & not on the opinion of the person writing the report.

Step 6. Court proceedings

The investigation is likely to lead to legal proceedings against the suspect, & members of the investigative team will probably be involved in any resultant court case. The evidence gathered during the investigation will need to be presented at court, & team members may be called to court to describe the evidence they have gathered & to explain how the suspect was identified.

QUESTION : 4 (c)

ABC Ltd. is a company registered under the Companies Act, 2013. The company is engaged in the business of loans & advances, acquisition of shares / stocks / bonds / debentures / securities issued by Government

or local authorities. For the year ended 31st March, 2021 following are some extracts from the financial statements :

(i) Paid-up share capital	₹ 40.53 Cr.
(ii) Non-Current Assets - Loans & Advances	₹ 55.90 Cr.
(iii) Current Assets - Loans & advances	₹ 344.47 Cr.
(iv) Total assets of the company	₹ 530 Cr.
(v) Intangible assets	₹ 3 Cr.
(vi) Profit for the Year	₹ 7.25 Cr.
(vii) Income from interest & dividends	₹ 52 Cr.
(viii) Gross income	₹ 102.75 Cr.

Directors intend to apply for registration as Non-Banking Financial Company (NBFC) u/s 45-IA of the Reserve Bank of India (Amendment) Act, 1997. Advise. (4 Marks)

ANSWER : 4 (c)

In order to identify a particular company as Non-Banking Financial Company (NBFC), it will consider both assets & 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

- (i) Financial assets constitute more than 50 % of the total assets (netted off by intangible assets) &
- (ii) Income from financial assets constitute more than 50 % of the gross income.

A company which fulfils both these criteria shall qualify as an NBFC & would require to be registered as NBFC by RBI.

In the given case of ABC Ltd, its Financial Assets are	= ₹ 55.90 + ₹ 344.47 = ₹ 400.37 Cr
Total Assets (netted off by intangible assets)	= ₹ 527 Cr
Income from financial assets	= ₹ 52 Cr
Gross Income	= ₹ 102.57 Cr

From the above, it is clear that ABC Ltd.'s financial assets constitute more than 50 % of the total assets (netted off by intangible assets) & income from financial assets constitutes more than 50 % of the gross income. Hence, ABC Ltd. fulfils both these criteria to qualify as an NBFC.

Thus ABC Ltd. can apply for registration u/s 45-IA of Reserve Bank of India (Amendment) Act, 1997 in prescribed form along with the necessary documents.

QUESTION : 5 (a)

Mr. Agarwal, in the course of audit of PQ Limited, wants to perform external confirmation procedures to obtain audit evidence. Guide Mr. Agarwal, listing out the factors that may assist him in determining whether external confirmation procedures are to be performed as substantive audit procedures.

(5 Marks)

ANSWER : 5 (a)

Factors that may assist Mr. Agarwal, the auditor in determining whether external confirmation procedures are to be performed as substantive audit procedures include:

- (i) The confirming party's knowledge of the subject matter - responses may be more reliable if provided by a person at the confirming party who has the requisite knowledge about the information being confirmed.
- (ii) The ability or willingness of the intended confirming party to respond - for example, the confirming party:
 - May not accept responsibility for responding to a confirmation request;
 - May consider responding too costly or time consuming;
 - May have concerns about the potential legal liability resulting from responding;
 - May account for transactions in different currencies; or

- May operate in an environment where responding to confirmation requests is not a significant aspect of day-to-day operations.
- In such situations, confirming parties may not respond, may respond in a casual manner or may attempt to restrict the reliance placed on the response.
- (iii) The objectivity of the intended confirming party - if the confirming party is a related party of the entity, responses to confirmation requests may be less reliable.

QUESTION : 5 (a)

Long Age Foundations Ltd. (LAF), a pharmaceutical company, collected the data from some hospitals & their experts tried to understand medical needs of elderly people. After complete study, their experts developed an application where LAF will provide complete health care after charging a nominal amount from the customers, if customers download this application in their mobile phones. CA P in his audit has used data analytics method also known as Computer Assisted audit techniques.

Give illustrations of suggested approach to get the benefit from the use of CAATs.

(5 Marks)

ANSWER : 5 (b)

The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques or CAATs. There are several steps that should be followed to achieve success with CAATs & any of the supporting tools. A suggested approach to benefit from the use of CAATs is as given below:

- Understand Business Environment including IT
- Define the objectives & criteria
- Identify source & format of data
- Extract Data
- Verify the completeness & Accuracy of Extracted data
- Apply Criteria on data obtained.
- Validate & confirm results.
- Report & document results & conclusions (SA 230)

QUESTION : 5 (c)

CA. M has been appointed as an auditor of Life Secure Insurance Ltd.

He observed that few insurance policies have been sold by the company in the last month of the financial year ending 31st March, 2021. While recognizing income in the income statement of the company, it is the responsibility of CA. M to make an assessment of the reasonability of the risk pattern managed by the management.

Also, it is to be ensured by him that Life Secure Insurance Ltd. should not issue policies, if the risk is not established before the closure of the F.Y. 2020-21. Indicate the circumstances when the company should not issue the policy documents.

(4 Marks)

ANSWER : 5 (c)

The auditor, CA M appointed as an auditor of Life Secure Insurance Ltd. should ensure that policy documents have not been issued, in case:

- (i) Premium had not been collected at all;
- (ii) Premium had been collected but the relevant cheques have been dishonoured; (refer Cheque Dishonoured Book);
- (iii) premium had not immediately been collected due to furnishing of a bank guarantee or cash deposit but either the deposit or guarantee had fallen short or has expired or the premium had been collected beyond the stipulated time limit (i.e., there is a shortfall in bank guarantee account or cash deposit account of the insured);

- (iv) premium had not been collected due to risk cover being increased or where stipulated limits have been exhausted in respect of open declaration policies (i.e., where premium has accrued but has not been received); &
- (v) instalments of premium have not been collected in time in respect of certain categories of policies, e.g., marine-cum-erection policies where facility has been granted for premium being paid in instalments (such facility is normally available subject to certain conditions, e.g., that the first equated instalment is more by 5 % of the total premium payable by instalments).
- (vi) Premium collected but policies not issued for long periods of time.
- (vii) Whether the premium received during the year but pertaining to risk commencing in the following year has been accounted for under the head 'Premium Received in Advance' & has been disclosed separately

QUESTION : 6 (a)

CA. Pradeep is appointed auditor of Delicious Foods Ltd. (DFL) a listed company to audit the financial statements for the year ended 31st March 2021. Paid-up share capital of DFL is ₹ 5.97 Cr. While auditing director's remuneration CA. Pradeep observed that Mr. Shrinivas Gupta has been appointed as an independent director.

Mr. Srinivas Gupta is holding shares of ₹ 8,95,500 in DFL & his wife is holding shares of ₹ 2,98,500 in the same company.

CA. Pradeep raised an objection on the appointment of independent director, but other directors explained that holding of shares by Mr. Srinivas is less than the prescribed limit hence, he is eligible to be appointed as independent director.

How will CA. Pradeep deal with this situation & how will he report this issue ?

(5 Marks)

ANSWER : 6 (a)

LODR Regulation 17 regarding Verification regarding Composition of Board of Directors of Listed Entity: An independent non-executive director should not be a substantial shareholder of the listed entity & in determining 'not a substantial shareholder'; he (together with his relatives) should not own 2% or more of total voting power of the listed entity.

In the given case of Delicious Foods Ltd. (DFL), Mr. Shrinivas Gupta along with his wife is substantial shareholder of the DFL, Listed Company, because their holding in DFL is 2 % of the total voting power of the DFL calculated as under:

Mr. Shrinivas Gupta's holding in DFL	= ₹ 8,95,500
His wife's holding in DFL	= ₹ 2,98,500
Combined holding of Mr. Shrinivas Gupta & his wife	= ₹ 11,94,000
Total Voting Power of DFL	= ₹ 597,00,000
Percent calculation	= $11,94,000 \times 100 / 59700000$
	= 2%

Hence objection raised by CA Pradeep on the appointment of independent director is valid & Mr. Shrinivas is not eligible to be appointed as independent director of the company.

In this case CA Pradeep should specifically mention in his report about the disqualification of appointment as independent director of Mr. Shrinivas. He should mention name of the disqualified director, date of disqualification & reasons of disqualifications in his audit report.

QUESTION : 6 (b)

CA Nitesh, while carrying out the Tax audit of PQR Ltd. observed that PQR Ltd. has entered into specified financial transactions covered u/s 285BA of the Income tax Act, 1961 PQR Ltd. has furnished statement of the specified financial transaction in Form No. 61 & Form No. 61 A.

Guide CA. Nitesh with reporting requirements under clause 42 of Form 3CD ?

The management contends that tax auditor need not report, if the transactions are not covered in the ambit of Section 269ST. Comment. (5 Marks)

ANSWER : 6 (b)

Clause 42 has been introduced where the tax auditor has to report that whether the taxpayer is required to furnish a statement of the specified financial transaction (in Form No.61 or Form No. 61A or Form No. 61B).

With respect to Form 61, the tax auditor should verify whether the taxpayer has entered into any transaction where the other party was required to quote PAN. He should verify whether the taxpayer has obtained declaration in Form No. 60 where the other party has not furnished his PAN. Wherever the taxpayer has received declarations in Form No. 60, the auditor should verify if the taxpayer has filed Form No. 61 including therein all the necessary particulars.

With respect to Form 61A, the tax auditor should ascertain whether the taxpayer is required to report any transactions u/s 285BA read with Rule 114E. It may be noted that specified transactions u/s 285BA include the issue of bonds, issue of shares, buy-back of shares by a listed company, etc. These transactions may not happen every year & hence special attention should be given in the year when a company taxpayer issues any security or a listed company undertakes buyback of shares.

While verifying the same, the tax auditor should ensure that the provisions of Rule 114E(3) have been properly considered & applied.

Failure to do so may result in a certain transaction not being reported. It may be noted that the payment may be received for various transactions & on different dates, & hence these may not be covered u/s 269ST but will have to be reported u/s 285BA.

Keeping in view above provisions, contention of the management that tax auditor need not report is incorrect & hence tax auditor will have to report u/s 285BA.

He would be required to report under clause 42 of Form 3CD as under:

S. No.	Income Tax Department Reporting entity Identification No.	Type of Form	Due date for furnishing	Date of furnishing, if furnished	Whether the form contains information about all details/ transactions which are required to be reported	If not please furnish list of the details/ transactions which are not reported
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QUESTION : 6 (c)

Comment with reference to the CA Act, 1949 & schedules thereto:

CA. D, a practicing Chartered Accountant, was appointed as a simplicitor Director in a Pvt. Ltd. company on 01-01-2020. After serving 18 months, Mr. D resigned as the Director. He accepted the appointment as the Statutory Auditor of the company with effect from 01-10-2021.

Is CA. D right in accepting the audit ?

(4 Marks)

ANSWER : 6 (c)

As per Clause (4) of Part I of the Second Schedule of the CA Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct

if he expresses his opinion on financial statements of any business or enterprise in which he, his firm, or a partner in his firm has a substantial interest.

Section 141 of the Companies Act, 2013 specifically prohibits a member from auditing the accounts of a company in which he is an officer or employee. Although the provisions of the aforesaid section are not specifically applicable in the context of audits performed under other statutes, e.g. tax audit, yet the underlying principle of independence of mind is equally applicable in those situations also. Therefore, the Council's views are clarified in the following situations.

As per the clarifications issued by the Council, a member shall not accept the assignment of audit of a Company for a period of two years from the date of completion of his tenure as Director, or resignation as Director of the said Company.

In the instant case, Mr. D, a practicing CA, is appointed as a Director Simplicitor in Pvt. Ltd. Company. Mr. D resigned as the Director & after 18 months of resignation accepted the Statutory Auditor position of the Company. In view of above provisions Mr. D cannot accept the Directorship of the company as tenure of two years after his resignation is yet to be completed.

Thus, CA, D would be held guilty of professional misconduct under clause 4 of Part 1 of Second Schedule of the CA Act, 1949.

OR

QUESTION : 6 (c)

CA. Manoj has been appointed as Peer Reviewer of M/s UV 4 Associates, a Chartered Accountant firm consisting of 18 partners. As a Practicing unit what are the obligations that are to be complied by M/s UV associates in addition to furnishing the questionnaire, statements & such other particulars as the Board may deem fit ? (4 Marks)

ANSWER : 6 (c)

M/s UV Associates-Practice Unit, in addition to the prescribed information to be furnished including the questionnaire, statements & such other particulars as the Board may deem fit, shall comply with the following:

- (i) Produce to the Reviewer or allow access to, any record, document or prescribed register maintained by the Practice Unit or any other record or document which is of a class or description so specified, & which is in the possession or under the control of the Practice Unit.
- (ii) Provide to the Reviewer such explanation or further particulars/ information in respect of anything produced in compliance with a requirement under sub clause (1) above, as the Reviewer shall specify.
- (iii) Provide to the Reviewer all assistance in connection with Peer Review.
- (iv) Where any information or matter relevant to a Practice Unit is recorded otherwise than in a legible form, the Practice Unit shall provide & present to the Reviewer a reproduction of any such information or matter, or of the relevant part of it in a legible form, with a translation in English or Hindi, if the matter is in any other language, & if such translation is requested for by the Reviewer. The Practice Unit shall be responsible & accountable for the accuracy & truthfulness of the translation so provided.

CA FINAL – ADVANCED AUDITING & PROFESSIONAL ETHICS

SUGGESTED ANSWERS - MAY 2021

QUESTION : 1 (a)

M/s SG & Co. Chartered Accountants were appointed as Statutory Auditors of XYZ Limited for the F.Y 2020-2021. The Company implemented internal controls for prevention & early detection of any fraudulent activity. Auditors carried out test of controls & found out no major observations. After the completion of audit, audit report was submitted by the auditors & audited results were issued. Fraud pertaining to the area of inventory came to light subsequently for the period covered by audit & auditors were asked to make submission as to why audit failed to identify such fraud. Auditors submitted that because of inherent limitations of audit, it is not possible to get persuasive evidence of certain matters like fraud. Do you think auditor made correct statement? Also discuss certain subject matters or assertions where it is difficult to detect material misstatements due to potential effects of inherent limitations.

(5 Marks)

ANSWER : 1 (a)

Certain assertions or subject matters where it is difficult to detect material misstatements due to potential effects of inherent limitations -

As per SA 200 - "Overall Objectives of the Independent Auditor & the Conduct of an Audit in Accordance with Standards on Auditing" & as per SQC 1 because of the inherent limitations of an audit, there is an unavoidable risk that some material misstatements of the financial statements may not be detected, even though the audit is properly planned & performed in accordance with SAs.

Accordingly, the subsequent discovery of a material misstatement of the financial statements resulting from fraud or error does not by itself indicate a failure to conduct an audit in accordance with SAs. However, the inherent limitations of an audit are not a justification for the auditor to be satisfied with less-than-persuasive audit evidence.

Whether the auditor has performed an audit in accordance with SAs is determined by the audit procedures performed in the circumstances, the sufficiency & appropriateness of the audit evidence obtained as a result thereof & the suitability of the auditor's report based on an evaluation of that evidence in the light of the overall objectives of the auditor.

In view of above, it can be concluded that auditors did not give correct statement.

In the case of certain assertions or subject matters, the potential effects of the inherent limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- (i) Fraud, particularly fraud involving senior management or collusion.
- (ii) The existence & completeness of related party relationships & transactions.
- (iii) The occurrence of non-compliance with laws & regulations.
- (iv) Future events or conditions that may cause an entity to cease to continue as a going concern.

QUESTION : 1 (b)

ABC Ltd. has been dealing in tyres since 1995, The Company envisaged to expand its business & wanted to manufacture the tyres besides trading. Accordingly, the machinery was imported, installed & manufacturing operations commenced. The Government also gave certain incentives like power subsidy, land acquisition subsidy, etc. After 2 years of operations, Company received a notice from the Income Tax authorities to pay tax on incentive received in the form of power subsidy. The demand notice was served for ₹ 150.00 Lakhs. The Company, however filed an appeal with higher tax authorities against the demand & the matter is undecided as on 31.03.2021. Legal team of the Company anticipated that tax liability might mature. The Company has not made a provision of anticipated tax liability. Considering the provisions of Companies Act, 2013, how an auditor of ABC Ltd. should see this matter & report in audit report, if required?

(5 Marks)

ANSWER : 1 (b)

Audit report - Legal team anticipated tax liability but the company did not make any provision for that -

The Council of the ICAI has taken note of the fact that there is a practice prevalent whereby companies do not make provision for tax even when such a liability is anticipated. It has expressed the view that on an overall consideration of the relevant provisions of law, non-provision for tax (where a liability is anticipated) would amount to contravention of the provisions of Sections 128 & 129 of the Companies Act, 2013.

Accordingly, it is necessary for the auditor to qualify his report & such qualification should bring out the manner in which the accounts do not disclose a "true & fair" view of the state of affairs of the company & the profit or loss of the company.

Applying the above to the facts given in the question, auditor should qualify his report.

An example of the manner in which the report on the balance sheet & the Statement of Profit & Loss may be qualified in this respect is given below: "The company has not provided for taxation in respect of its profits & the estimated aggregate amount of taxation not so provided for is ' including for the Year ended on To the extent of such non-provision for the year, the profits of the Company for the financial year under report have been overstated & to the extent of such aggregate non-provision, the reserves of the company appearing in the said balance sheet have been over-stated & the current liabilities & provisions appearing in the said balance sheet have been understated"

QUESTION : 1 (c)

CA. R, a Chartered Accountant, in practice is specializing in the field of Information Systems Audit. He is considered to be one of the experts of this field because of his command over the subject. HKC Limited, a Company engaged in rendering management consultancy offered him to appoint as its managing director. CA. R accepted the position of managing director without obtaining prior permission from the Institute. One of his friends CA. S informed him that now he cannot retain full time certificate of practice, thus cannot do attest function & train articled assistants. Comment with reference to the provisions of the CA Act, 1949 & schedules thereto. (4 Marks)

ANSWER : 1 (c)

Provisions of the CA Act, 1949 & Schedules thereto -

As per Clause (11) of Part I of First Schedule to the CA Act, 1949, a Chartered Accountant in practice will be 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.

The Council decided to allow members in practice to hold the office of Managing Director, Whole-time Director or Manager of a body corporate within the meaning of the Companies Act, 2013 provided that the body corporate is engaged exclusively in rendering Management Consultancy & Other Services permitted by the Council in pursuant to Section 2(2)(iv) of the CA Act, 1949 & complies with the conditions(s) as specified by the Council from time to time in this regard. The name of the Management Consultancy Company is required to be approved by the Institute & such Company has to be registered with the Institute.

The members can retain full time Certificate of Practice besides being the Managing Director, Whole-time Director or Manager of such Management Consultancy Company. There will be no restriction on the quantum of the equity holding of the members, either individually &/ or along with the relatives, in such Company. Such members shall be regarded as being in full- time practice & therefore can continue to do attest function either in individual capacity or in Proprietorship/Partnership firm in which capacity they practice & wherein they are also entitled to train articled/audit assistants.

Thus, the action of CA R is valid.

QUESTION : 2 (a)

MN & Associates, Chartered Accountants have been appointed as statutory Auditors of Cotton Ltd. for the F.Y 2020-2021. The Company is into the business of yam manufacturing. For this purpose, cotton

ginning is also done within the factory premises. Raw cotton is purchased from local market & processed in-house. The Company received a notice from the State Government to deposit market development fee for the last 5 years to the tune of ₹ 10.00 crores. The Company & all other organizations in the same business has not deposited the market development fee, taking shelter of an old circular issued by the Government, The trade association met with the government officials to resolve the matter & agreed to deposit the same prospectively. However, the matter relating to payment of development fee for the last 5 years is pending before the Government as at the end of the financial year. The Company, however, disclosed the same in notes to accounts, as contingent liability, without quantifying the effect & proper explanation. If the liability is provided in the books of accounts, entire reserves will be wiped off. Auditor seeks your guidance as to how this disclosure affects them while forming an opinion on financial statements. (5 Marks)

ANSWER : 2 (a)

Forming an opinion & reporting on financial statements -

As per Ind AS 37, "Provisions, Contingent Liabilities & Contingent Assets", an entity should disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability &, where practicable.

- (a) an estimate of its financial effect, measured in the standard;
- (b) an indication of the uncertainties relating to the amount or timing of any outflow; &
- (c) the possibility of any reimbursement.

SA - 700 - Forming an opinion & reporting on financial statements:

The auditor shall evaluate whether in view of the requirements of the applicable financial reporting framework -

- (i) The financial statements adequately disclose the significant accounting policies selected & applied;
- (ii) The accounting policies selected & applied are consistent with the applicable financial reporting framework & are appropriate;
- (iii) The accounting estimates made by the management are reasonable;
- (iv) The information presented in the financial statements is relevant, reliable, comparable & understandable;
- (v) The financial statements provide adequate disclosures to enable the intended users to understand the effect of material transactions & events on the information conveyed in the financial statements.

If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with management &, depending on the requirements of the applicable financial reporting framework & how the matter is resolved, shall determine whether it is necessary to modify the opinion in the auditor's report in accordance with SA 705.

In the present case, auditor may consider modifying his opinion considering the financial effect of liability not disclosed properly.

QUESTION : 2 (b)

Milk Ltd. is engaged in the business of manufacturing & distribution of various milk products like cheese, curd, paneer, etc. Government made certain changes in rules & regulations relating to this sector, consequently management decided to go for expansion. Management was looking for some financial investor, who can fund some part of the proposed expansion. Mr. X is interested in the venture & appoints you to act as an advisor to the proposed investment in the business of Milk Ltd. You have to investigate the audited financial statements & ensure that the valuation of shares of the company on the basis of audited financial statements is appropriate. What process will be used for checking & whether you can put reliance on already audited statement of accounts ? (5 Marks)

ANSWER : 2 (b)

Process used for checking & reliance on already audited statement of accounts -

Following process may be carried out-

- (1) If the statements of account produced before the investigator were not audited by a qualified accountant, then of course there arises a natural duty to get the figures in the accounts properly checked & verified.
 - (2) However, when the accounts produced to the investigator have been specially prepared by a professional accountant, who knows or ought to have known that these were prepared for purposes of the investigation, he could accept them as correct relying on the principle of liability to third parties.
 - (3) Nevertheless, it would be prudent to see first that such accounts were prepared with objectivity & that no bias has crept in to give advantage to the person on whose behalf these were prepared.
- Whether the investigator can put reliance on the already audited statement of account - If the investigation has been launched because of some doubt in the audited statement of account, no question of reliance on the audited statement of account arises. However, if the investigator has been requested to establish value of a business or a share or the amount of goodwill payable by an incoming partner, ordinarily the investigator would be entitled to put reliance on audited materials made available to him unless, in the course of his test verification, he finds the audit to have been carried on very casually or unless his terms of appointment clearly require to test everything afresh.

QUESTION : 2 (c)

M/s RB Ltd. is engaged in the trading of engineering goods. Turnover of the Company for the year ended 31.03.2021 was ₹ 150.00 crores. During the F.Y 2018-2019, the Company claimed deduction of bad debts amounting to ₹ 100.00 lakhs while filing income tax return (Out of total debts of ₹ 150.00 lakhs due from Mr. X). However, during the F.Y 2020-2021, the Company was able to recover ₹ 75.00 lakhs from Mr. X through legal means & correctly credited to its profit & loss account. As a tax auditor, is it required to report such transactions in Tax Audit report under Income Tax Act, 1961 ? (4 Marks)

ANSWER : 2 (c)**Tax audit report under Income Tax Act, 1961 -**

In the given case of RB Ltd, the company had claimed deduction on account of bad debts amounting to Rs 100 Lakhs in the F.Y. 2018-19. However, in F.Y 2020-21 company recovered Rs 75 Lakhs which was correctly credited to its profit & loss account. This amount of Rs 75 Lakhs would be taxed u/s 41(4) of the Income Tax Act, 1961.

Tax Auditor shall report this under clause 25 as under:

Clause 25: Any amount of profit chargeable to tax u/s 41 & computation thereof.

The tax auditor should obtain a list containing all the amounts chargeable u/s 41 with the accompanying evidence, correspondence, etc. He should in all relevant cases examine the past records to satisfy himself about the correctness of the information provided by the assessee. The tax auditor has to state the profit chargeable to tax under this section. This information has to be given irrespective of the fact whether the relevant amount has been credited to the profit & loss account or not. The computation of the profit chargeable under this clause is also to be stated.

The tax auditor should maintain the following in his working papers for the purpose of furnishing details required in the format provided in the e-filing utility:

Sr. No.	Name of person	Amount of income	Section	Description of transaction	Computation if any
1	2	3	4	5	6

QUESTION : 3 (a)

PQ Limited, a listed entity, headquartered in Mumbai & is having 15 branches all over India. The Company is in the business of buying paddy grown by farmers directly & processing to produce final products for selling in domestic as well as international markets. PQ Limited appointed four firms of Chartered Accountants for audit of its head office & branches. Your firm is one of those firms. It was agreed that your

firm will act as Principal auditor. What factors will be considered by you while accepting the position of Principal auditor ? (5 Marks)

ANSWER : 3 (a)

Factors to be considered while accepting the position of Principal auditor -

SA 600 - Using the work of Another Auditor -

While accepting the position of Principal Auditor, the auditor should consider whether the auditor's own participation is sufficient to be able to act as the principal auditor.

For this purpose, the auditor would consider:

- (a) the materiality of the portion of the financial information which the principal auditor audits;
- (b) the principal auditor's degree of knowledge regarding the business of the components;
- (c) the risk of material misstatements in the financial information of the components audited by the other auditor; &
- (d) the performance of additional procedures as set out in this SA regarding the components audited by other auditor resulting in the principal auditor having significant participation in such audit.

QUESTION : 3 (b)

M/s GH & Associates have been appointed as Central Statutory Auditors of BNB Bank, a nationalized bank, headquartered in New Delhi for the F.Y 2020-2021. Bank functions in automated environment using "FLC Software". While preparing audit report, one of the partner highlighted that some matters covered by Companies Act, 2013 & the requirements of Companies (Auditor's Report), Order, 2020 reporting. You are required to answer the following : -

- [i] To which authority auditors should submit their audit report ?
- [ii] List the matters covered under Companies Act, 2013 &
- [iii] Reporting under Companies (Auditor's Report), Order, 2020.

(5 Marks)

ANSWER : 3 (b)

(i) Authority to whom Auditors to submit their Audit Report -

In the case of a nationalised bank, the auditor is required to make a report to the Central Government.

So, GH & Associates, Central Statutory Auditors of BNB Bank- a nationalized bank, would be required to submit their report to Central Govt.

(ii) The auditor of a banking company is also required to state in the report the matters covered by Section 143 of the Companies Act, 2013.

1. **Report on adequacy & operating effectiveness of Internal Controls over Financial Reporting** in case of banks which are registered as companies under the Companies Act in terms of Section 143(3)(i) of the Companies Act, 2013 which is normally to be given as an Annexure to the main audit report as per the Guidance Note on Audit of Internal Financial Controls over Financial Reporting issued by the ICAI.
 2. **Report on whether any serious irregularity was noticed in the working** of the bank which requires immediate attention (in accordance with sec 143(12) of the Companies Act, 2013.)
 3. **As per reporting requirements cast through Rule 11 of the Companies (Audit & Auditors) Rules, 2014** the auditor's report shall also include their views & comments on the following matters, namely:
 - (a) Whether the bank has disclosed the impact, if any, of the pending litigations on its financial position in its financial statements.
 - (b) Whether the bank has made provision, as required under the law or accounting standards, for material foreseeable losses, if any, on long term contracts including derivative contracts.
 - (c) Whether there has been any delay in transferring amounts, required to be transferred to the Investor Education & Protection Fund by the bank.
- (iii) Reporting requirements relating to the Companies (Auditor's Report) Order, 2020 are not applicable to a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949.

QUESTION : 3 (c)

CA. P was appointed GST Auditor of M/s AMR Ltd. for the F.Y 2020. During the course of audit, CA. P found that the Company has wrongly claimed ITC of ₹ 10.00 lakhs on car repair & insurance expenses. Accordingly, the auditor made recommendations in GSTR- 9C. Management of the company contended that recommendation of auditor is not binding upon them & they will not deposit the same. Comment.

(4 Marks)

ANSWER : 3 (c)**Contention of Management that recommendation of GST auditor in GSTR-9C not binding upon them -**

At the outset, it can be inferred from the heading to Part V of FORM GSTR-9C that the auditor has only a recommendatory power, for recommendations given by the auditor may or may not be acceptable to the registered person. If it is acceptable, there are no further questions. But if it is not acceptable, then the question that arises is how can the auditor resolve the issue.

At this juncture, the auditor needs to exercise his professional diligence, skill, legal knowledge & care in determining any additional tax liability which is payable by the registered person. The registered person has the option to accept, reject or partially accept the recommended additional tax liability.

In line with such recommendations, though not explicitly stated anywhere in the relevant Form or GST law-

- (1) the registered person can choose to make the payment of the additional tax liability in full or in part;
- (2) the registered person can even choose to reject the complete recommendations of the auditor & not make the payment at all.

QUESTION : 4 (a)

Vineet & Associates have been offered Statutory Audit of TLP Ltd. As a part of ethical requirements of the ICAI, CA. V, partner of the firm, communicated with the previous auditor enquiring as to whether any professional reason exists for which he should not accept the audit assignment. Previous auditor informed that he issued a qualified report, so management is changing the auditor. Comment with reference to the provisions of the CA Act, 1949 & schedules thereto as to whether Vineet & Associates can accept the audit.

(4 Marks)

ANSWER : 4 (a)**Provisions of the Chartered Accountants Act, 1949 & Schedules thereto -**

As per Clause (8) of Part I of First Schedule to the CA Act, 1949, a Chartered Accountant in practice will be 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.

The professional reasons for not accepting an audit would be:

- (a) Non-compliance of the provisions of Sections 139 & 140 of the Companies Act, 2013 as mentioned in Clause (9) of the Part - I of First Schedule to The CA Act, 1949; &
- (b) Non-payment of undisputed Audit Fees by auditees other than in case of Sick Units for carrying out the Statutory Audit under the Companies Act, 2013 or various other statutes; &
- (c) Issuance of a qualified report.

There is no rule, written or unwritten, which would prevent an auditor from accepting the appointment offered to him under the circumstance of Issuance of qualified report. However, before accepting the audit, he should ascertain the full facts of the case. For nothing will bring the profession to disrepute so much as the knowledge amongst the public that if an auditor is found to be "inconvenient" by the client, he could readily be replaced by another who would not displease the client & this point cannot be too over-emphasised.

From the above it can be concluded that Vineet & Associates may accept the audit of TLP Ltd if CA V is satisfied that the attitude of the retiring auditor was not proper & justified. If, on the other hand, CA V feels that the retiring auditor had qualified the report for good & valid reasons, he should refuse to accept the audit of TLP Ltd.

QUESTION : 4 (b)

The auditors are required to understand, evaluate & validate the entity level controls as a part of audit engagement, the result of which has an impact on the nature, timing & extent of other audit procedures. In evaluating the effect of such control, existence, effectiveness & assessment of the whistle-blower policy in the company is very important. Specify the procedure you would perform for an understanding & evaluation of such whistle-blower policy. (5 Marks)

ANSWER : 4 (b)

Procedure for understanding & evaluation of whistle-blower policy -

Auditors are required to understand, evaluate & validate the entity level controls as a part of an audit engagement. The results of testing entity level controls could have an impact on the nature, timing & extent of other audit procedures including testing of controls. For example, when the entity level controls at a company are effective, the auditor may consider reducing the number of samples in the test of controls & where the auditor finds the entity level controls ineffective, the auditor may consider to increase the rigour of testing by increasing sample sizes. In small & less complex companies, the entity level controls may not formally defined or documented. In such situations, the auditor should design audit procedures accordingly to obtain evidence of the existence & effectiveness of entity level controls.

The following example shows how the auditor performs an understanding & evaluation of the whistle-blower policy in a company:

- (i) Does the company have a whistle-blower policy?
- (ii) Is this policy documented & approved?
- (iii) Has the whistle-blower policy been communicated to all the employees?
- (iv) Are employees aware of this policy & understand its purpose & their obligations?
- (v) Has the company taken measures viz., training, to make the employees understand the contents & purpose of the policy?
- (vi) Does the company monitor effectiveness of the policy from time-to-time?
- (vii) How does the company deal with deviations & non-compliance?

QUESTION : 4 (c)

CA Gudia has been appointed as Management Auditor of XYZ Ltd. The principle reason for her appointment is that current managerial decisions are not up to the mark, especially in relation to investments made by the Company. The Company is going to make huge investments in one of the ventures identified. Management Auditor was required to ensure that systems & procedures of Company are working effectively & meeting the requirements. What aspects should be considered by CA Gudia to determine that the systems & procedures are meeting current requirements? (5 Marks)

ANSWER : 4 (c)

Aspects to be considered by Management auditor to determine that the systems & procedures are meeting current requirements -

CA Gudia should proceed as under :

The evaluation of a system or a procedure actually includes three separate considerations. First, is the system or procedure meeting all of the current requirements? Second, is it operating effectively? & third, what is the degree of effectiveness?

To determine whether the system or procedure is meeting current requirements, the following among other things should be considered:

- Is the system or procedure designed to promote the achievement of the company's objectives, & is it accomplished effectively?
- Does the system or procedure operate within the framework of the organisational structure?

- Does the system or procedure adequately provide methods of control in order to obtain maximum performance with the least expenditure of time & effort?
- Do the routines designated in the system or procedures indicate performance in a logical sequence?
- Does the system or procedure provide the means for effective coordination between one department & another?
- Have all required functions been established?
- Has the necessary authority been designated to carry out responsibilities?
- Can any changes be made to improve effectiveness?

The important thing is to make sure that the system or procedure is designed to meet the desired results.

QUESTION : 5 (a)

M/s ALM Ltd. is into the business of trading of toys since 2001. The company was performing well till year 2015 & after that sales started showing downward trend. The Company had borrowed working capital funds from LP Bank Ltd. On 01.08.2020, account of the borrower was classified as NPA. Bank appointed forensic auditor, to identify, if any diversion of funds is there or not. Forensic auditor confirmed the diversion of funds. Matter went to the court of law & company was asked to recast its financial statements for the last 5 years. Management contended that Companies Act, 2013 does not allow recasting for more than three preceding financial years. Do you agree with the views of the management? (5 Marks)

ANSWER : 5 (a)

Recasting of financial statements -

Re-opening of accounts on Court's or Tribunal's orders: Section 130 of the Companies Act, 2013 states that a company shall not re-open its books of account & not recast its financial statements, unless an application in this regard is made by the Central Government, the Income-tax authorities, the Securities & Exchange Board of India (SEBI), any other statutory regulatory body or authority or any person concerned & an order is made by a court of competent jurisdiction or the Tribunal to the effect that—

- (i) the relevant earlier accounts were prepared in a fraudulent manner; or
- (ii) the affairs of the company were mismanaged during the relevant period, casting a doubt on the reliability of financial statements.

The Order for reopening of accounts not to be made beyond eight financial years immediately preceding the current financial year unless & until Government has, u/s 128(5), issued a direction for keeping books of account longer than 8 years, reopening of accounts can be made for such longer period.

However, a notice shall be given by the Court or Tribunal in this regard & shall take into consideration the representations, if any.

Keeping in view above, the contention of the ALM Ltd that the Companies Act, 2013 does not allow recasting for more than three preceding financial years is incorrect.

QUESTION : 5 (b)

HK & Co. Chartered Accountants have been auditors of SAT Ltd (a listed entity) for the last 8 financial years. CA. H, partner of the firm, has been handling the audit assignment very well since the appointment. The audit work of CA. H & her team is reviewed by a senior partner CA. K to assure that audit is performed in accordance with professional standards & regulatory & legal requirements. CA. K was out of India for some personal reasons, so this year CA. G has been asked to review the audit work. In your opinion, what areas CA. G should consider at the time of review. List any four areas & also comment whether firm is complying with Standard on Quality Control or not. (5 Marks)

ANSWER : 5 (b)

Compliance with Standard on Quality Control on review of audit work -

As per SQC 1, an engagement quality control review for audits of financial statements of listed entities includes considering the following:

- The work has been performed in accordance with professional standards & regulatory & legal requirements;
- Significant matters have been raised for further consideration;
- Appropriate consultations have taken place & the resulting conclusions have been documented & implemented;
- There is a need to revise the nature, timing & extent of work performed;
- The work performed supports the conclusions reached & is appropriately documented;
- The evidence obtained is sufficient & appropriate to support the report; &
- The objectives of the engagement procedures have been achieved.

The firm should establish policies & procedures:

- (i) Setting out criteria for determining the need for safeguards to reduce the familiarity threat to an acceptable level when using the same senior personnel on an assurance engagement over a long period of time; &
- (ii) For all audits of financial statements of listed entities, requiring the rotation of the engagement partner after a specified period in compliance with the Code.

The familiarity threat is particularly relevant in the context of financial statement audits of listed entities. For these audits, the engagement partner should be rotated after a predefined period, normally not more than seven years.

From the facts given in the question & from the above stated paras of SQC 1, it can be concluded that firm is not complying with SQC 1 as Engagement Partner H is continuing for more than 7 years.

QUESTION : 5 (c)

M/s GSB Limited is into the business of construction for the past 25 years. Management of the Company came to know that building material sent to construction sites are of substandard quality whereas the payment released by the accounts department of the Company are on the higher side. Forensic Auditor was asked to carry out detailed investigation. Forensic auditor completed his investigation & now preparing his report. What are the broad areas of information that needs to be incorporated in the report of forensic auditor ? (4 Marks)

ANSWER : 5 (c)

Broad areas of information to be incorporated in the report of Forensic auditor -

Issuing an audit report is the final step of a fraud audit. Auditors will include information detailing the fraudulent activity, if any has been found. The client will expect a report containing the findings of the investigation, including a summary of evidence, a conclusion as to the amount of loss suffered as a result of the fraud & to identify those involved in fraud.

The report may include sections on the nature of the assignment, scope of the investigation, approach utilized, limitations of scope & findings &/or opinions. The report will include schedules & graphics necessary to properly support & explain the findings.

The report will also discuss how the fraudster set up the fraud scheme, & which controls, if any, were circumvented. It is also likely that the investigative team will recommend improvements to controls within the organization to prevent any similar frauds occurring in the future.

The forensic auditor should have active listening skills which will enable him to summarize the facts in the report. It should be kept in mind that the report should be based on the facts assimilated during the process & not on the opinion of the person writing the report.

QUESTION : 6 (a)

One of the objectives of Internal control relating to accounting system is that all transactions are promptly recorded in an appropriate manner to permit the preparation of financial information & to maintain accountability of assets. To achieve this objective, certain matters should be ensured by accounting controls. List down matters to be ensured by accounting controls. (5 Marks)

ANSWER : 6 (a)

Matters to be ensured by accounting controls -

Basic Accounting Control Objectives: The basic accounting control objectives which are sought to be achieved by any accounting control system are -

- Transactions are executed in accordance with management's general or specific authorisation;
- Transactions & other events are real & promptly/timely recorded at correct amounts;
- Transactions should be classified in appropriate accounts & in the appropriate period to which it relates;
- Transactions are properly posted.
- Transactions should be recorded in a manner so as to facilitate preparation of financial statements in accordance with applicable accounting standards, other accounting policies & practices & relevant statutory requirements;
- Transactions are properly disclosed.
- Recording of transactions should facilitate maintaining accountability for assets;
- Assets & records are required to be protected from unauthorized access, use or disposition;
- Records of assets, such as sufficient description of the assets (to facilitate identification, its location should also be maintained, so that the assets could be physically verified periodically.
- Transactions are properly summarized.

QUESTION : 6 (b)

CA. S has been appointed as Statutory Auditor of SRT Ltd. for the financial year 2020-2021. The Company while preparing financial statements for the year under audit prepared one additional profit & loss account that disclosed specific items of expenditure & included the same as an appendix to the financial statements. CA. S has not been able to understand this as the additional profit & loss account is not covered under applicable financial reporting framework. Guide him as to how he should deal with this issue while reporting on the financial statements of SRT Ltd. (5 Marks)

ANSWER : 6 (b)

If supplementary information that is not required by the applicable financial reporting framework is presented with the audited financial statements, the auditor shall evaluate whether, in the auditor's professional judgment, supplementary information is nevertheless an integral part of the financial statements due to its nature or how it is presented. When it is an integral part of the financial statements, the supplementary information shall be covered by the auditor's opinion.

If supplementary information that is not required by the applicable financial reporting framework is not considered an integral part of the audited financial statements, the auditor shall evaluate whether such supplementary information is presented in a way that sufficiently & clearly differentiates it from the audited financial statements. If this is not the case, then the auditor shall ask management to change how the unaudited supplementary information is presented.

If management refuses to do so, the auditor shall identify the unaudited supplementary information & explain in the auditor's report that such supplementary information has not been audited.

When an additional profit & loss account that discloses specific items of expenditure is disclosed as a separate schedule, included as an appendix to the financial statements, the auditor may consider this to be supplementary information that can be clearly differentiated from the financial statements.

Thus, additional profit & loss account is not considered an integral part of the audited financial statements & the auditor shall evaluate that supplementary information is presented in a way that sufficiently & clearly differentiates it from the audited financial statements.

QUESTION : 6 (c)

CAB Insurance Company Ltd was incorporated on 01.07.2020. Company is mainly in the area of health insurance & planning to expand in other fields of general insurance. You have been appointed as Chief Financial Officer (CFO) of the Company. The Company has made investment as per guidelines in real estate investment property & Equity Securities & Derivatives. Guide CFO as to how the same should be valued ?

(4 Marks)

ANSWER : 6 (c)

Valuation of Real estate investment property & Valuation of Equity Securities & Derivative Instruments that are traded in markets -

In case of CAB Insurance Company Ltd dealing in Health Insurance & Planning to expand in other fields of general insurance: Guidance to CFO for Valuation of Real estate investment property & Valuation of Equity Securities & Derivative Instruments that are traded in markets.

Valuation of Real estate investment property - The value of investment property shall be determined at historical cost, subject to revaluation at least once in every three years. The change in the carrying cost of the investment property shall be taken to revaluation reserve.

- The insurer shall assess at each balance sheet date whether any impairment of the property has occurred.
- Gains/losses arising due to changes in the carrying amount of real estate shall be taken to equity under 'Revaluation Reserve'. The Profit on sale of investments or loss on sale of investments, as the case maybe shall include any accumulated changes in the carrying amount previously recognized in equity under the heading revaluation reserve in respect of particular property & being recycled to the relevant revenue account or profit & loss account on sale of that property.
- The bases for revaluation shall be disclosed in the notes to accounts. The authority may issue directions specifying the amount to be released from the revaluation reserve for declaring bonus to the policyholders. For the removal of doubt, it is clarified that except for the amount that is released to policyholders as per the authority's direction, no other amount shall be distributed to shareholders out of revaluation reserve account.

An impairment loss shall be recognized as an expense in the revenue/ Profit & loss account immediately, unless the asset is carried at revalued amount. Any impairment loss of a revalued asset shall be treated as a revaluation decrease of that asset & if the impairment loss exceeds the corresponding revaluation reserve, such excess shall be recognized as expense in the Revenue/Profit & loss account.

Valuation of Equity Securities & Derivative Instruments that are traded in markets-

Listed equity securities & derivative instruments that are traded in active markets shall be measured at fair value on the balance sheet date. For the purpose of calculation of fair value, the lowest of the last quoted closing price at the stock exchanges where the securities are listed shall be taken.

- The insurer shall assess on each balance sheet date whether any impairment of listed equity security(ies)/ derivative(s) instruments has occurred.
- Unrealised gains/losses arising due to changes in the fair value of the listed equity shares & the derivative instruments shall be taken to equity under the head 'Fair value change account'. The profit on sale of investments or loss on sale of investment as the case maybe shall include accumulated changes in the fair value previously recognized under equity under the heading 'Fair value changes account' in respect of a particular security & being recycled to the relevant Revenue account or Profit & loss account on actual sale of that security.
- The Authority may issue directions specifying the amount to be released from the Fair Value Change Account for declaring bonus to the policyholders. For the removal of doubt, it is clarified that except for the amount that is released to policyholders as per the Authority's prescription, no other amount shall be distributed to shareholders out of Fair Value Change Account. Also, any debit balance in Fair Value Change Account shall be reduced from profit/free reserves while declaring dividends.

The insurer shall assess, on each balance sheet date, whether any impairment has occurred. An impairment loss shall be recognized as an expense in Revenue/Profit & Loss Account to the extent of the difference between the re-measured fair value of the security/investment & its acquisition cost as reduced by any previous impairment loss recognized as expense in Revenue/ Profit & Loss Account. Any reversal of impairment loss earlier recognized in Revenue/Profit & Loss Account shall be recognized in Revenue/Profit & Loss Account.

Unlisted & other than actively traded Equity Securities & Derivative Instruments - Unlisted equity securities & derivative instruments & listed equity securities & derivative instruments that are not regularly traded in active markets shall be measured at historical cost. Provision shall be made for diminution value of such investments. The provision so made shall be reversed in subsequent periods if estimates based on external evidence show an increase in the value of the investment over its' carrying amount. The increased carrying amount of the investment due to the reversal of the provision shall not exceed the historical cost. For the purposes of this regulation, a security shall be considered as being not actively traded, if as per guidelines governing mutual funds laid down from time to time by SEBI, such a security is classified as "thinly traded".

OR

QUESTION : 6 (c)

M/s. SR & Associates is one of the three firms shortlisted by ARG Cooperative Bank for assignment of Statutory Audit for the F.Y 2021. Bank mailed the list of branches to the audit firms along with the maximum fee per branch & asked them to submit the quotations. SR & Associates responded to the bank & submitted their quotation. Comment with reference to the provisions of the CA Act, 1949 & schedules thereto. (4 Marks)

ANSWER : 6 (c)

Provisions of the CA Act, 1949 & Schedules thereto -

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

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

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

However, as per the guideline issued by the Council of the ICAI, a member of the Institute in practice shall not respond to any tender issued by an organization or user of professional services in areas of services which are exclusively reserved for chartered accountants, such as audit & attestation services.

However, such restriction shall not be applicable where minimum fee of the assignment is prescribed in the tender document itself or where the areas are open to other professionals along with the Chartered Accountants.

In the given case of ARG Cooperative Bank, Bank mailed the list of branches to the audit firms along with maximum fees per branch, in response to which SR & Associates responded & submitted their quotation.

Keeping in view the facts, clause 6 & guideline issued by the council, it can be concluded that SR & Associates is guilty of Professional misconduct.