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SUGGESTED SOLUTION

CA FINAL NOV'19

SUBJECT- AUDIT

Test Code - FNJ 7248

BRANCH - () (Date :)

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ANSWER 1(A)

Data Analytics : Generating and preparing meaningful information from raw system data using processes, tools and techniques is known as Data Analytics. The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques of 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.

(4 MARKS)

ANSWER 1(B)

Considerations for Planning and Performing Audit in case of Special Purpose Framework: As per SA 800 “Special Considerations-Audits of Financial Statements Prepared in accordance with Special Purpose Frameworks”, financial statements prepared in accordance with a special purpose framework may be the only financial statements an entity prepares. In such circumstances, those financial statements may be used by users other than those for whom the financial reporting framework is designed.

While planning and performing audit of such special purpose framework based company, the auditor should consider below mentioned factors:

- (i) To obtain an understanding of the entity’s selection and application of accounting policies. In the case of financial statements prepared in accordance with the provisions of a contract, the auditor shall obtain an understanding of any significant interpretations of the contract that management made in the preparation of those financial statements.
- (ii) Compliance of all SAs relevant to audit, the auditor may judge it necessary to depart from a relevant requirement in an SA by performing alternative audit procedures to achieve the aim of that requirement.
- (iii) Application of some of the requirements of the SAs in an audit of special purpose financial statements may require special consideration by the auditor. For example, in SA 320, judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. In the case of an audit of special purpose financial statements, however, those judgments are based on a consideration of the financial information needs of the intended users.
- (iv) In the case of special purpose financial statements, such as those prepared in accordance with the requirements of a contract, management may agree with the intended users on a threshold below which misstatements identified during the audit will not be corrected or otherwise adjusted. The existence of such a threshold does not relieve the auditor from the requirement to determine materiality in accordance with SA 320 for purposes of planning and performing

the audit of the special purpose financial statements.

- (v) Communication with those charged with governance in accordance with SAs is based on the relationship between those charged with governance and the financial statements subject to audit, in particular, whether those charged with governance are responsible for overseeing the preparation of those financial statements. In the case of special purpose financial statements, those charged governance may not have such a responsibility.

(6 MARKS)

ANSWER 2(A)

As per SA 620, Using the work of an Auditor's Expert, the nature, scope and objectives of the auditor's expert's work may vary considerably with the circumstances, as may the respective roles and responsibilities of the auditor and the auditor's expert, and the nature, timing and extent of communication between the auditor and the auditor's expert. It is therefore required that these matters are agreed between the auditor and the auditor's expert.

In certain situations, the need for a detailed agreement in writing is required like –

- The auditor's expert will have access to sensitive or confidential entity information.
- The matter to which the auditor's expert's work relates is highly complex.
- The auditor has not previously used work performed by that expert.
- The greater the extent of the auditor's expert's work, and its significance in the context of the audit.

In the given case, considering the complexity involved in the valuation and volume of derivatives and also due to the fact that the auditor and auditor's expert were new to each other, auditor should have signed a formal agreement/ engagement letter with the auditor's expert in respect of the work assigned to him.

(5 MARKS)

ANSWER 2(B)

The statement on Peer Review lays down the scope of review to be conducted as under :

The Peer Review process shall apply to all the assurance services provided by a Practice Unit.

1. Once a Practice Unit is selected for Review, its assurance engagement records pertaining to the Peer Review Period shall be subjected to Review.
2. The Review shall cover :
 - (i) Compliance with Technical, Professional and Ethical Standards.
 - (ii) Qualify of reporting
 - (iii) Systems and procedures for carrying out assurance services.
 - (iv) Training programmes for staff (including articled and audit assistants) concerned with assurance functions, including availability of appropriate infrastructure.
 - (v) Compliance with directions and /or guidelines issued by the Council to the Members, including Fees to be charged, Number of audits undertaken, register for Assurance Engagements conducted during the year and such other related records.
 - (vi) Compliance with directions and / or guidelines issued by the Council in relating to article assistants and /or audit assistants, including attendance register, work diaries, stipend payments, and such other related records.

As it is clear from the above, that the Statement of Peer Review aims to confine the scope of review to preceding three years since this would establish the consistency or deviations, if any, in respect of procedures followed by the practice unit. A Practice Unit means members practice, whether practicing individually or a firm of Chartered Accountants. **(5 MARKS)**

ANSWER 3(A)

(a) As per clause (xiii) of para 3 of CARO 2016 the auditor is required to report, “whether all transactions with the related parties are in compliance with sections 177 and 188 of Companies Act, 2013 where applicable and the details have been disclosed in the Financial Statements etc., as required by the applicable accounting standards”.

In the present case, the auditor is required to report as per clause xiii of para 3 of CARO 2016 regarding receipt of long term borrowing from Parent Company which qualifies as a transaction with the related party.

(b) As per clause Clause (x) of para 3 of CARO 2016 the auditor is required to report, “whether any fraud by the company or any fraud on the Company by its officers or employees has been noticed or reported during the year; If yes, the nature and the amount involved is to be indicated.”

In the instant case, a fraud has been identified in recruitment of employees by the HR Department where in certain sums were alleged to have been taken as kickback from the company of amounting rupees approx.. 12 lakh. The auditor is required to report on the same in accordance with clause (x) of para 3 of CARO 2016.

(4 MARKS)

ANSWER 3(B)

One of the following additional requirement as stipulated under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”) on which Section 177 of the Companies Act, 2013 (relating to audit committee) is silent is – The Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee whichever is greater, but there should be a minimum of two independent directors present.

Besides, there is a mandatory review requirement and to review only monthly information system is not sufficient. Here the audit committee members reviewed only monthly information system of the company and the same is not sufficient as per LODR Regulations.

The Audit Committee shall mandatorily review the following information as per LODR Regulations:

- (i) Management discussion and analysis of financial condition and results of operations;
- (ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;
- (iii) Management letters / letters of internal control weaknesses issued by the statutory auditors;
- (iv) Internal audit reports relating to internal control weaknesses; and
- (v) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee;
- (vi) Statement of deviations: (a) quarterly statement of deviations including report of

monitoring agency if applicable and (b) annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

Applying the above, the decision taken by the audit committee is not in line with the LODR Regulations.

(6 MARKS)

ANSWER 4(A)

Audit should be risk – based or focused on areas of greatest risk to the achievement of the audited entity’s objectives. Risk – based audit (RBA) is an approach to audit that analyses audit risks, sets materiality thresholds based on audit risk analysis and develops audit programmes that allocate a larger portion of audit resources to high – risk areas.

RBA consists of four main phases starting with the identification and prioritization of risks, to the determination of residual risk, reduction of residual risk to acceptable level and the reporting to auditee of audit results. These are achieved through the following :

Step 1 – Understand auditee operations to identify and prioritize risks : Understanding auditee operations involves processes for reviewing and understanding the audited organization’s risk management processes for its strategies, framework of operations, operational performance and information process framework, in order to identify and prioritize the error and fraud risks that impact the audit of financial statements. The environment in which the auditee operates, the information required to monitor changes in the environment, and the process or activities integral to the audited entity’s success in meeting its objectives are the key factors to an understanding of agency risks. Likewise, a performance review of the audited entity’s delivery of service by comparing expectations against actual results may also aid in understanding agency operations.

Step 2 – Assess auditee management strategies and controls to determine residual audit risk : Assessment of management risk strategies and controls is the determination as to how controls within the auditee are designed. The role of internal audit in promoting a sound accounting system and internal control is recognized, thus the SAI should evaluate the effectiveness of internal audit to determine the extent to which reliance can be placed upon it in the conduct of substantive tests.

Step 3 – Manage residual risk to reduce it to acceptable level : Management of residual risk requires the design and execution of a risk reduction approach that is efficient and effective to bring down residual audit risk to an acceptable level. This includes the design and execution of necessary audit procedures and substantive testing to obtain evidence in support of transactions and balances. More resources should be allocated to areas of high audit risks, which were earlier known through the analytical procedures undertaken.

Step 4 – Inform auditee of audit results through appropriate report : The results of audit shall be communicated by the auditor to the audited entity. The auditor must immediately communicate to the auditee reportable conditions that have been observed even before completion of the audit, such as weaknesses in the internal control system, deficiencies in the design and operation of internal controls that affect the organisation’s ability to record, process, summarize and report financial data.

(6 MARKS)

ANSWER 4(B)

Corporate Social Responsibility Expenses: Company (Corporate Social Responsibility Policy) Rules, 2014 mandated the corporate entities that the expenditure incurred for Corporate Social Responsibility (CSR) should not be the expenditure incurred for the activities in the ordinary course of business. If expenditure incurred is for the activities in the ordinary course of business, then it will not be qualified as expenditure incurred on CSR activities.

In the instant case, Beneath minerals Limited is a public sector company which is engaged in extraction of mineral from land, for that it has to pump out water in the first layer of the soil if the minerals are to be excavated. The company pumps out water and diverts the water through a water course constructed by it to nearby villages and the water is allowed to be used by villagers for drinking purposes. Company has disclosed the cost of construction of water course as CSR expenses in the statement of Profit and Loss, which is not correct as this expenditure incurred for the construction of water course is included in the ordinary course of activities of business.

Therefore, the treatment done by showing the cost of construction of water course as CSR expense is not correct.

(4 MARKS)

ANSWER 5. CORRECT OPTION

(1*10=10 MARKS)

1. B
2. A
3. D
4. B
5. C
6. B
7. C
8. A
9. D
10. B