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CA FINAL NOV'19

SUBJECT- AUDIT

Test Code - **FNJ 7300**

BRANCH - () (Date :)

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ANSWER -1

1. B
2. A
3. D
4. A
5. A
6. B
7. C
8. C
9. D
10. D
11. B
12. D
13. D
14. B
15. C
16. C
17. B
18. C
19. A
20. A

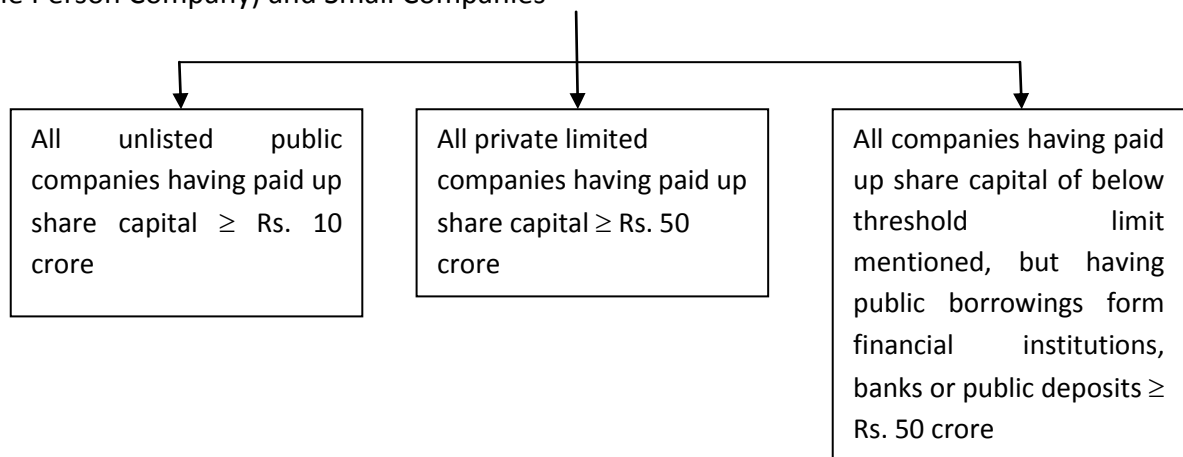
ANSWER -1

ANSWER -A

Rotation of Auditor & Cooling Off Period Provisions : The provision related to Rotation of Auditor & Cooling Off Period is newly inserted by section 139(2) of the Companies Act, 2013 read with Rule 5 of the Companies (Audit & Auditors) Rules, 2014, which is discussed as under :

The provisions related to rotation of auditor are applicable to those companies which are prescribed in Companies (Audit and Auditors) Rules. 2014, which prescribes the following classes of companies excluding one person companies and small companies namely :

Class of Companies for Rotation of Auditor → including Listed Companies + excluding OPC (One Person Company) and Small Companies



- (i) all unlisted public companies having paid up share capital of Rs. 10 crore or more;
- (ii) all private limited companies having paid up share capital of Rs. 50 crore or more;

- (iii) all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of Rs. 50 crores or more.

As per Section 139(2) of the Companies Act, 2013, no listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re – appoint –

- (a) an individual as auditor for more than one term of 5 consecutive years; and
(b) an audit firm as auditor for more than two terms of 5 consecutive years.

In the given case, Ram Ltd. is a private company having paid up share capital of Rs. 5 crore and public borrowings of Rs. 100 crore. The company has appointed M/s Shyam & Co., a chartered accountant firm, as the statutory auditor in its AGM held at the end of September, 2017 for 11 years.

The provisions relating to rotation of auditor will be applicable as the public borrowings exceeds Rs. 50 crore. Therefore, Ram (P) Ltd. can appoint M/s Shyam & Co. as an auditor of the company for not more than one term of five consecutive years twice i.e. M/s Shyam & Co. shall hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2022 and thereafter can be re – appointed as auditor for one more term of five years i.e. upto year 2027. The appointment shall be subject to ratification by members at every annual general meeting of the company. As a result, the appointment of M/s Shyam & Co. made by Ram Ltd. for 11 years is void.

(5 MARKS)

ANSWER –B

Re – evaluation of the Materiality Concept : In the instant case, Y & Co., as an auditor has applied the concept of materiality for the financial statements as a whole. But they want to re – evaluate the materiality concept on the basis of additional information of import of machinery for production of new product which draws attention to a particular aspect of the company’s business.

As per SA 320 “Materiality in Planning and Performing an Audit”, while establishing the overall audit strategy, the auditor shall determine materiality for the financial statement as a whole. He should set the benchmark on the basis of which he performs his audit procedure. If, in the specific circumstances of the entity, there is one or more particular classes of transactions, account balances or disclosures for which misstatements for lesser amounts than the materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements, the auditor shall also determine the materiality level or levels to be applied to those particular classes of transactions, account balances or disclosures.

The auditor shall revise materiality for the financial statements 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.

If the auditor concludes a lower materiality for the same, then he should consider the fact that whether it is necessary to revised performance materiality and whether the nature, timing and extent of the further audit procedures remain appropriate.

Thus, Y & Co. can re – evaluate the materiality concepts after considering the necessity of such revision.

ANSWER –C

Non-Compliance of Laws and Regulations & Reporting Requirements: As per SA 250 “Consideration of Laws and Regulations in an Audit of Financial Statement”, it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity’s operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity’s financial statements. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements.

Further, the auditor is required to report under clause (vii)(a) of Para 3 of CARO, 2016 whether the company is regular in depositing undisputed statutory dues including employees’ state insurance with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated by the auditor.

In the instant case, even though accrual principles have been followed, disclosure of non-payment is necessary. The auditor should disclose the fact of non-payment of rupees 7.50 lakhs in his report.

(4 MARKS)

ANSWER -2

ANSWER -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.

(4 MARKS)

ANSWER –B

As per the Statement, Technical, Professional and Ethical Standards – means

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

(ii) Standards;

Standards issued by the Institute of Chartered Accountants of India including –

(a) Engagement standards

(b) Statements

(c) Guidance notes

(d) Standards on Internal Audit

(e) Statements on Quality Control

(f) Notifications / Directions/ Announcements/ Guidelines/ Pronouncements/ Professional standards issued from time to time by the Council or any of its committees.

(iii) Framework for the Preparation and presentation of financial statements, Framework of Statements and Standard on Auditing, Standard on Assurance Engagements, Standards on Quality Control and Guidance Notes on related services issued, from time to time, by the Institute of Chartered Accountants of India and Framework for Assurance Engagements;

(iii) Provision of the various relevant statutes and / or regulations which are applicable in the context of the specific engagements being reviewed including instructions, guidelines, notifications, directions issued by regulatory bodies as covered in the scope of assurance engagements.

(4 MARKS)

ANSWER –C

Soliciting Clients : As per Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another chartered accountant in practice and responding to tenders.

Further, section 140(4)(iii) of the Companies Act, 2013, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of the company and to be read out at the meeting. However, the content of latter should be set out in a dignified manner how he has been acting independently and conscientiously through the term of his office and may, in addition, indicate, if he so chooses, his willingness to continue as auditor, if re – appointed by the shareholders.

Thus, the incorporation as an independent professional, made by CA. Smart, while submitting representation under section 140(4)(iii) of the Companies Act, 2013 and indication of willingness of continue as an auditor if reappointed by shareholders, does not leads to solicitation.

Therefore, CA. Smart will not be held guilty for professional misconduct under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

(6 MARKS)

ANSWER -3

ANSWER -A

Provision for Claim : No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co – insurance premium.

In view of the above, the insurance company is not liable to pay the claim and hence no provision for claim is required.

(4 MARKS)

ANSWER -B

Areas excluded from scope of Peer Reviewer are:

- (i) Management Consultancy Engagements;
- (ii) Representation before various Authorities;
- (iii) Engagements to prepare tax returns or advising clients in taxation matters;
- (iv) Engagements for the compilation of financial statements;
- (v) Engagements solely to assist the client in preparing, compiling or collating information other than financial statements;
- (vi) Testifying as an expert witness;
- (vii) Providing expert opinion on points of principle, such as Accounting Standards or the applicability of certain laws, on the basis of facts provided by the client; and
- (viii) Engagement for Due diligence.

(5 MARKS)

ANSWER -C

As per Clause (8) of Part I of First Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct, if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been Issued certificate under the Restricted Certificate Rules, 1932 without first communicating with him in writing.

This clause is applicable in situation of replacing of one auditor by another auditor. Internal auditor and statutory auditor are parallel positions and not replacement positions. The management generally appoints the internal auditor whereas the statutory auditor will be

appointed by the shareholders in the AGM. In this situation, there is no need for communication by one to other.

In view of above the contention of the statutory auditor is unacceptable and there is no question of communicating in writing by Mr. T.

(5 MARKS)

ANSWER -4

ANSWER -A

Verification of Accounts Receivable: As per SA 510 "Initial Audit Engagements – Opening Balances", while conducting an initial audit engagement, the objective of the auditor with respect to opening balances is to obtain sufficient appropriate audit evidence about whether-

- (i) Opening balances contain misstatements that materially affect the current period's financial statements; and
- (ii) Appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes thereto are properly accounted for and adequately presented and disclosed in accordance with the applicable financial reporting framework.

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

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

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

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

In the given case, the management of Captura (P) Ltd. has restrained CA. Mack, its auditor, from obtaining appropriate audit evidence for balances of Accounts Receivable outstanding as it is from the preceding year. CA. Mack, on believing that the preceding year balances have already been audited and on the statement of the management that there are no receipts and credits during the current year, therefore excluded the verification of Accounts Receivable from his audit programme.

Thus, CA. Mack should have requested the management to provide written representation for their views and expressions; and he should also not exclude the audit procedure of closing balances of Accounts Receivable from his audit programme.

(5 MARKS)

ANSWER -B

Other Misconduct : CA Kumar has engaged his Articled Assistant for his own 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 and 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 and 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 Kumar is guilty of 'Other Misconduct'.

(4 MARKS)

ANSWER –C

Qualified Opinion

We have audited the standalone financial statements of ABC Limited (“the Company”), which comprise the balance sheet as at March 31, 20X1, and the statement of Profit and Loss, (statement of changes in equity) and the statement of cash flows for the year then ended, and notes to the financial statements, including a summary of significant accounting policies and other explanatory information (in which are included the Returns for the year ended on that date audited by the branch auditors of the Company’s branches located at *(location of branches)*)².

In our opinion and to the best of our information and 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 aforesaid financial statements present fairly, in all material respects, or *give a true and fair view* in conformity with the accounting principles generally accepted in India of the state of affairs of the Company as at March 31st, 2XXX and profit/loss, *(changes in equity)* and its cash flows for the year ended on that date.

Basis for Qualified Opinion

The Company’s short-term marketable securities are carried in the statement of financial position at xxx. Management has not marked these securities to market but has instead stated them at cost, which constitutes a departure from the Accounting Standards prescribed in section 133 of the Companies Act, 2013. The Company’s records indicate that had management marked the marketable securities to market, the Company would have recognized an unrealized loss of Rs.xxx in the statement of comprehensive income for the year. The carrying amount of the securities in the statement of financial position would have been reduced by the same amount at March 31, 20X1, and income tax, net income and shareholders’ equity would have been reduced by Rs.xxx, Rs.xxx and Rs.xxx, respectively.

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the *Auditor’s Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance

with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ICAI's Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion.

(5 MARKS)

ANSWER -5

ANSWER -A

While conducting the operational audit the auditor has to come across many irregularities and areas where improvement can be made and therefore he gives his suggestions and recommendations.

These suggestions and recommendations for improvements may not be accepted by the hostile managers and in effect there may be cold war between the operational auditor and the managers. This would defeat the very purpose of the operational audit.

The Participative Approach comes to the help of the auditor. In this approach the auditor discusses the ideas for improvements with those managers that have to implement them and 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 co – operative enterprise.

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

Hence, Operational Auditor of DLF manufacturing unit should adopt above mentioned participative approach to tackle the hostile management of DLF.

(5 MARKS)

ANSWER –B

According to SA-200, "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the Audit Risk is a risk that Auditor will issue an inappropriate opinion while Financial Statements are materially misstated.

Audit Risk, has two components: Risk of material Misstatement and Detection Risk. The relationship can be defined as follows.

Audit Risk = Risk of material Misstatement X Detection Risk

Risk of material Misstatement: - Risk of Material Misstatement is anticipated risk that a material Misstatement may exist in Financial Statement before start of the Audit. It has two components Inherent risk and Control risk. The relationship can be defined as

Risk of material Misstatement = Inherent risk X control risk

Inherent risk: it is a susceptibility of an assertion about account balance; class of transaction, disclosure towards misstatements which may be either individually or collectively with other Misstatement becomes material before considering any related internal control which is 40% in the given case.

Control risk: it is a risk that there may be chances of material Misstatement even if there is a control applied by the management and it has prevented defalcation to 75%.

Hence, control risk is 25% (100%-75%)

Risk of material Misstatement: Inherent risk X control risk i.e. 40% X 25 % = 10%

Chances of material Misstatement are reduced to 10% by the internal control applied by management.

Detection risk: It is a risk that a material Misstatement remained undetected even if all Audit procedures applied, Detection Risk is 100-60 = 40%

In the given case, overall Audit Risk can be reduced up to 4% as follows: Audit Risk:

Risk of Material Misstatement X Detection Risk = 10X 40% = 4%

(5 MARKS)

ANSWER –C

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 -6

ANSWER -A

- (a) Since the goods were not approved and returned after the stipulated period of 6 months, the value of the said supplies would not be included in turnover in the audited financial statements. However, as per the 2nd proviso to section 142(12) of the CGST Act since the goods were returned after 6 months from appointed date (i.e. 1.6.2017), GST would be payable for the tax period December 2017. Though the transaction originated in the period

April 2017 to June 2017, the turnover will not be reflected under this Sl. No. However, one may reflect such adjustment under Part II, sl. No. 5 Clause O – ‘Adjustments in turnover due to reasons not listed above’ as addition.

- (b) The said goods are liable to excise duty since the goods have been cleared on 30.4.2017. The goods would not form part of turnover as per the financial statements since it is a branch transfer. It would stand reflected as branch transfers under the State Level VAT laws. Since audit is being conducted for Bangalore GSTIN and since supply has occurred from Hyderabad GSTIN, it would not be necessary to make adjustments for the period April 2017 to June 2017.
- (c) As per proviso to Rule 3(b) of the Clause of Taxation Rules, 2011, the point of taxation in the impugned case would be the date on which bill has been raised i.e. 3.7.2017. Though invoice has been raised in the GST regime, service tax is payable since service has been provided during the currency of the Finance Act, 1994. The date for payment of service tax as per the machinery provision i.e. POTR, 2011 may be 3.7.2017 but the said service would be liable to service tax because the charge u/s 66B gets attracted for the period June 2017. Further as per S. 142(11)(b) since if a transaction is liable for service tax, then tax would not be payable under the GST Laws. Hence the said amount should be deducted as turnover under this Sl. No. for the period April 2017 to June 2017.

(3*2 = 6 MARKS)

ANSWER –B

As per SA 580, “Written Representation”, as written representations are necessary audit evidence, the auditor’s opinion cannot be expressed, and the auditor’s report cannot be dated, before the date of the written representations. Furthermore, because the auditor is concerned with events occurring up to the date of the auditor’s report that may require adjustment to or disclosure in the financial statements, the written representations are dated as near as practicable to, but not after, the date of the auditor’s report on the financial statements.

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

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

Situations may arise where current management were not present during all periods referred to in the auditor’s report. Such persons may assert that they are not in a position to provide some or all of the written representations because they were not in place during the period. This fact, however, does not diminish such persons’ responsibilities for the financial statements as a whole. Accordingly, the requirement for the auditor to request from them written representations that cover the whole of the relevant period(s) still applies.

(4 MARKS)

ANSWER –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 audit evidence obtained in previous audits for control is a matter of professional judgement. In addition, the length of time between retesting such controls is also a matter of professional judgement.

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.

(4 MARKS)