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CA FINAL

SUBJECT- AUDIT

Test Code - FNJ 7304

BRANCH - () (Date :)

Head Office : Shraddha, 3rd Floor, Near Chinai College, Andheri (E), Mumbai – 69.

Tel : (022) 26836666

ANSWER – 1

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

ANSWER – 1

ANSWER – A

Related Party Disclosures :As per Ind AS 24, “Related Party Disclosures”, a reporting entity is exempt from the disclosure requirements in relation to related party transactions and outstanding balances, including commitments, with (i) a government that has control or joint control of, or significant influence over, the reporting entity; and (ii) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.

If a reporting entity applies the above exemption, it shall disclose the following about the transactions and related outstanding balances referred to:

- (1) the name of the government and the nature of its relationship with the reporting entity (i.e. control, joint control or significant influence);
- (2) the following information in sufficient detail to enable users of the entity’s financial statements to understand the effect of related party transactions on its financial statements:
 - (i) the nature and amount of each individually significant transaction; and
 - (ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent.

Further, as per SA 550 Related Parties, in forming an opinion on the financial statements in accordance with SA 700, the auditor shall evaluate whether the identified related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

In the instant case, Power Supply Corporation Limited, a Government Company has procured spares for transmitters for rupees 850 crore from abroad through a corporation namely Procurement and Supply India Limited which is also owned and controlled by Government of India. Even after applying the exemption of Ind AS 24, Power Supply Corporation Limited has to disclose the matters specified above (i.e.name of Government, natures of its relationship with reporting entity, the nature and amount of transaction etc.). Contention of Management of Corporation regarding no requirement of disclosure for transactions between State Controlled Enterprise is not tenable.

(5 MARKS)

ANSWER – B

As per **SA 210 “Agreeing the Terms of Audit Engagements”**, in order to establish whether the preconditions for an audit are present, the auditor shall:

- (a) Determine whether the financial reporting framework to be applied in the preparation of the financial statements is acceptable; and
- (b) Obtain the agreement of management that it acknowledges and understands its responsibility
 - (i) For the preparation of the financial statements in accordance with the applicable financial reporting framework, including where relevant their fair presentation;
 - (ii) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; and
 - (iii) To provide the auditor with:
 - a. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
 - b. Additional information that the auditor may request from management for the purpose of the audit; and
 - c. Unrestricted access to persons within the entity from whom the auditor determines it necessary to obtain audit evidence.

Further, if management or those charged with governance impose a limitation on the scope of the auditor’s work in the terms of a proposed audit engagement such that the auditor believes the limitation will result in the auditor disclaiming an opinion on the financial statements, the auditor shall not accept such a limited engagement as an audit engagement, unless required by law or regulation to do so.

In addition if the preconditions for an audit are not present, the auditor shall discuss the matter with management. Unless required by law or regulation to do so, the auditor shall not accept the proposed audit engagement.

In the instant case, Mr. Ram should not accept the appointment as statutory auditor of XYZ Private Limited due to limitation imposed on his scope of work.

(5 MARKS)

ANSWER – C

Etymologically, **auditing and investigation** are largely overlapping concepts because auditing is nothing but an investigation used in a broad sense. Both auditing and investigation are fact finding techniques but their basic nature and objectives differ as regards scope, frequency, basis, thrust, depth and conclusiveness. Audit and investigation differ in objectives and in their nature. Auditing is general while investigation is specific.

Basis of Difference	Investigation	Audit
(i) Objective	An investigation aims at establishing a fact or a happening or at assessing a particular situation.	The main objective of an audit is to verify whether the financial statements display a true and fair view of the state of affairs and the working results of an entity.
(ii) Scope	The scope of investigation may be governed by statute or it may be non-statutory.	The scope of audit is wide and in case of statutory audit the scope of work is determined by the provisions of relevant law.
(iii) Periodicity	The work is not limited by rigid time frame. It may cover several years, as the outcome of the same is not certain.	The audit is carried on either quarterly, half- yearly or yearly.
(iv) Nature	Requires a detailed study and examination of facts and figures.	Involves tests checking or sample technique to draw evidences for forming a judgement and expression of opinion.
(v) Inherent Limitations	No inherent limitation owing to its nature of engagement.	Audit suffers from inherent limitation.
(vi) Evidence	It seeks conclusive evidence.	Audit is mainly concerned with prima- facie evidence.
(vii) Observance of Accounting	It is analytical in nature and requires a thorough mind capable of observing, collecting and evaluating facts.	Is governed by compliance with generally accepted accounting principles,

Principles		audit procedures and disclosure requirements.
(viii) Reporting	The outcome is reported to the person(s) on whose behalf investigation is carried out.	The outcome is reported to the owners of the business entity.

(4 MARKS)

ANSWER – 2

ANSWER – A

SA 505 “External Confirmations”, establishes standards on the auditor’s use of external confirmation as a means of obtaining audit evidence. If the management refuses to allow the auditor to send a confirmation request, the auditor shall:

- (i) Inquire as to Management’s reasons for the refusal, and seek audit evidence as to their validity and reasonableness,
- (ii) Evaluate the implications of management’s refusal on the auditor’s assessment of the relevant risks of material misstatement, including the risk of fraud, and on the nature, timing and extent of other audit procedures, and
- (iii) Perform alternative audit procedures designed to obtain relevant and reliable audit evidence.

If the auditor concludes that management’s refusal to allow the auditor to send a confirmation request is unreasonable or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with those in charge of governance in accordance with SA 260 “Communication with Those Charged with Governance” and also determine its implication for the audit and his opinion in accordance with SA 705 “Modifications to the Opinion in the Independent Auditor’s Report”.

A refusal by management to allow the auditor to send a confirmation request is a limitation on the audit evidence the auditor may wish to obtain. The auditor is therefore required to inquire as to the reasons for the limitation. A common reason advanced is the existence of a legal dispute or ongoing negotiation with the intended confirming party, the resolution of which may be affected by an untimely confirmation request. The auditor is required to seek audit evidence as to the validity and reasonableness of the reasons because of the risk that management may be attempting to deny the auditor access to audit evidence that may reveal fraud or error.

(4 MARKS)

ANSWER – B

Maintenance of Books of Account: As per the Council General Guidelines 2008, under Chapter 5 on maintenance of books of accounts, it is specified that if a chartered accountant in practice or the firm of Chartered Accountants of which he is a partner fails to maintain and keep in respect of his/its professional practice, proper books of account including the Cash Book and Ledger, he is deemed to be guilty of professional misconduct.

Accordingly, it does not matter that as per section 44ADA of the Income Tax Act Mr. X declared his income on presumptive basis. Here, it may be noted that though 44ADA of the Income Tax Act exempt the requirement of books and accounts but as per Council.

General Guidelines a chartered accountant in practice is required to maintain and keep proper books of accounts including cash book and ledger. Hence, Mr. X is guilty of professional misconduct.

(4 MARKS)

ANSWER – C

Delegation of Authority to the Employee: As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct “if he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements”.

In this case CA. ‘A’ proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is not a partner but a member of the Institute of Chartered Accountants.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause like issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

- (i) In the given case, Mr. ‘Y’, a chartered accountant being employee of M/s A & Co. has issued audit queries which were raised during the course of audit. Here “Y” is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
- (ii) In this instance, Mr. “Y”, CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee can attend to routine matter in tax practice as decided by the council, subject to provisions of Section 288 of the Income Tax Act. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.

(6 MARKS)

ANSWER – 3

ANSWER – A

There are several steps that should be followed to achieve success with CAATs and any of the supporting tools. A suggested approach to benefit from the use of CAATs is given below:

- Understand Business Environment including IT;
- Define the Objectives and Criteria;
- Identify Source and Format of Data;
- Extract Data;
- Verify the Completeness and Accuracy of Extracted Data;
- Apply Criteria on Data Obtained;
- Validate and Confirm Results.

ANSWER – 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, Beneathminerals 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.

(5 MARKS)

ANSWER – C

Eligibility to be a Reviewer :

- (i) A Peer Reviewer shall: -
 - (a) Be a member with at least 10 years of experience in practice.
 - (b) Is in Practice as per the Chartered Accountants Act, 1949.
 - (c) Should have undergone the requisite training as prescribed by the Board.
 - (d) Should furnish a declaration as prescribed by the Board, at the time of acceptance of Peer Review appointment.
 - (e) Should have signed the Declaration of Confidentiality as prescribed by the Board.
 - (f) Should have conducted audit of Level I Entities for at least 7 years to be eligible for conducting Peer Review of Level I Entities as referred to in Para II of this Statement.
- (ii) For being a Reviewer a member should not have: -
 - (a) Disciplinary action / proceedings pending against him
 - (b) been found guilty by the Council or the Disciplinary Board or Committee at any time.
 - (c) been convicted by a Competent Court whether within or outside India, of an offence involving moral turpitude and punishable with transportation or imprisonment.
 - (d) any Obligation or conflict of interest in the Practice Unit or its Partners / Personnel.
- (iii) A Reviewer shall not accept any professional assignment from the Practice Unit for a period two years from the date of appointment.

ANSWER – 4

ANSWER – A

Direction by 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 and 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 and 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 and the auditor shall also be liable for action under section 447.

It is hereby clarified that the case of a firm, the liability shall be of the firm and 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.

ANSWER – B

Why Operational Audit?: The need for operational auditing has arisen due to the inadequacy of traditional sources of information for an effective management of the company where the management is at a distance from actual operations due to layers of delegation of responsibility, separating it from actualities in the organisation.

Operational audit is considered as a specialised management information tool to fill the void that conventional information sources fail to fill. Conventional sources of management information are departmental managers, routine performance report, internal audit reports, and periodic special investigation and survey. These conventional sources fail to provide information for the best direction of the departments all of whose activities do not come under direct observation of managers. The shortcomings of these sources can be stated as under:

- (i) Executives and managers are too preoccupied with implementation of plans and achieving of targets. They are left with very little time to collect information and locate problems. They may come across problems that have come to surface but they are hardly aware of problems that are brewing and potential.
- (ii) Managers or their aides are generally relied upon for transmitting information than for looking for information or for analysing situations.
- (iii) The information that is transmitted by managers is not necessarily objective - often it may be biased for various reasons.
- (iv) Conventional internal audit reports are often routine and mechanical in character and have a definite leaning towards accounting and financial

information. They are also historical in nature.

- (v) Other performance reports contained in the annual audited accounts and the routine reports prepared by the operating departments have their own limitations. The annual audited accounts are good as far as an overall evaluation is concerned in monetary terms.

Sales may be shown at a higher monetary value compared to the previous year and this may apparently suggest that the functioning of the sales department is satisfactory. But this may have been caused by a number of factors inspite of a really bad performance on the sales front. This fact may not be readily known unless one cares to analyse the sales data by reference to notes and explanations to the accounts and other related accounting data. Even a study of this nature may not fully reveal the weakness. It is quite possible that the established market for sales has been lost partly while some fortuitous sales have compensated the loss.

The routine weekly production report may include production 'that is subsequently rejected by the quality control staff, or to avoid showing a bad production performance; even the partly produced goods may also be included. Remember, all this can happen inspite of specific management instructions about the basis on which the production report is to be made out.

Another important point may be noticed in the matter of routine departmental reports. The busy management people, who can afford time only to glance over the performance reports, cannot be expected to make an integrated reading of several reports or to undertake an analysis of such reports. What they need is reliable, unmanipulated and objective report which they would like to look into to understand the situation.

- (vi) Operations of controls in a satisfactory manner cannot be relied upon to bring to light the environmental conditions. Controls are specific and their satisfactory operation is related to the specific situation under control. Also monitoring of the breakdown or non-operation of controls is a periodic phenomenon.
- (vii) Surveys and special investigations, no doubt, are very useful but these are at the best occasional in character. Also, they are costly, time consuming and keep the departmental key personnel busy during the period they are on. These are basically an attempt to carry out a post-mortem rather than to enlighten the management about the ways on improvement or for better performance or to give a signal for dangers and disasters to come.

(4 MARKS)

ANSWER – C

Circumstances in which Emphasis of Matter Paragraph in Auditor's Report is mandated in case of Financial Statements prepared in accordance with a Special Purpose Framework: As per SA 706, "Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report" and/or SA 800, "Special Considerations— Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks", the auditor's report on special purpose financial statements shall include an Emphasis of Matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. The auditor

shall include this paragraph under an appropriate heading.

The special purpose financial statements may be used for purposes other than those for which they were intended. For example, a regulator may require certain entities to place the special purpose financial statements on public record. To avoid misunderstandings, the auditor alerts users of the auditor's report that the financial statements are prepared in accordance with a special purpose frame work and, therefore, may not be suitable for another purpose.

Restriction on Distribution or Use: In addition to the alert required above, the auditor may consider it appropriate to indicate that he auditor's report is intended solely for the specific users. Depending on the law or regulation of the particular jurisdiction, this may be achieved by restricting the distribution or use of the auditor's report. In these circumstances, the emphasis of matter paragraph given above maybe expanded to include these other matters, and the heading may be modified accordingly.

(5 MARKS)

ANSWER – 5

ANSWER – A

Reporting in Tax Audit Report: Any amount of GST/Tax payable on the last day of previous year (opening balance) as well as on the last day of current year has to be reported in Tax Audit Report under clause 26(A) and 26(B) in reference of section 43 B.

Clause 26 (A) dealt GST/VAT payable on the pre-existed of the first day of the previous year but was not allowed in the assessment of any preceding previous year and was either paid {clause 26(A) (a)}/ or/ and/ not paid during the previous year {clause 26(A)(b)}

The details will be as under in regard to opening balances:

Liability Pre-existed on the previous year.

Sr. No.	Section	Nature of Liability	Outstanding Opening balance not allowed in previous year	Amount paid/set-off during the year	Amount written back to P&L Account	Amount unpaid at the end of the year
01	43B(a)	VAT/GST	100 lakh	50 lakh	0	50 lakh

It has been assumed that 50 lakh was allowed in last year as it was paid before the due date of return.

Liability incurred during the previous year

Sr. No.	Section	Nature of Liability	Amount incurred in previous year but remaining outstanding on last day	Amount paid/set-off before the due date of filing return/date upto which reported in the tax audit	Amount unpaid on the due of filing of return/date upto which reported in the tax audit report,
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			of previous year.	report, whichever is earlier	whichever is earlier
01	43B(a)	VAT/GST	100 lakh	40 lakh	60 lakh

(5 MARKS)

ANSWER – B

Sale of Non-Performing Assets: In case of Sale of NPA by Bank, the auditor should examine :

- the policy laid down by the Board of Directors in this regard relating to procedures, valuation and delegation of powers.
- that only such NPA has been sold which has remained NPA in the books of the bank for at least 2 years.
- the assets have been sold/ purchased “without recourse’ only.
- subsequent to the sale of the NPA, the bank does not assume any legal, operational or any other type of risk relating to the sold NPAs.
- the NPA has been sold at cash basis only.
- the bank has not purchased an NPA which it had originally sold.
- that on the sale of the NPA, the same has been removed from the books of the account.
- that the short fall in the net book value has been charged to the profit and loss account.
- that where the sale is for a value higher than the NBV, no profit is recognised and the excess provision has not been reversed but retained to meet the shortfall/ loss because sale of other non-performing financial assets.

(5 MARKS)

ANSWER – C

Points of Indication that may direct the Auditor to Judge that the Risks Identified may be Significant: As per SA 315 “Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment”, as part of the risk assessment the auditor shall determine whether any of the risks identified are, in the auditor’s judgment, a significant risk. In exercising this judgment, the auditor shall exclude the effects of identified controls related to the risk.

In exercising judgment as to which risks are significant risks, the auditor shall consider at least the following:

- Whether the risk is a risk of fraud;
- Whether the risk is related to recent significant economic, accounting, or other developments like changes in regulatory environment, etc., and, therefore, requires specific attention;
- The complexity of transactions;
- Whether the risk involves significant transactions with related parties;
- The degree of subjectivity in the measurement of financial information related to the risk, especially those measurements involving a wide range of measurement uncertainty; and

(vi) Whether the risk involves significant transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

When the auditor has determined that a significant risk exists, the auditor shall obtain an understanding of the entity's controls, including control activities, relevant to that risk.

(4 MARKS)

ANSWER – 6

ANSWER – A

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 letter 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 to 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 – B

Not Exercising Due Diligence: According to Clause (7) of Part I of Second Schedule of Chartered Accountants 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.

It is a vital clause which unusually gets attracted whenever it is necessary to judge whether the accountant has honestly and reasonably discharged his duties. The expression negligence covers a wide field and extends from the frontiers of fraud to collateral minor negligence.

Where a Chartered Accountant had not completed his work relating to the audit of the accounts a company and had not submitted his audit report in due time to enable the company to comply with the statutory requirement in this regard, he was guilty of professional misconduct under Clause (7).

Since, Mr. Anil has not completed his audit work in time and consequently could not submit audit report in due time and consequently, company could not comply with the statutory requirements, the auditor is guilty of professional misconduct under Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

(4 MARKS)

ANSWER – C

Matters covered in Reporting in case of Comprehensive Audit are: 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 results of comprehensive appraisals of selected undertakings conducted by the Audit Board etc. Some of the issues examined in comprehensive audit are:

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

(4 MARKS)