SUGGESTED SOLUTION

CA FINAL N'19

SUBJECT- AUDIT

Test Code – FNJ 7318

BRANCH - () (Date :)

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

Tel : (022) 26836666

SECTION -A

ANSWER -1

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

SECTION –B

ANSWER -1

ANSWER -A

Inventory under the Custody and Control of a Third Party: As per SA 501, "Audit Evidence—Specific Considerations for Selected Items" when inventory under the custody and control of a third party is material to the financial statements, the auditor shall obtain sufficient appropriate audit evidence regarding the existence and condition of that inventory by performing one or both of the following:

(i) Request confirmation from the third party as to the quantities and condition of inventory held on behalf of the entity.

(ii) Perform inspection or other audit procedures appropriate in the circumstances, for example where information is obtained that raises doubt about the integrity and objectivity of the third party, the auditor may consider it appropriate to perform other audit procedures instead of, or in addition to, confirmation with the third party. Examples of other audit procedures include:

- Attending, or arranging for another auditor to attend, the third party's physical counting of inventory, if practicable.
- Obtaining another auditor's report, or a service auditor's report, on the adequacy of the third party's internal control for ensuring that inventory is properly counted and adequately safeguarded.
- Inspecting documentation regarding inventory held by third parties, for example,

warehouse receipts.

- Requesting confirmation from other parties when inventory has been pledged as collateral.

(5 Marks)

ANSWER -B

Money of Clients to be Deposited in Separate Bank Account: Clause (10) of Part I of Second Schedule states that a Chartered Accountant shall be deemed to be guilty of professional misconduct if "he fails to keep money of his clients in separate banking account or to use such money for the purpose for which they are intended".

In the given case, M/s Amudhan & Co. received the money in January, 2019 which is to be paid only in July 2019, hence, it should be deposited in a separate bank account. Since in this case M/s Amudhan & Co. has failed to keep the sum of ` 2.8 lakhs received on behalf of their client in a separate Bank Account, it amounts to professional misconduct under Clause (10) of Part I of Second Schedule.

(4 Marks)

ANSWER -C

Auditor's Report for Audits Conducted in Accordance with Both Standards on Auditing Issued by ICAI and International Standards on Auditing or Auditing Standards of Any Other Jurisdiction: As per SA 700, "Forming an Opinion and Reporting on Financial Statements", an auditor may be required to conduct an audit in accordance with, in addition to the Standards on Auditing issued by ICAI, the International Standards on Auditing or auditing standards of any other jurisdiction. If this is the case, the auditor's report may refer to Standards on Auditing in addition to the International Standards on Auditing or auditing standards of such other jurisdiction, but the auditor shall do so only if:

(a) There is no conflict between the requirements in the ISAs or such auditing standards of other jurisdiction and those in SAs that would lead the auditor:

(i) to form a different opinion, or

(ii) not to include an Emphasis of Matter paragraph or Other Matter paragraph that, in the particular circumstances, is required by SAs; **and**

(b) The auditor's report includes, at a minimum, each of the elements set out in Auditor's Report Prescribed by Law or Regulation discussed above when the auditor uses the layout or wording specified by the Standards on Auditing. However, reference to "law or regulation" in above paragraph shall be read as reference to the Standards on Auditing. The auditor's report shall thereby identify such Standards on Auditing.

When the auditor's report refers to both the ISAs or the auditing standards of a specific jurisdiction and the Standards on Auditing issued by ICAI, the auditor's report shall clearly identify the same including the jurisdiction of origin of the other auditing standards.

(5 Marks)

ANSWER -2

ANSWER -A

Evaluating the Adequacy of the Auditor's Expert's Work: As per SA 620 on "Using the Work of an Auditor's Expert", specific procedures to evaluate the adequacy of the auditor's expert's work for the auditor's purposes may include:

(i) Inquiries of the auditor's expert.

(ii) Reviewing the auditor's expert's working papers and reports.

(iii) Corroborative procedures, such as:

- Observing the auditor's expert's work;
- Examining published data, such as statistical reports from reputable, authoritative sources;
- Confirming relevant matters with third parties;
- Performing detailed analytical procedures; and
- Re-performing calculations.

(iv) Discussion with another expert with relevant expertise when, for example, the findings or conclusions of the auditor's expert are not consistent with other audit evidence.

(v) Discussing the auditor's expert's report with management.

Therefore, as per SA 620 on "Using the Work of an Auditor's Expert", the auditor shall evaluate the adequacy of the auditor's expert's work for the auditor's purposes, including:

(i) The relevance and reasonableness of that expert's findings or conclusions, and their consistency with other audit evidence;

(ii) If that expert's work involves use of significant assumptions and methods, the relevance and reasonableness of those assumptions and methods in the circumstances; and

(iii) If that expert's work involves the use of source data that is significant to that expert's
work, the relevance, completeness, and accuracy of that source data.

If the auditor determines that the work of the auditor's expert is not adequate for the auditor's purposes, the auditor shall:

(i) Agree with that expert on the nature and extent of further work to be performed by that expert; or

(ii) Perform further audit procedures appropriate to the circumstances.

(5 Marks)

ANSWER –B

Opinion Paragraph of Audit Report: In the instant case, M/s Hary Ltd. acquired 55% shares in M/s Sam Ltd. and the company did not prepare the consolidated financial statements because on the date of acquisition the fair value of certain assets and liabilities has not been ascertained. Therefore, accounting is done on estimate basis only which is not correct as the financial statements are materially misstated due to non-consolidation of subsidiary. The material misstatement is deemed to be pervasive to the consolidated financial statements. Thus, the auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidences, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

Adverse Opinion

In our opinion and to the best of our information and according to the explanations given to us, because of the significance of the matter discussed in the *Basis for Adverse Opinion* section of our report, the accompanying consolidated financial statements do not give a true and fair view in conformity with the accounting principles generally accepted in India, of their consolidated state of affairs of the Group, its associates and jointly controlled entities, as at March 31, 2019, *of* its consolidated profit/loss, *(consolidated position of changes in equity)* and the consolidated cash flows for the year then ended.

Basis for Adverse Opinion is given below:

As explained in Note X, the M/s Hary Ltd. has not consolidated subsidiary M/s Sam Ltd. that the M/s Hary Ltd acquired during 2018 because it has not yet been able to determine the fair values of certain of the subsidiary's material assets and liabilities at the acquisition date. This investment is therefore accounted for on an estimate basis. Under the accounting principles generally accepted in India, the Group should have consolidated this subsidiary and accounted for the acquisition based on provisional amounts. Had M/s Sam Ltd. been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

(4 Marks)

ANSWER – C

Engagement-specific safeguards in the work environment may include:

(i) Involving an additional professional accountant to review the work done or otherwise advise as necessary.

(ii) Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.

(iii) Discussing ethical issues with those charged with governance of the client.

(iv) Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.

(v) Involving another firm to perform or re-perform part of the engagement.

(vi) Rotating senior assurance team personnel.

(5 Marks)

ANSWER -3

ANSWER -A

Verification regarding Composition of Board [Regulation 17]

(i) The auditor should ascertain whether, throughout the reporting period, the Board of Directors comprises an optimum combination of executive and non-executive directors, with at least one woman director and not less than 50% of the Board of Directors comprising non-executive directors. The minutes of the Board of Directors' meetings should be verified to ascertain whether a director is an executive director or a non-executive director.

(ii) The auditor should also verify that where the Chairperson of the Board is a non-executive director, at least one-third of the Board should comprise of independent directors and in case the listed entity does not have a regular non-executive Chairperson, at least half of the Board of Directors should comprise independent directors. Further, if the regular non-executive 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 determining the number of requisite independent directors and/or non-executive directors, the fraction, if any, in the number of one-half or one-third as the case may be, should be rounded off. Since the terms in this clause refer to 'not less than' and 'at least', it would be appropriate to compute the number by rounding off any fraction to the next integer. For example, in a Board headed by a non-executive Chairman and comprising of six other directors (i.e., seven directors), the independent directors should be three or more.

(iii) Annual disclosure submitted by the directors to the Board of Directors may be examined for this purpose. If the Board of Directors has followed any particular procedure(s) to ascertain the independence of directors, the auditor should examine the same. Effect of changes in the composition of the Board and/or its Chairman and its impact on compliance throughout the reporting period should also be examined.

(iv) An independent non-executive director, apart from receiving remuneration, should not have any material pecuniary relationship with the listed entity, its holding, subsidiary or associate company, or their promoters, or directors, during the two immediately preceding financial years or during the current financial year. Also, such independent director, either by himself or with any of his relatives should not be a material supplier, service provider or customer or a lessor or lessee of the listed entity and should not also 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.

(6 Marks)

ANSWER -B

Special audit considerations arise in the audit of banks because of:

(i) the particular nature of risks associated with the transactions undertaken;

(ii) the scale of banking operations and the resultant significant exposures which can arise within short period of time;

(iii) the extensive dependence on IT to process transactions;

(iv) the effect of the statutory and regulatory requirements;

(v) the continuing development of new products and services and banking practices which may not be matched by the concurrent development of accounting principles and auditing practices;

(vi) Evolution of technology and providing services through Net Banking and Mobiles has exposed banks to huge operational and financial risk.

The auditor should consider the effect of the above factors in designing his audit approach. It is imperative for Branch Auditor and SCAs to have detailed knowledge of the products offered and risks associated with them, and appropriately address them in their audit plan to the extent they give rise to the risk of material misstatements in the financial statements.

In today's environment, the banks use different applications to carry out different transactions which may include data flow from one application to other application; the auditor while designing his plans should also understand interface controls between the various applications.

(4 Marks)

ANSWER -C

Assignment as Advisor and Consultant: The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services.

In the instant case, CA Natraj accepted an assignement as advisor and consultant to the public issue of shares by his client M/s Super Ltd. In addition, he also underworte the public issue of the companyto the extent of 25% at a commission of 1%. Contention of CA. Natraj that advisor, consultant and underwriting work is part of management consultancy work and permitted by the council is not correct as Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services.

Conclusion: In view of this, CA. Natraj would be guilty of misconduct under the Chartered Accountants Act, 1949.

(4 Marks)

ANSWER -4

ANSWER -A

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.

(i) **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.

(ii) **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.

(iii) **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.

(iv) **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.

(v) 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.

(5 Marks)

ANSWER -B

Indebtedness to the Company: According to the section 141(3)(d)(ii) of the Companies Act, 2013, a person who is indebted to the company for an amount exceeding ` 5,00,000 shall be disqualified to act as an auditor of such company and further under section 141(4) he shall vacate his office of auditor when he incurs this disqualification subsequent to his appointment.

Further a person or a firm who directly or indirectly has business relationship with a company or its subsidiary or its holding or associate company, is also not qualified to be appointed as auditor of the company. But here business relationship does not include commercial transactions which are in the ordinary course of the business of the company at arm's length price.

However, where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for such appointment.

In the given case, PQ & Co., an audit firm with P & Q as partners is appointed as statutory auditor of M/s Mango Orchards Hotel Ltd. and the audit firm is a regular customer of the hotel and the partners usually stay in the same hotel at various locations. They also settle the payments for such stay against quarterly bills raised by the company.

Assuming the balance amount at any time during the year due to the hotel does not exceed the prescribed limits of rupees 5,00,000, PQ & Co., is not disqualified to be appointed as statutory auditor of M/s Mango Orchards Hotel Ltd as per section 141(3)(d)(ii), in the absence of the same the auditor shall be disqualified to act as an auditor and shall vacate his office of auditor when he incurs this disqualification subsequent to the appointment.

Since in term of section 141(3)(e) of Companies Act, 2013 PQ & Co. is not a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company of such nature as may be prescribed, the auditor shall not be disqualified to act as an auditor and shall not required to vacate his office of auditor.

(4 Marks)

ANSWER –C

The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to,

(i) conduct a supplementary audit under section 143(6)(a), of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorized, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct; and

comment upon or supplement such audit report under section 143(6)(b): It may be noted that any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136

i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

(ii) In view of above provisions, the approach of directors of Sunlight Ltd. is not correct. They are required to mandatory send the Supplementary Audit Report and comments of C&AG to every member of the company etc. as prescribed and also be placed before the annual general meeting of the company in the same manner as in case of audit report. Since in the given case neither the report has been distributed nor discussed in the Annual General Meeting, the directors of the company will be liable for contravention of aforesaid sections.

(5 Marks)

ANSWER -5

ANSWER -A

Various Risk: Businesses today operate in a dynamic environment. The volatility, unpredictability and 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 and 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.

(5 Marks)

OR

Inherent Limitations: A practitioner is expected to provide either a reasonable assurance (about whether the subject matter of examination is materially misstated) or a limited assurance (stating that nothing has come to the practitioner’s attention that causes the practitioner to believe that the subject matter is materially misstated) since it is difficult to reduce engagement risk to zero due to inherent limitations of the audit. The inherent limitations could arise from:

(i) the nature of financial reporting;

(ii) the use of selective testing;

(iii) the inherent limitations of internal controls;

(iv) the fact that much of the evidence available to the practitioner is persuasive rather than conclusive;

(v) the nature of procedures to be performed in a specific situation;

(vi) the use of professional judgment in gathering and evaluating evidence and forming conclusions based on that evidence;

(vii) in some cases, the characteristics of the underlying subject matter when evaluated or measured against the criteria; and

(viii) the need for the engagement to be conducted within a reasonable period of time and at a reasonable cost.

Therefore, whenever a practitioner is required to give a "certificate" or a "report" for special purpose, the practitioner needs to undertake a careful evaluation of the scope of the engagement, i.e., whether the practitioner would be able to provide reasonable assurance or limited assurance on the subject matter.

ANSWER –B

Capital Receipts which, if not credited to the profit and loss account, are to be stated under clause 16(e) of Form 3CD:

(a) **Guidance for reporting capital receipts**: Capital receipts are not generally credited to profit and loss account hence the auditor should take enough care to check out any transaction generating the capital receipts by –

- Enquiring whether the assessee is in receipt of any amount of capital nature during the previous year.
- Going through the financial statements, in particular reserve account, to ascertain whether the assessee has received any such receipts and credited them directly to reserve account.
- Enquiring whether the assessee has credited such receipts to profit and loss account.
- Checking that any such receipts is accounted for in terms of method of accounting followed by the assessee.

(b) **Illustrative examples of capital receipts:** The following is an illustrative list of capital receipts which, if not credited to the profit and loss account, are to be stated under clause 16(e) of Form 3CD-

(i) Capital subsidy received in the form of Government grants, which are in the nature of promoters' contribution i.e., they are given with reference to the total investment of the undertaking or by way of contribution to its total capital outlay. For e.g., Capital Investment Subsidy Scheme.

(ii) Government grant in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value.

(iii) Compensation for surrendering certain rights.

(iv) Profit on sale of fixed assets/investments to the extent not credited to the profit and loss account.

(4 Marks)

ANSWER –C

Perform the Analysis: The actual analysis performed will be dependent upon the nature of the assignment and may involve:

(i) calculating economic damages;

(ii) summarizing a large number of transactions;

(iii) performing a tracing of assets;

(iv) performing present value calculations utilizing appropriate discount rates;

(v) performing a regression or sensitivity analysis;

(vi) utilizing a computerized application such as a spread sheet, data base or computer model; and

(vii) utilizing charts and graphics to explain the analysis.

(5 Marks)

ANSWER -6

ANSWER -A

Compliance of conditions of Corporate Governance in case of Listed Company: As per Listing Obligation and Disclosure Requirements Regulations 2015, depending upon the facts and circumstances, some situations may require an adverse or qualified statement or a disclosure without necessarily making it a subject matter of qualification in the Auditors' Certificate, in respect of compliance of requirements of corporate governance for example:

(i) The Audit Committee shall meet at least four times in a year and not more than one hundred and twenty days shall lapse between two meetings. The number of days between the meetings held on 1.9.2018 and 3.01.2019 is more than 120 days. Hence it is a non-compliance and would require qualification in certificate of corporate governance

(ii) Since the Chairman is the non-executive director, there should be 1/3rd of directors (rounded to next integer) to be independent. In this case, 4 directors need to be independent. Any vacancy during shortfall of independent directorship should be filled within next 3 months or before the start of next meeting, whichever is later. In the instant case, since the independent director was appointed after lapse of 3 months (i.e. on 1.9.2018) and after next first meeting 1/6/2018, there is default which would require qualification in certificate on corporate governance.

(5 Marks)

ANSWER -B

Other Misconduct: CA Raman has engaged his Articled Assistant for his own election campaigning for the Regional 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 Raman is guilty of 'Other Misconduct'.

(4 Marks)

ANSWER -C

Contingent Liabilities for Banks: The Third Schedule to the Banking Regulation Act, 1949, requires the disclosure of the following as a footnote to the balance sheet-

(A) Contingent liabilities
- (i) Claims against the bank not acknowledged as debts.
- (ii) Liability for partly paid investments.
- (iii) Liability on account of outstanding forward exchange contracts.
- (iv) Guarantees given on behalf of constituents-
  - (1) In India.
  - (2) Outside India.
- (v) Acceptances, endorsements and other obligations.
- (vi) Other items for which the bank is contingently liable.

(B) Bills for collection.

(5 Marks)