FINAL – November 2017

AUDIT

Test Code – 8014
Branch (MULTIPLE)

(50 Marks)

Note: All questions are compulsory.

Question 1

Power of Tribunal in case Auditor acted in a Fraudulent Manner:

- As per sub- section (5) of the section 140 of the Companies Act, 2013, the Tribunal either *suo motu* or on an application made to it by the Central Government or by any person concerned, if it is satisfied that the auditor of a company has, whether directly or indirectly, acted in a fraudulent manner or abetted or colluded in any fraud by, or in relation to, the company or its directors or officers, it may, by order, direct the company to change its auditors. **(2 Marks)**
- 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. **(2 Marks)**
- 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 of the said Act. **(2 Marks)**
- 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. **(2 Marks)**

Question 2 a (4 marks)

Reporting to Shareholders	**Reporting to those Charged with Governance**	
Section 143 of the Companies Act, 2013 deals with the provisions relating to reporting to Shareholders. Thus, it is a Statutory Audit Report which is addressed to the members.	Standard on Auditing 260 deals with the provisions relating to reporting to those Charged with Governance.	2 marks
Statutory Audit Report is on true and fair view and as per prescribed Format.	It is a reporting on matters those charged with governance like scope of audit, audit procedures audit modifications, etc	1 mark
Statutory Audit Reports are in public domain.	Reporting to those Charged with Governance is an internal document i.e. private report.	1 mark

b (4 marks)

Audit Qualification	**Emphasis of Matter**	
Standard on Auditing 705 “Modifications to the Opinion in the Independent Auditor’s Report”, deals with the provisions relating to Audit Qualification	Standard on Auditing 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor’s Report” deals with the provisions relating to Emphasis of Matter	1 mark
Audit Qualifications are also known as “subject to report” or “except that report”.	Emphasis of Matter is a paragraph which is included in auditor’s report to draw users’ attention to important matter(s) which are already disclosed in Financial Statements and are fundamental to users’ for understanding of Financial Statements	1 mark
Audit Qualifications are given when auditor is having reservations on some of the items out of the financial statements as a whole i.e. Auditor’s Judgment about the Pervasiveness of the Effects or Possible Effects on the Financial Statements relating to if the impact of material misstatements is not pervasive on the financial statements but is present at some levels of the financial statements, qualified report is issued.	Emphasis of Matter is a paragraph which is issued when there is a uncertainty relating to future outcome of exceptional litigation, regulatory action, etc.;or there is early application (where permitted) of a new accounting standard that has a pervasive effect on the financial statements in advance of its effective date.	2 marks

Question 3

a. **Statutory Liquidity Ratio (SLR) Requirements:** The Reserve Bank of India requires statutory central auditors of banks to verify the compliance with SLR requirements of 12 odd dates in different months of a financial year not being Fridays. The resultant report is to be sent to the top management of the bank and to the Reserve Bank. The report of the statutory auditors in relation to compliance with SLR requirements has to cover two aspects-

- correctness of the compilation of DTL (Demand and Time Liabilities) position; and
- maintenance of liquid assets. **(1 Mark)**

b. **Audit Approach and Procedure:**

i. Obtain an understanding of the relevant circulars of the RBI, particularly regarding composition of items of DTL. **(1/2 Mark)**

ii. Require the branch auditors to send their weekly trial balance as on Friday and these are consolidated at the head office. Based on this consolidation, the DTL position is determined for every reporting Friday. The statutory central auditor should request the branch auditors to verify the correctness of the trial balances relevant to the dates selected by him. The branch auditors should also be specifically requested to examine the cash balance at the branch on the selected dates. **(1/2 Mark)**

iii. Examine, on a test basis, the consolidations regarding DTL position prepared by the bank with reference to the related returns received from branches. The auditor should examine whether the valuation of securities done by the bank is in accordance with the guidelines prescribed by the RBI. **(1/2 Mark)**

iv. While examining the computation of DTL, specifically examine that the following items have been excluded from liabilities- **(1 Mark)**

- Part amounts of recoveries from the borrowers in respect of debts considered bad and doubtful of recovery.
- Amounts received in Indian currency against import bills and held in sundry deposits pending receipts of final rates.
- Un-adjusted deposits/balances lying in link branches for agency business like dividend warrants, interest warrants, refund of application money, etc., in respect of shares/debentures to the extent of payment made by other branches but not adjusted by the link branches.
- Margins held and kept in sundry deposits for funded facilities-

v. Similarly, specifically examine that the following items have been included in liabilities-**(1 Mark)**

- Net credit balance in branch adjustment accounts including these relating to foreign branches. Interest on deposit as at the end of the firm half year reversed in the beginning of the next half-year.
- Borrowings from abroad by banks in India needs to be considered as 'liabilities to other' and thus, needs to be considered at gross level unlike 'liabilities towards banking system in India', which are permitted to be netted off against 'assets towards banking system in India'. Thus, the adverse balances in Nostro Mirror Account needs to be considered as 'Liabilities to other'
- The reconciliation of Nostro accounts (with Nostro Mirror Accounts) needs to be scrutinized carefully to analyze and ascertain if any inwards remittances are received on behalf of the customers / constituents of the bank and have remained unaccounted and / or any other debit (inward) entries have remained unaccounted and are pertaining to any liabilities for the bank.

vi. Examine whether the consolidations prepared by the bank include the relevant information in respect of all the branches. **(1/2 Mark)**

vii. It may be noted that, even though interest accrues on a daily basis, it is recorded in the books only at periodic intervals. Thus, examine whether such interest accrued but not accounted for in books is included in the computation of DTL. **(1/2 Mark)**

viii. The auditor at the central level should apply the audit procedures listed above to the overall consolidation prepared for the bank as a whole. Where such procedure is followed, the central auditor should adequately describe the same in his report. **(1/4 Mark)**

ix. While reporting on compliance with SLR requirements, the auditor should specify the number of unaudited branches and state that he has relied on the returns received from the unaudited branches in forming his opinion. Recently, there has been introduction of Automated Data Flow (ADF) for CRR & SLR reporting and the auditors should develop necessary audit procedures around this. **(1/4 Mark)**

Question 4

Non-cash Transactions with Relative of Director: As per Clause (xv) of paragraph 3 of CARO, 2016, the auditor is required to report "whether the company has entered into any non - cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act, 2013 have been complied with". **(1 mark)**

Section 192 of the said Act deals with restriction on non-cash transactions involving directors or persons connected with them. The section prohibits the company from entering into such types of arrangements unless it is an arrangement by which the company acquires or is t o acquire assets for consideration other than cash, from such director or person so connected. **(1 mark)**

In the instant case, RNT Ltd. has entered into non-cash transactions with Mr. Ram, son of one of the directors, which is an arrangement by which RNT Ltd. is in process to acquire assets for consideration other than cash. In the above situation, the provisions of section 192 of Companies Act, 2013 have been complied with. **(1 mark)**

However, the reporting requirements under this clause are given in two parts. The first pa rt requires the auditor to report on whether the company has entered into any non -cash transactions with the directors or any persons connected with such director/s. The second part of the clause requires the auditor to report whether the provisions of sec tion 192 of the Act have been complied with. Therefore, the second part of the clause becomes reportable only if the answer to the first part is in affirmative. **(1 mark)**

In the given situation, RNT Ltd. has entered into non -cash transactions with Mr. Ram, son of director, which is affirmative answer to the first part of the Clause (xv) of Paragraph 3 of CARO, 2016, thus, reporting is required for the same. Draft report is given below:

According to the information and explanations given to us, RNT Ltd. has entered into non-cash transactions with Mr. Ram, son of one of the directors, during the year, for the acquisition of assets, which in our opinion is covered under the provisions of section 192 of the Companies Act, 2013. **(2 marks)**

Question 5

Decline in Net Profits despite Increasing Sales: As per the facts that there has been consistently high turnover but declining net profits is an anomalous situation. It may be attributed to one or more following reasons requiring further investigation-

(i) **Unfavourable Sales mix**: Where the company sells different chemical products with different product margins, the product with the maximum PV ratio/margin should have a higher share in the total sales. If due to revision of sales mix, more quantities of unprofitable products are sold, profits will be reduced despite an increase in sales. **(1 Mark)**

(ii) **Negative Impact of Financial Leverage**: Where the company does not have sufficient own funds (equity) but has a higher debt-equity ratio, the interest commitments will be higher. As the volume of its operation increases, higher debt and interest charges would result in lower profits. **(1 Mark)**

(iii) **Other Items included in Sales**: The figure of sales as per Statement of Profit and Loss may include incidental revenues, e.g., freight, excise duty, sales-tax, etc. where the amount of excise duty goes up considerably the total sales may show an increase which is not represented by a real increase in sales quantity/value. **(1 Mark)**

(iv) **High Administrative and Selling Expenses**: Administrative and selling costs are generally period costs which are fixed in nature. Their increase is generally not proportional to sale increase. However, a reduction in profit could also be due to increase in administrative overheads and sales overheads at a rate higher than the rate of increase in sales. **(1 Mark)**

(v) **Cost-Price Relationship**: If the increases in cost of raw materials and labour has not been compensated by a corresponding increase in the sales price this would also result in higher sales and declining profits. In spite of same sales quantity, for the increasing cost of raw materials and other services, per unit values of the product has been increased which is however unmatched by the increase in cost. **(1 Mark)**

(vi) **Competitive Price**: Where sales have been made at cut-throat prices in order to eliminate competition from the market, the profits would be in the declining trend in the short-run. **(1/2 Mark)**

(vii) **Additions to Fixed Assets**: Where there are heavy additions to fixed assets and consequent depreciation charges in the initial years of additions, there may be reduction in profits in spite of increased sales. **(1/2 Mark)**

Question 6

(a) 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 pr actice 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". **(1 mark)**

In this case CA. 'Zen' proprietor of M/s Z & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Yen, 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 of India. **(1 mark)**

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 in the certain instances 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, etc. **(1 mark)**

However, issuance of production certificate to a client under Central Excise Act, 1944 is not a routine work. Thus, issuance of such certificate by Mr. "Yen" being an employee of M/s Z & Co. is outside his authorities. Therefore, CA. 'Zen' is guilty of professional misconduct under Clause (12) of Part I of First Schedule of the Chartered Accountants Act, 1949. **(1 mark)**

(b) **Making Roving Inquiries:** Clause (6) of Part I of the First Schedule to the Chartered Accountants Act, 1949 states that a Chartered Accountant in practice shall be deemed to be guilty of misconduct if he solicits clients or professional work either directly or indirectly by a circular, advertisement, personal communication or interview or by any other means. **(1 mark)**

Such a restraint has been put so that the members maintain their independence of judgement and may be able to command respect from their prospective clients. **(1 mark)**

In case of making an application for the empanelment for the allotment of audit and other professional work, the Council has opined that, "where the existence of such a panel is within the knowledge of the member, he is free to write to the concerned organization with a request to place his name on the panel. However, it would not be proper for the member to make roving inquiries by applying to any such organization for having his name included in any such panel." **(1 mark)**

Accordingly, Mr. Den is guilty of misconduct in terms of the above provision as he has solicited professional work from the Finance Ministry, by inquiring about the maintenance of the panel . **(1 mark)**

(c) **Charging Excess Fees:** The prescribed scale of fees for the professional assignments done by the chartered accountants is recommendatory in nature. Charging an excessive fee for a professional assignment does not constitute any misconduct in the context of the provisions of the Chartered Accountants Act, 1949 and regulation made thereunder since the matter of fixation of actual fee charged in individual cases depends upon the mutual agreement and understanding between the member and the client. **(2 marks)**

In the given case, CA. Pratash has charged excess fees comparative to the scale of fees recommended by the Committee as well as duly considered by the Council of ICAI. In this context, it may be noted that the scale of fees is the minimum prescribed scale of fees. **(1 mark)**

From the above facts and provisions, it may be concluded that CA. Pratash is not liable for any misconduct under the Chartered Accountants Act, 1949. Therefore, the contention of WRV Pvt. Ltd. is not tenable. **(1 mark)**

(d) **Maintenance of Branch Office in the Same City:** As per section 27 of the Chartered Accountants Act, 1949 if a chartered accountant in practice has more than one office in India, each one of these offices should be in the separate charge of a member of the Institute. However, a member can be in-charge of two offices if the second office is located in the same premises or in the same city, in which the first office is located; or the second office is located within a distance of 50 Kilometres from the municipal limits of a city, in which the first office is located. **(1 mark)**

In the given case, Mr. Ken, Chartered Accountant in practice as a sole proprietor at Mumbai has an office in suburbs of Mumbai, and due to increase in the work he opened another branch within the city near the sales tax office. **(1 mark)**
He also employed a retired sales tax commissioner to run the new office and the second office is situated within a distance of 30 kms from his office in the suburb. **(1 mark)**

In view of above provisions, there will be no misconduct if Mr. Ken will be in-charge of both the offices. However, he is bound to declare which of the two offices is the main office. **(1 mark)**

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