



## FINAL – MAY 2018

ADVANCED AUDITING AND PROFESSIONAL ETHICS

Test Code – F44

Branch (MULTIPLE) Date : 28.01.2018

Note: *all question are compulsory*

### Question 1

Formulation of Audit Strategy: While formulating the audit strategy for a company, following factors may be considered -

General Factors: (2 marks)

- (i) The engagement objectives.
- (ii) The results of the business review, including major developments in the client's business and industry, significant operating results and financial arrangements.
- (iii) Preliminary judgements as to materiality.
- (iv) Identified inherent risks. The team should also consider the risk of fraud and, in particular, any evidence of a high level of risk to the firm. They should take into account the results of procedures for the acceptance and continuation of clients.
- (v) The degree to which the team should carry out further assessment of controls as a means of reducing substantive tests.
- (vi) The broad nature, extent and timing of substantive tests, or changes to the previous year's strategy for substantive testing.
- (vii) Main points relating to planning and controlling the audit or comments on the adequacy of the existing arrangements.

Specific Factors for Online Shopping: (3 marks)

The auditor shall also obtain an understanding of the information system including the related business processes due to new venture of online shopping in the following areas:

- (i) The classes of transactions in the entity's operations that are significant to the financial statements;
- (ii) The procedures, within both information technology (IT) and manual systems, by which those transactions are initiated, recorded, processed, corrected as necessary, transferred to the general ledger and reported in the financial statements;
- (iii) The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, record, process and report transactions; this includes the correction of incorrect information and how information is transferred to the general ledger. The records may be in either manual or electronic form;
- (iv) How the information system captures events and conditions, other than transactions, that are significant to the financial statements;
- (v) Controls surrounding journal entries, including non-standard journal entries used to record non-recurring, unusual transactions or adjustments.

### Question 2

Basic system of Control: Internal Checks and Internal Audit are important constituents of Accounting Controls. Internal check system implies organization of the overall system of book-

keeping and arrangement of staff duties in such a way that no one person can carry through a transaction and record every aspect thereof.

In the given case of New Life Hospital, the person- in-charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. Thus, one of the basic system of control i.e. internal check which includes segregation of duties or maker and checker has been violated where transaction processing is allocated to different persons in such a manner that no one person can carry through the completion of a transaction from start to finish or the work of one person is made complimentary to the work of another person. (1 mark)

The general conditions pertaining to the internal check system may be summarized as under-  
(4 marks)

- (i) No single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.
- (ii) Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.
- (iii) Every member of the staff should be encouraged to go on leave at least once a year.
- (iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.
- (v) There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.
- (vi) Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.
- (vii) Budgetary control should be exercised and wide deviations observed should be reconciled.
- (viii) For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.
- (ix) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.
- (x) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.

### Question 3

(a) Auditing procedures using CAATs: CAATs may be used in performing various auditing procedures, including the following: (3 marks)

- i. Tests of details of transactions and balances, for example, the use of audit software for recalculating interest or the extraction of invoices over a certain value from computer records;

- ii. Analytical procedures, for example, identifying inconsistencies or significant fluctuations;
- iii. Tests of general controls, for example, testing the set-up or configuration of the operating system or access procedures to the program libraries or by using code comparison software to check that the version of the program in use is the version approved by management;
- iv. Sampling programs to extract data for audit testing;
- v. Tests of application controls, for example, testing the functioning of a programmed control; and
- vi. Re-performing calculations performed by the entity's accounting systems.

(a) Consideration of Factors in Use of CAATs: In determining whether to use CAATs, the auditor should consider the following factors: (3 marks)

- (i) Availability of sufficient IT knowledge and expertise: It is essential that members of the audit team should possess sufficient knowledge and experience to plan, execute and use the results of CAAT. The audit team should have sufficient knowledge to plan, execute and use the results of the particular CAAT adopted.
- (ii) Availability of CAATs and suitable computer facilities and data in suitable format: The auditor may plan to use other computer facilities when the use of CAATs on an entity's computer is uneconomical or impractical, for example, because of an incompatibility between the auditor's package programme and entity's computer.
- (iii) Impracticability of manual tests due to lack of evidence: Some audit procedures may not be possible to perform manually because they rely on complex processing (for example, advanced statistical analysis) or involve, amounts of data that would overwhelm any manual procedure.
- (iv) Impact on effectiveness and efficiency in extracting a data: It includes selection of samples, applying analytical procedures, time involved in application of CAAT, etc.
- (v) Time Constraints: In certain data, such as transaction details, are often kept for a short time and may not be available in machine-readable form by the time auditor wants them. Thus, the auditor will need to make arrangements for the retention of data required, or may need to alter the timing of the work that requires such data.

Question 4

) Appointment of First Auditor: Provisions of the Companies Act, 2013 relating to appointment of first auditor are stated below-

- a. Appointment of First Auditor in the case of a company, other than a Government Company- (1 ½ marks)

As per Section 139(6), the first auditor of a company, other than a Government company, shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

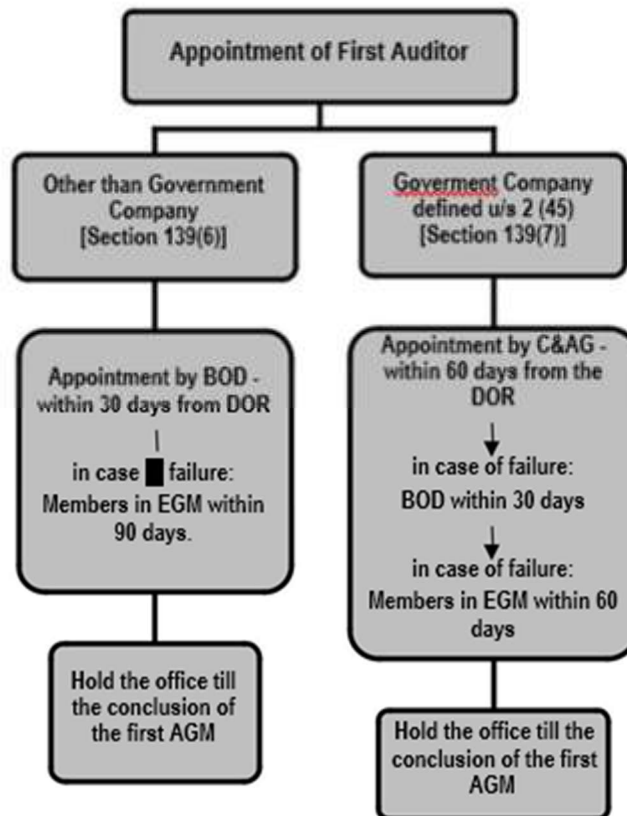
In the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

The members of the company shall within 90 days at an extraordinary general meeting appoint the auditor. Appointed auditor shall hold office till the conclusion of the first annual general meeting.

b. Appointment of First Auditor in the case of Government Company-  
(1 ½ marks)

Section 139(7) provides that in the case of a Government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments, the first auditor shall be appointed by the Comptroller and Auditor-General of India within 60 days from the date of registration of the company.

In case the Comptroller and Auditor-General of India does not appoint such auditor within the above said period, the Board of Directors of the company shall appoint such auditor within the next 30 days. Further, in the case of failure of the Board to appoint such auditor within next 30 days, it shall inform the members of the company who shall appoint such auditor within 60 days at an extraordinary general meeting. Auditors shall hold office till the conclusion of the first annual general meeting.



(ii) Appointment of First Auditor by the Managing Director: (2 marks)

Apparently, there are two issues arising out of the situation given in the question, viz., first one relates to appointment of first auditor by the Managing Director; and second pertains to relation of such an auditor with the Managing Director. Regarding the first issue relating to appointment of auditor, particularly, in this case relating to appointment of first auditor, it may be noted that as per the provisions of section 139(6) of the Companies Act, 2013, the first auditor of a company shall be appointed by the Board of Directors within 30 days from the date of registration of the company.

As per the facts given in the case, the appointment of CA Rajnath as first auditor by the Managing Director of Malta Pvt. Ltd. by himself is in violation of section 139(6) of the Companies Act, 2013, which authorizes the Board of Directors to appoint the first auditor of the company within one month of registration of the company.

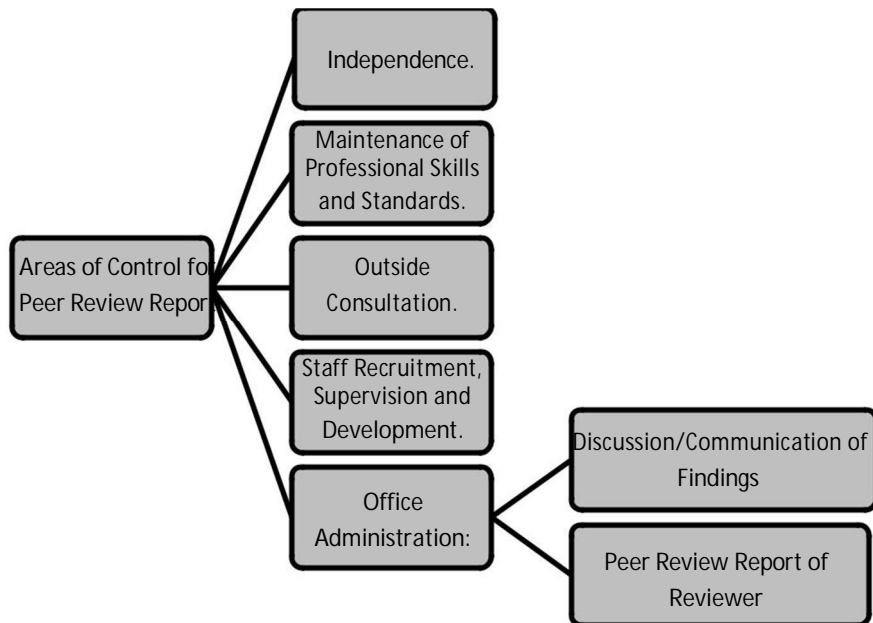
Thus, the appointment of CA Rajnath is not valid. Under the circumstances, the second issue relating to relationship of auditor with Managing Director becomes redundant.

#### Question 5

Areas of Control for Reporting Stage of Peer Review.

The Peer Review Report should state that the system of quality control for the assurance services of the Practice Unit for the period under review has been designed so as to carry out the assurance services in a manner that ensures compliance with Technical, Professional and Ethical Standards.

The Peer Review Report shall address the compliance report or otherwise on the following areas of controls:



- a. Independence.
- b. Maintenance of Professional Skills and Standards.
- c. Outside Consultation.
- d. Staff Recruitment, Supervision and Development.
- e. Office Administration (2 marks)
  - i) Discussion/Communication of Findings

After completing the on-site review, the Reviewer, before making his Report to the Board, shall communicate his findings to the Practice Unit if in his opinion, the systems and procedures are deficient or non-compliant with reference to any matter that has been noticed by him or if there are other matters where he wants to seek clarification. The Practice Unit shall within 15 days after the date of receipt of the findings, make any submissions or representations, in writing to the Reviewer. (1 mark)

ii) Peer Review Report of Reviewer

At the end of an on-site review if the Reviewer is satisfied with the reply received from the Practice Unit, he shall submit a Peer Review Report to the Board along with his initial findings, response by the Practice Unit and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

In case the Reviewer is of the opinion that the response by the Practice Unit is not satisfactory, the Reviewer shall accordingly submit a modified Report to the Board incorporating his reasons for the same. The Reviewer shall also submit initial findings, response by the Practice Unit and the manner in which the responses have been dealt with. A copy of the report shall also be forwarded to the Practice Unit.

In case of a modified report, The Board shall order for a "Follow On" Review after a period of one year from the date of issue of report as mentioned in (B) above. If the Board so decides, the period of one year may be reduced but shall not be less than six months from the date of issue of the report. (1 mark)

Question 6

- a. 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".

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 to acquire assets for consideration other than cash, from such director or person so connected. (1 mark)

In the instant case, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, son of director, which is an arrangement by which RPS 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.

However, the reporting requirements under this clause are given in two parts. The first part 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 section 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, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, 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, RPS Ltd. has entered into non-cash transactions with Mr. Rahul, 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. (1 mark)*

- b. Title deeds of Immovable Property in the name of Director: As per Clause (i)(c) of Paragraph 3 of the CARO, 2016, the auditor is required to report on whether the title deeds of immovable properties are held in the name of the company. If not, provide the details thereof.

The auditor should verify the title deeds available and reconcile the same with the fixed assets register. The scrutiny of the title deeds of the immovable property may reveal a number of discrepancies between the details in the fixed assets register and the details available in the title deeds. This may be due to various reasons which needs to be examined. (1 mark)

In the given case, NSP Limited has its factory building, appearing as fixed assets in its financial statements in the name of director. Thus, the auditor shall report on the same under Clause (i)(c) of Paragraph 3 of the CARO, 2016. (1 mark)

The reporting under this clause, where the title deeds of the immovable property are not held in the name of the Company, may be made incorporating following details, in the form of a table or otherwise:

A In case of land:-

- total number of cases,
- whether leasehold / freehold,
- gross block and net block, (as at Balance Sheet date), and
- remarks, if any.

B. In case of Buildings:-

- total number of cases,

- *gross block & net block, (as at Balance Sheet date) and*
- *remarks, if any.*

(1 mark)

#### Question 7

- a. As per Part IV of First Schedule of the CA Act, a member of the Institute whether in practice or not, shall be deemed to be guilty of other misconduct if he-
1. Is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term not exceeding six months.
  2. In the opinion of the Council, brings disrepute to the profession or the Institute as a result of his action, whether or not related to his professional work.

As per Part III of Second Schedule to the CA Act, a member of the Institute whether in practice or not shall be deemed to be guilty of other misconduct if he Is held guilty by any civil or criminal court for an offence which is punishable with imprisonment for a term exceeding six months.

This provision empowers the Council to enquire any misconduct of a member even if it does not arise of professional misconduct. (2 marks)

Some illustrative examples, where a member may be found guilty of "Other Misconduct", under the aforesaid provisions rendering, himself unfit to be member are:

- (i) Where a chartered accountant retains the books of account and documents of the client and fails to return these to the client on request without a reasonable cause.
- (ii) Where a chartered accountant makes a material misrepresentation.
- (iii) Where a chartered accountant uses the services of his articled or audit clerk for purposes other than professional practice.
- (iv) Conviction by a competent court of law for any offence under Section 8(v) of the Chartered Accountants Act 1949.
- (v) Misappropriation by office-bearer of a Regional Council of the Institute, of a large amount and utilisation thereof for his personal use.
- (vi) Non-replying within a reasonable time and without a good cause to the letter of the public authorities.
- (vii) Where certain assessment records of income tax department belonging to the client of Chartered Accountant were found in the almirah of the bed-room of the chartered accountant.
- (viii) Where a chartered accountant had adopted coercive methods on a bank for having a loan sanctioned to him.

(2 marks)

- b. Ceiling limit for signing the Tax Audit Reports: As per Council General Guidelines 2008, a member of the Institute in practice shall not accept, in a financial year, more than the "specified number of tax audit assignments" under Section 44AB of the Income-tax Act, 1961. It is also provided further that where any partner of a firm of Chartered Accountants in practice accepts one or more tax audit assignments in his individual capacity, the total



number of such assignments which may be accepted by him shall not exceed the "specified number of tax audit assignments" in the aggregate.

In the case of firm of Chartered Accountants in practice "the specified number of tax audit assignments" means, 60 tax audit assignments per partner in the firm, in a financial year, whether in respect of corporate or non-corporate assesses.

Further, as per clarification issued by the Institute on Tax Audit Assignments, tax audit reports may be signed by the partners in any manner whatsoever in accordance with specified audit limits. Thus, one partner can individually sign all the tax audit reports subject to specified tax audit assignment limits on behalf of all the partners in the firm of Chartered Accountants in practice or all the partners of the firm can collectively sign the tax audit reports. (2 marks)

In the instant case, there are 6 partners in M/s XYZ & Co., a Chartered Accountants firm, accordingly specified ceiling limit for the firm will be (60 tax audit assignments per partner X 6 partners) = 360. Therefore, all the 6 partners of the firm can collectively sign 360 tax audit reports. This maximum limit of 360 tax audit assignments may be distributed between the partners in any manner whatsoever. For instance, 1 partner can individually sign 360 tax audit reports in case remaining 5 partners are not signing any tax audit report.

Assuming Mr. Gaurav has signed 290 tax audit reports consisting of both corporate and non-corporate assessee on behalf of firm and remaining partners are signing audit reports within the specified number of tax audit assignments u/s 44AB i.e. upto 70.

Hence, Mr. Gaurav shall not be deemed to guilty of professional misconduct provided total number of tax audit reports on behalf of firm do not exceeds 360. (2 marks)

- c. Printing of QR Code on Visiting Cards: As per Clause (7) 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 advertises his professional attainments or services. (1 mark)

Ethical Standards Board has also clarified that a member in practice is allowed to print Quick Response Code (QR Code) on the visiting Card, provided that the Code does not contain information that is not otherwise permissible to be printed on a visiting Card. (1 mark)

In the given case, Mr. M has printed visiting cards which carries Quick Response Code (QR Code) besides other details. The visiting card as well as the QR Code contains his name, office and residential address, contact details, e-mail id and name of the firm's website which are otherwise allowed to be printed on the visiting cards of a Chartered Accountant in practice.

Thus, Mr. M is not guilty under Clause (7) of Part I of First Schedule to the Chartered Accountants Act, 1949. (2 marks)

- d. Certification of Projected Financial Forecast: Under Clause (3) of Part I of Second Schedule to the Chartered Accountants Act, 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct, if he permits his name or the name of his firm to be used in connection with an estimate of earnings contingent upon future transactions in a manner which may lead to the belief that he vouches for the accuracy of the forecast. (1 mark)

Further, SAE 3400 "The Examination of Prospective Financial Information", provides that the management is responsible for the preparation and presentation of the prospective financial information, including the identification and disclosure of the sources of information, the basis of forecasts and the underlying assumptions. The auditor may be asked to examine and report on the prospective financial information to enhance its credibility, whether it is intended for use by third parties or for internal purposes. Thus, while making report on projection, the auditor need to mention that his responsibility is to examine the evidence supporting the assumptions and other information in the prospective financial information, his responsibility does not include verification of the accuracy of the projections, therefore, he does not vouch for the accuracy of the same. (1 mark)

In the instant case, Mr. L, a chartered accountant, has prepared and certified a projected financial forecast of his client Abacus Ltd. which was forwarded to the client's bank to secure some loans and based on which the bank sanctioned a loan to the client is not in order.

Thus, Mr. L will be held guilty of misconduct in view of above. (2 mark)

#### Question 8

##### Obligation of Auditor to Submit an Exception Report to the Bank

1. Where, in the case of a non-banking financial company, the statement regarding any of the matters to be included in the auditor's report is unfavourable or qualified, or in the opinion of the auditor the company has not complied with:
  - the provisions of Chapter III B of Reserve Bank of India Act, 1934; or
  - the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998; or
  - Non-Banking Financial (Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007; or
  - Non-Banking Financial (Non- Deposit Accepting or Holding) Companies Prudential Norms (Reserve Bank) Directions, 2007;

it shall be the obligation of the auditor to make a report containing the details of such unfavourable or qualified statements and/or about the non-compliance, as the case may be, in respect of the company to the concerned Regional Office of the Department of Non-Banking Supervision of the Bank under whose jurisdiction the registered office of the company is located as per Second Schedule to the Non-Banking Financial Companies Acceptance of Public Deposits (Reserve Bank) Directions, 1998. (3 marks)

2. The duty of the Auditor under above stated paragraph (1) shall be to report only the contraventions of the provisions of RBI Act, 1934, and Directions, Guidelines, instructions referred to in sub-paragraph (1) and such report shall not contain any statement with respect to compliance of any of those provisions. (1 mark)

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