



J.K. SHAH[®]
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FINAL MAY 2019 EXAM

SUBJECT- AUDIT

Test Code - FNJ 7137

BRANCH - () (Date :)

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Answer 1:

(1 mark x 30 = 30 marks)

- 1) D
- 2) C
- 3) D
- 4) A
- 5) C
- 6) D
- 7) A
- 8) A
- 9) D
- 10) A
- 11) A
- 12) C
- 13) B
- 14) B
- 15) A
- 16) B
- 17) D
- 18) C
- 19) A
- 20) D
- 21) A
- 22) A
- 23) D
- 24) D
- 25) C
- 26) A
- 27) D
- 28) D
- 29) B
- 30) B

Answer 2:

(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. **(5 marks)**

(B)

Audit Programme of a Complex :

- (i) Peruse the Memorandum of Association and Articles of Association of the entity.
- (ii) Ensure the object clause permits the entity to engage in this type of business.
- (iii) In the case of income from sale of tickets :
 - (1) Verify the control system as to how it is ensured that the collections on sale of tickets of various shows are properly accounted.
 - (2) Verify the system of relating to online booking of various shows and the system of realization of money.
 - (3) Check that there is overall system of reconciliation of collections with the number of seats available for different shows on a day.
- (iv) Verify the internal control system and its effectiveness relating to the income from cafe shops, pubs etc., located within the multiplex.
- (v) Verify the system of control exercised relating to the income receivable from advertisements exhibited within the premises and inside the hall such as hoarding, banners, slides, short films etc.
- (vi) Verify the system of collection from the parking areas in respect of the vehicles parked by the customers.
- (vii) In the case of payment to the distributors verify the system of payment which may be either through out right payment or percentage of collection or a combination of both. Ensure at the time of settlement any payment of advance made to the distributor is also adjusted against the amount due.
- (viii) Verify the system of payment of salaries and other benefits to the employees and ensure that statutory requirements are complied with.
- (ix) Verify the payments effected in respect of the maintenance of the building and ensure the same is in order. **(5 marks)**

Answer 3:

(A)

Under section 35 of the Companies Act, 2013 -

- (1) Where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—
 - (a) is a director of the company at the time of the issue of the prospectus;
 - (b) has authorized himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;
 - (c) is a promoter of the company;
 - (d) has authorized the issue of the prospectus; and
 - (e) is an expert referred to in sub-section (5) of section 26,Shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage.
- (2) No person shall be liable under sub-section (1), if he proves—

- (a) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent, or
- (b) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.
- (3) Notwithstanding anything contained in this section, where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

Under section 448, an auditor is liable for criminal prosecution, if he, in any return, certificate, balance sheet, prospectus, statement or other document required by or for the purpose of the Act, makes a statement (a) which is false in any material particular knowing it to be false; or (b) which omits any material fact knowing it to be material. If convicted, he can be punished with imprisonment and also with fine as provided under section 447 of the said Act. **(6 marks)**

(B)

Direct Assistance from Internal Auditor :

As per **SA 610 “Using the Work of Internal Auditor”**, the external auditor **shall not use internal auditors to provide direct assistance** to perform procedures that involve making significant judgments in the audit.

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

(2 marks)

Significant judgments include the following :

Assessing the risks of material misstatement;

Evaluating the sufficiency of tests performed;

Evaluating the appropriateness of management’s use of the going concern assumption;

Evaluating significant accounting estimates; and

Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor’s report.

In view of above, Mr. Anand cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

(4 marks)

(C)

Reviewers, based on the conclusions drawn from the review, shall issue a preliminary report and subsequently the final report. A clean report indicates that the reviewer is of the opinion that the affairs are being conducted in a manner that ensures the quality of services rendered. However, a **reviewer may qualify the report due to one or more of the following :**

- ◆ non-compliance with technical standards;
- ◆ non-compliance with relevant laws and regulations;
- ◆ quality control system design deficiency;

- ◆ non-compliance with quality control policies and procedures; or
- ◆ non-existence of adequate training programmes for staff.

(4 marks)

(D)

Applicability of IND AS: Section 129(1) of the Companies Act, 2013, governs the requirements to be satisfied by financial statements. The provisions thereunder which should be complied with are:

- financial statements shall, give a true and fair view of the state of affairs of the company or companies as at the end of financial year, comply with the notified accounting standards under section 133 and be in such form or forms specified in Schedule III to the Companies Act, 2013 and
- The items contained in such financial statements shall be in accordance with the accounting standards.

Further, as per section 133 of the Companies Act, 2013, the Central Government has notified Companies (Indian Accounting Standards) Rules, 2015 dated 16.02.2015 in exercise of the powers conferred by section 133. The said rules list the Indian Accounting Standards (Ind AS) and the class of companies required to comply with the Ind AS while preparation of their financial statements.

Here, it may be noted that the companies covered under Section 8 are required to comply the provisions of the Companies Act, 2013, unless and until any exemption is provided. Therefore, companies registered under Section 8 are not exempted from the requirements of section 133 and section 129 of the Companies Act, 2013.

In the given case, only contention of management that being a section 8 company having charitable object, Ind-AS cannot apply to the company, therefore financial statements prepared under the earlier GAAP and a note for the same is given, is not tenable.

However, the auditor is required to ensure the applicable monetary limits w.r.t Ind-AS and need to advise the management to prepare the financial statements as per Ind-AS accordingly. In case of non-compliance the auditor should report accordingly. (4 marks)

Answer 4:

(A)

(I) When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework Different than that of the Parent:

The parent may have components located in multiple geographies outside India applying an accounting framework (GAAP) that is different than that of the parent in preparing its financial statements. Foreign components prepare financial statements under different financial reporting frameworks, which may be a well - known framework (such as US GAAP or IFRS) or the local GAAP of the jurisdiction of the component. Local component auditors may be unable to report on financial statements prepared using the parent's GAAP because of their unfamiliarity with such GAAP.

When a component's financial statements are prepared under an accounting framework that is different than that of the framework used by the parent in preparing group's consolidated financial statements, the parent's management perform a conversion of the components' audited financial statements from the framework used by the component to the framework under which the consolidated financial statements are prepared. The conversion adjustments are audited by the principal auditor to ensure that the financial information of the component(s) is suitable and appropriate for the purposes of consolidation.

A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual, to facilitate the preparation of the group's consolidated financial statements. The group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. The local component auditor can then audit and issue an audit report on the components financial statements prepared in accordance with "group accounting policies".

When applying the approach of using group accounting policies as the financial accounting framework for components to report under, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's financial statements. This ensures that the information prepared under the requirements of the group accounting policies will be directly usable and relevant for the preparation of consolidated financial statements by the parent entity, eliminating the need for auditing by the auditor, the differences between the basis used for the component's financial statements and that of the consolidated financial statements. The Principal auditor can then decide whether or not to rely on the components' audit report and make reference to it in the auditor's report on the consolidated financial statements. **(3 marks)**

(II) When the Component(s) Auditor Reports under an Auditing Framework Different than that of the Parent:

Normally, audits of financial statements, including consolidated financial statements, are performed under auditing standards generally accepted in India ("Indian GAAS"). In order to maintain consistency of the auditing framework and to enable the parent auditor to rely and refer to the other auditor's audit report in their audit report on the consolidated financial statements, the components' financial statements should also be audited under a framework that corresponds to Indian GAAS. **(2 marks)**

(B)

Following are the certain illustrative points, Auditors are required to follow during the Audit of Accounting or Premium:

1. Collection of Premium :

- Check whether there is **daily reconciliation process** to reconcile the amounts collected, entered into the system and deposited into the bank.
- Check that there is **appropriate mechanism to ensure all the collections** are deposited into the Bank on timely basis.

2. Calculation of Premium :

- Check that **Accounting system**, employed by the Company, calculates **premium amounts** and its respective **due dates correctly**.
- Check that system employed as such is equipped to **calculate all types of premium modes correctly**.

3. Recognition of Income :

- Check that **premium is recognised only on the basis of 'Issued Policies'** and not on underwriting date.
- Check that there is inbuilt mechanism the system **all the premium collected are correctly allocated** all various components of the Policies.

- Check that there is **appropriate mechanism in place to conduct reconciliation** on daily basis and reconciling items, if any, are rectified / followed up.

4. Accounting of 'Advance Premium' :

- Check, whether system has capability to **identity regular and advance premium.**
- Check whether there is a **process of applying advance premium to a contract when premium is due.**

5. Reporting of Premium figures to IRDA/ Management :

- Check the **methodology for generation of MIS** from the system and there is no manual intervention.
- Check the procedure for **Maker/ Checker before finalising the MIS.**
- Check whether there is a reconciliation process between premium Income as per financials and as reported.

6. Other Areas :

- Check whether there are **appropriate SOPs** developed by the Companies and are **strictly followed** by all the departments / branches of the Company.
- Ensure duly **approved Delegation of Authority parameters matrix** already in place for authorisation limits.
- Premium recognition and refund of premium are independent processes with adequate **segregation of duties amongst the personnel.**
- Check that the Company conducts premium reconciliation on daily basis.
- Check the **robustness of interface between administration and accounting system.**

Auditors may also refer to IRDA (Preparation of Financial Statements & Auditors Report of Insurance Companies) Regulations, 2000 for premium accounting. **(1 mark x 6 = 6 marks)**

(C)

Application of Share Premium Account :

Section 52 of the Companies Act, 2013 (herein after referred as the Act) deals with the application of premium received on issue of shares. Sub – section (1) of the said section provides that where a company issues shares at a premium, whether for cash or otherwise, a sum equal to the aggregate amount of the premium received on those shares shall be **transferred to an account called "Securities Premium Account"** and the provisions of this Act relating to reduction of share capital of a company except as provided in this section shall apply as if the securities premium account was the paid up share capital of the company. Sub – section (2) of the said section provides that notwithstanding anything contained in sub – section (1), securities premium account may be applied by the company for issue of bonus shares; writing off the preliminary expenses; writing off the expenses of, or the commission paid or discount allowed on, any issue of shares or debentures of the company; in providing for the premium payable on redemption of any redeemable preference shares or any debentures of the company; for the purchase of its own shares or other securities. In view of these provisions of the Companies Act, 2013, it is not permitted to adjust its accumulated losses against the securities premium account. **(5 marks)**

(D)

Circulating Information Contained in Own Website :

As per **clause (6) of Part I of the 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.

However, the guidelines approved by the council of the Institute of Chartered Accountants of India permit creation of own website by a chartered accountant in his or his firm name and no standard format or restriction on colours is there. The chartered accountant or firm, as per the guidelines, should ensure that none of the information contained in the website be circulated on their own or through E – mail or by any other mode except on a specific “Pull” request.

Further, members are not required to intimate the Website address to the Institute. Members are only required to comply with the Website Guidelines issued by the Institute in this regard.

In the given case, Mr. Brilliant has circulated the information contained in the website through E – mail to public at large. Therefore, he is guilty of professional misconduct under clause (6) of Part I of the First Schedule to the said Act. However, there is no such misconduct for not intimating website address to the Institute.

Answer 5:

(A)

Reporting Requirement for Disqualifications in Cost Audit Report:

A tax auditor is required to ascertain under **Clause (37) of Form 3CD** whether cost audit was carried out and if yes, provide the details of disqualification or disagreement on any matter/item/value/quantity as may be reported / identified by the cost auditor.

The tax auditor should obtain the copy of cost audit from the assessee. Even though the tax auditor is not required to make any detailed study of such report, he has to take note of the details of disqualification or disagreement on any matter/item/value/quantity as may be reported / identified by the cost auditor. The tax auditor need not express any opinion in a case where such audit has been ordered but the same has not been carried out.

In the given case, the cost auditor of Beam Ltd. has reported certain disqualifications in **Form CRA-3 of the cost audit report**.

Therefore, the tax auditor of Beam Ltd. is required to provide the details of disqualifications reported by the cost auditor under Clause (37) of the Form 3CD. Thus, the contention of the management of Beam Ltd. not to reveal any of the disqualifications related to the cost audit on the belief that there is no correlation between tax audit and cost audit is not acceptable. **(5 marks)**

(B)

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 Kilometers from the municipal limits of a city**, in which the first office is located. Further a member having two offices of the type referred to above, shall have to declare which of the two offices is his main office, which would constitute his professional address. **(2 marks)**

In the given case, M & Co., a sole proprietary Chartered Accountant firm in practice with an office in a busy belt of a city and had great difficulty in regularly attending to the consultancy needs of his clients. Therefore, a facilitation centre was opened in the industrial cluster and the proprietor is managing both the office and facilitation centre. Though distance between his office and facilitation centre i.e. sort of second office is within prescribed range i.e. 50 kilometres but M& Co., will be liable for misconduct as prescribed intimation about facilitation centre and main office should be sent to the Institute of Chartered Accountants of India. **(2 marks)**

(C)

Various Stages involved in the Conduct of the Quality Review Assignments are :

- Selection of Audit Firm and Technical Reviewer to conduct Quality Review and sending Offer Letter of Engagement to the Technical Reviewer.
- Technical Reviewer to convey his acceptance of Letter of Engagement by sending necessary declarations for meeting eligibility conditions and furnishing statement of confidentiality by the Technical Reviewer and his assistant/s, if any.
- Intimation to the Audit Firm about the proposed Quality Review and acceptance of the assignment by the Technical Reviewer. Also marking a copy of the intimation to the Technical Reviewer.
- Technical Reviewer to send the specified Quality Review Program General Questionnaire to the Audit firm for filling – up and call for additional information from the Audit Firm, if required.
- Technical Reviewer to carry out the Quality Review by visiting the office of the Audit Firm by fixing the date as per mutual consent.
- Technical Reviewer to send the preliminary report to Audit Firm.
- Audit firm to submit representation on the preliminary report to the Technical Reviewer.
- Technical Reviewer to submit final report alongwith a copy of Annual report of the company/ entity for the year, to be Board in the specified format, on their (individual) letterhead, duly signed and dated within 45 days from the date of acceptance of the assignment.
- Technical Reviewer should also send a copy of their final report to the Statutory Auditor/ Audit firm, requesting the firm to send their submissions thereon to the Board within 7 days of receipt of the final report with a copy to Technical Reviewer. Upon receipt of their final submission, Technical Reviewer shall submit within next 7 days a summary of their findings, reply of the audit firm thereon alongwith their final comments in the specified format.
- Quality Review Group to consider the report of the Technical Reviewer and responses of the Audit firm and make recommendations to Quality Review Board.
- Quality Review Board to consider the report of the Quality Review Group and decide the final course of action.

(6 marks)

(D)

Reporting for issue of shares for value exceeding fair market value:

In this case, AB Ltd. is a company, other than a company in which the public are substantially interested. During the previous year 2017-18, it receives consideration for issue of shares (i.e. Rs. 80 per share) which exceeds the face value (i.e. Rs. 10 per share) and fair market value of the shares (i.e. Rs. 60 per share).

A tax auditor has to furnish the details of shares issued during the previous year, under **clause 29 of Form 3CD**, in case, the assessee received any consideration for issue of shares which exceeds the fair market value of the shares as referred to in **section 56(2)(viib)** of the Income Tax Act, 1961.

Section 56(2)(viib) provides that where a company, not being a company in which the public are substantially interested, receives, in any previous year, from any person being a resident, any consideration for issue of shares that exceeds the face value of such shares, the aggregate consideration received for such shares as exceeds the fair market value of the shares shall be chargeable to income-tax under the head "Income from other sources".

Since section 56(2)(viib) is applicable to companies in which public is not substantially interested, reporting under this clause is to be done only for corporate assessee. The auditor should obtain from the auditee, a list containing the details of shares issued, if any, by him to any person being

a resident and verify the same from the books of accounts and other relevant documents.

As per the facts of the case, provisions and explanations given above, the income generated by AB Ltd., due to differences in consideration received and fair market value of shares issued, is chargeable to income-tax under the head "Income from other sources" as per section 56(2)(viib) of the Income Tax Act, 1961.

Therefore, the tax auditor of AB Ltd. is required to furnish the details of shares issued under clause 29 of Form 3CD. The contention of the management of the company, behind non-reporting, that it is a normal issue of shares, is not acceptable. **(5 marks)**

Answer 6:

(A)

False Declaration as Authorized Representative: In connection with proceedings under the Income Tax Act 1961, a Chartered Accountant often acts as the authorized representative of his clients and attends before an Income Tax Authority or the appellate tribunal.

Any person who acts or induces, in any manner another person to make and deliver to the Income Tax Authorities a false account, statement, or declaration, relating to any income chargeable to tax which he knows to be false or does not believe to be true will be liable under section 278 of the Income Tax Act 1961. Further, in case of submission of any information which is false and which the Chartered Accountant either knows or believes to be false or untrue, he would be liable to rigorous imprisonment which may extend to seven years (in other cases two years) and/or to a fine.

In the instant case, Mr. Ram, a chartered accountant has appeared before the Income Tax Authorities as the authorized representative of his client and delivered a false declaration, thus, he would be liable under section 278 of the Income Tax Act, 1961. **(4 marks)**

(B)

Qualified Opinion

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

In our opinion and to the best of our information and according to the explanations given to us, except for the effects of the matter described in the *Basis for Qualified Opinion* section of our report, the aforesaid financial statements present fairly, in all material respects, or *give a true and fair view* in conformity with the accounting principles generally accepted in India of the state of affairs of the Company as at March 31st, 2XXX and profit/loss, (*changes in equity*) and its cash flows for the year ended on that date. **(3 marks)**

Basis for Qualified Opinion

The Company's short-term marketable securities are carried in the statement of financial position at xxx. Management has not marked these securities to market but has instead stated them at cost, which constitutes a departure from the Accounting Standards prescribed in section 133 of the Companies Act, 2013. The Company's records indicate that had management marked the marketable securities to market, the Company would have recognized an unrealized loss of Rs.xxx in the statement of comprehensive income for the year. The carrying amount of the

securities in the statement of financial position would have been reduced by the same amount at March 31, 20X1, and income tax, net income and shareholders' equity would have been reduced by Rs.xxx, Rs.xxx and Rs.xxx, respectively.

We conducted our audit in accordance with Standards on Auditing (SAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the ICAI's Code of Ethics. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified opinion. (3 marks)

(C)

Sharing and Accepting of Part of Profits with an Advocate:

According to **Clause (2) of Part I of the First Schedule to the Chartered Accountants Act, 1949**, a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he pays or allows or agrees to pay or allow, directly or indirectly, any share, commission or brokerage in the fees or profits of his professional business, to any person other than a member of the Institute, for the purpose of rendering such professional services from time to time in or outside India. (1.5 marks)

Furthermore, **Clause (3) of Part I of the First Schedule** to the said Act states that a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he accepts any part of the profits of the professional work of a person who is not a member of the Institute. (1.5 marks)

However, a practicing member of the Institute can share fees or profits arising out of his professional business with such members of other professional bodies or with such other persons having such qualifications as prescribed by the Council under **Regulation 53 – A of the Chartered Accountants Regulations, 1988**. Under the said regulation, the member of **"Bar Council of India"** is included. (1 mark)

Therefore, Mr. Preet, an advocate, a member of Bar Council, is allowed to share part of profits of his professional work with Ms. Preeti. Hence, Ms. Preeti, a practicing Chartered Accountant, will not be held guilty under any of the abovementioned clauses for paying and accepting part of profits from Mr. Preet. (1 mark)

(D)

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". (1 mark)

In the instant case, CA. G received sum of rupees 20 lakh from his client who is a film artist for monthly installment payment of Goods and Service Tax. This money should have been deposited in a separate bank account. CA. G utilized the amount of last instalment for his own advance tax payment, though he paid the same along with interest and bore the interest due to short fall in remittance of tax of his client. (2 marks)

As per fact of the case CA. G has failed to keep the sum of rupees 20 lakh received on behalf of his client in a separate Bank Account and utilized the same for his own advance tax payment amounts to professional misconduct under Clause (10) of Part I of Second Schedule. **(2 marks)**