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SUGGESTED SOLUTION
INTERMEDIATE M'19 EXAM

SUBJECT- AUDIT

Test Code – CIM 8119

(Date :)

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ANSWER-1

(a) **Incorrect:** As per section 141 of the Companies Act, 2013, a person shall be eligible for appointment as an auditor of a company only if he is a chartered accountant.

Thus, Mr. N is disqualified to be appointed as an auditor of XYZ Limited.

(b) **Incorrect:** The provisions of Companies Act, 2013 grant rights to the auditor to access books of account and vouchers of the company. He is also entitled to require information and explanations from the company. Therefore, he has a statutory right to inspect the minute book.

(c) **Correct:** As per SA 200 "Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing", the purpose of an audit is to enhance the degree of confidence of intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.

(d) **Correct:** An audit is an independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon. It is clear that the basic objective of auditing, i.e., expression of opinion on financial statements does not change with reference to nature, size or form of an entity.

(e) **Incorrect:** As per the provisions of the Companies Act, 2013 a person is disqualified to be appointed as an auditor of a company if his relative is holding any security of or interest in the company of face value exceeding Rs.1 lakh.

Therefore, AB & Co. shall be disqualified for being appointed as an auditor of XYZ Ltd. as Mr. C, the relative of Mr. B who is a partner in AB & Co., is holding securities in XYZ Ltd. having face value of Rs.2 lakh.

ANSWER-2

(a) Appointment of Subsequent Auditors in case of Non Government Companies: Section 139(1) of the Companies Act, 2013 provides that every company shall, at the first annual general meeting appoint an individual or a firm as an auditor who shall hold office from the conclusion of that meeting till the conclusion of its sixth annual general meeting and thereafter till the conclusion of every sixth meeting.

The following points need to be noted in this regard-

- (i) The company shall place the matter relating to such appointment of ratification by member at every Annual General Meeting.
- (ii) Before such appointment is made, the written consent of the auditor to such appointment, and a certificate from him or it that the appointment, if made, shall be in accordance with the conditions as may be prescribed, shall be obtained from the auditor.
- (iii) The certificate shall also indicate whether the auditor satisfies the criteria provided in **section 141**.

The company shall inform the auditor concerned of his or its appointment, and also file a notice of such appointment with the Registrar within 15 days of the meeting in which the auditor is appointed.

(b) Filling of a Casual Vacancy

As per **Section 139(8)**, any casual vacancy in the office of an auditor shall-

- (i) In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days.

If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within three months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting.

- (ii) In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor-General of India within 30 days.

It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within the said period the Board of Directors shall fill the vacancy within next 30 days.

Casual Vacancy by Resignation: As per **section 140(2)** the auditor who has resigned from the company shall file within a period of 30 days from the date of resignation, a statement in the prescribed **Form ADT-3** (as per Rule 8 of CAAR) with the company and the Registrar, and in case of the companies referred to in **section 139(5)** i.e. Government company, the auditor shall also file such statement with the Comptroller and Auditor-General of India, indicating

the reasons and other facts as may be relevant with regard to his resignation. In case of failure the auditor shall be punishable with fine which shall not be less than fifty thousand rupees but which may extend to five lakh rupees as per **section 140(3)**.

ANSWER-3

ANSWER-A

Duty of Auditor to Inquire on certain matters: It is the duty of auditor to inquire into the following matters-

- (a) whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members;
- (b) whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company;
- (c) where the company not being an investment company or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company;
- (d) whether loans and advances made by the company have been shown as deposits;
- (e) whether personal expenses have been charged to revenue account;
- (f) where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.

ANSWER-B

Information which assist the Auditor in accepting and continuing of relationship with Client: As per SA 220, "Quality Control for an Audit of Financial Statements" the auditor should obtain information considered necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement and when considering acceptance of a new engagement with an existing client. The following information would assist the auditor in accepting and continuing of relationship with the client:

- (i) The integrity of the principal owners, key management and those charged with governance of the entity;
- (ii) Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources;
- (iii) Whether the firm and the engagement team can comply with relevant ethical requirements; and
- (iv) Significant matters that have arisen during the current or previous audit engagement, and their implications for continuing the relationship.

ANSWER-4

ANSWER-A

(a) Right to report to the members of the company on the accounts examined by him -

The auditor shall make a report to the members of the company on the accounts examined by him and on every financial statements which are required by or under this Act to be laid before the company in general meeting and the report shall after taking into account the provisions of this Act, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of this Act or any rules made there under or under any order made under this section and to the best of his information and knowledge, the said accounts, financial statements give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year and such other matters as may be prescribed.

(b) Right to obtain information and explanation from officers - This right of the auditor to obtain from the officers of the company such information and explanations as he may think necessary for the performance of his duties as auditor is a wide and important power. In the absence of such power, the auditor would not be able to obtain details of amount collected by the directors, etc. from any other company, firm or person as well as of any benefits in kind derived by the directors from the company, which may not be known from an examination of the books. It is for the auditor to decide the matters in respect of which information and explanations are required by him. When the auditor is not provided the information required by him or is denied access to books, etc., his only remedy would be to report to the members that he could not obtain all the information and explanations he had required or considered necessary for the performance of his duties as auditors.

ANSWER-B

- (a) As per section 141(3)(d)(i), a person shall not be eligible for appointment as an auditor of a company, who, or his relative or partner is holding any security of or interest in the company or its subsidiary, or of its holding or associate company or a subsidiary of such holding company. However, as per proviso to this section, the relative of the person may hold the securities or interest in the company of face value not exceeding of Rs.1,00,000.

In the instant case, M/s RM & Co. is an audit firm having partners CA. R and CA. M. Mr. Bee is a relative of CA. R and he is holding shares of Enn Ltd. of face value of Rs. 50,000 only (5,000 shares x Rs. 10 per share).

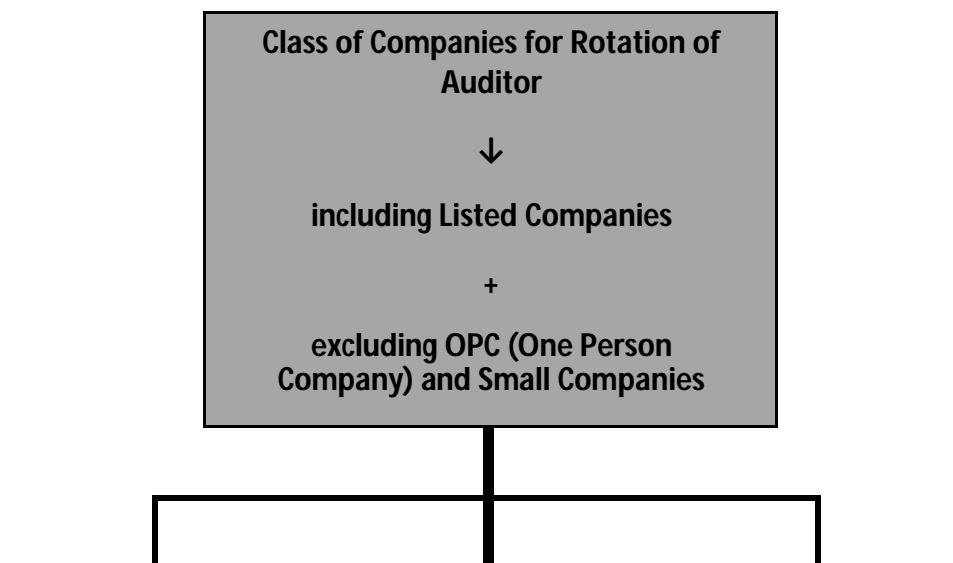
Therefore, M/s RM & Co. is not disqualified for appointment as an auditors of Enn Ltd. as the relative of CA. R (i.e. partner of M/s RM &Co.) is holding the securities in Enn Ltd. which is within the limit mentioned in proviso to section 141(3)(d)(i) of the Companies Act,2013.

- (b) Section 141(3)(i) of the Companies Act, 2013 disqualifies a person for appointment as an auditor of a company who is engaged as on the date of appointment in consulting and specialized services as provided in section 144. Section 144 of the Companies Act, 2013 prescribes certain services not to be rendered by the auditor which includes investment banking services.

Therefore, CA. Poshin is advised not to accept the assignment of auditing as the investment banking service is specifically notified in the list of services not to be rendered by him as per section 141(3)(i) read with section 144 of the Companies Act, 2013.

ANSWER-5

- (a) **Applicability of Section 139(2) Rotation of Auditor:** As per rules prescribed in Companies (Audit and Auditors) Rules, 2014, for applicability of section 139(2) the class of companies shall mean the following classes of companies excluding one person companies and small companies-



All unlisted public companies having paid up share capital \geq Rs. 10 crore

All private limited companies having paid up share capital \geq Rs. 50 crore

All companies having paid up share capital of below threshold limit mentioned, but having public borrowings from financial institutions, banks or public deposits $>$ Rs. 50 crore

- (I) all unlisted public companies having paid up share capital of rupees ten crore or more;
- (II) all private limited companies having paid up share capital of rupees fifty crore or more;
- (III) all companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of rupees fifty crores or more.

From the above, it can be concluded that rotational provisions would not be applicable.

(b) Matters to be included in the auditor's report- statutory dues and repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders (CARO, 2016)-

Clause (vii) (a) whether the company is regular in depositing undisputed statutory dues including provident fund, employees' state insurance, income-tax, sales-tax, service tax, duty of customs, duty of excise, value added tax, cess and any other statutory dues with the appropriate authorities and if not, the extent of the arrears of outstanding statutory dues as at the last day of the financial year concerned for a period of more than six months from the date they became payable, shall be indicated;

(b) where dues of income tax or sales tax or service tax or duty of customs or duty of excise or value added tax have not been deposited on account of any dispute, then the amounts involved and the forum where dispute is pending shall be mentioned. (A mere representation to the concerned Department shall not constitute a dispute).

Clause (viii) whether the company has defaulted in repayment of loans or borrowing to a financial institution, bank, Government or dues to debenture holders? If yes, the period and the amount of default to be reported (in case of defaults to banks, financial institutions, and Government, lender wise details to be provided).

ANSWER-6

ANSWER-A

The firm's system of quality control should include policies and procedures addressing each of the following elements:

- (a) Leadership responsibilities for quality within the firm.
- (b) Ethical requirements.
- (c) Acceptance and continuance of client relationships and specific engagements.
- (d) Human resources.
- (e) Engagement performance.
- (f) Monitoring.

ANSWER-B

(a) The auditor is not expected to, and cannot, reduce audit risk to zero and cannot therefore obtain absolute assurance that the financial statements are free from material misstatement due to fraud or error. This is because there are inherent limitations of an audit. The inherent limitations of an audit arise from:

- (i) **The Nature of Financial Reporting:** The preparation of financial statements involves judgment by management in applying the requirements of the entity's applicable financial reporting framework to the facts and circumstances of the entity. In addition, many financial statement items involve subjective decisions or assessments or a degree of uncertainty, and there may be a range of acceptable interpretations or judgments that may be made.
- (ii) **The Nature of Audit Procedures:** There are practical and legal limitations on the auditor's ability to obtain audit evidence. For example:
 - 1. There is the possibility that management or others may not provide, intentionally or unintentionally, the complete information that is relevant to the preparation and presentation of the financial statements or that has been requested by the auditor.
 - 2. Fraud may involve sophisticated and carefully organised schemes designed to conceal it. Therefore, audit procedures used to gather audit evidence may be ineffective for detecting an intentional misstatement that involves, for example, collusion to falsify documentation which may cause the auditor to believe that audit evidence is valid when it is not. The auditor is neither trained as nor expected to be an expert in the authentication of documents.
 - 3. An audit is not an official investigation into alleged wrongdoing. Accordingly, the auditor is not given specific legal powers, such as the power of search, which may be necessary for such an investigation.
- (iii) **Timeliness of Financial Reporting and the Balance between Benefit and Cost:** The matter of difficulty, time, or cost involved is not in itself a valid basis for the auditor to omit an audit procedure for which there is no alternative.

Appropriate planning assists in making sufficient time and resources available for the conduct of the audit. Notwithstanding this, the relevance of information, and thereby its value, tends to diminish over time, and there is a balance to be struck between the reliability of information and its cost.

(iv) **Other Matters that Affect the Limitations of an Audit:** In the case of certain subject matters, limitations on the auditor's ability to detect material misstatements are particularly significant. Such assertions or subject matters include:

- Fraud, particularly fraud involving senior management or collusion.
- The existence and completeness of related party relationships and transactions.
- The occurrence of non-compliance with laws and regulations.
- Future events or conditions that may cause an entity to cease to continue as a going concern.