

Note: All questions are compulsory.

Question 1 (6 marks)

(a) Services not to be rendered by the auditor: (2/3rd mark for each point)

Section 144 of the Companies Act, 2013 is a new provision which prescribes certain services not to be rendered by the auditor. An auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the audit committee, as the case may be, but which shall not include any of the following services (whether such services are rendered directly or indirectly to the company or its holding company or subsidiary company), namely:

- (i) Accounting and book keeping services;
- (ii) Internal audit;
- (iii) Design and implementation of any financial information system;
- (iv) Actuarial services;
- (v) Investment advisory services;
- (vi) Investment banking services;
- (vii) Rendering of outsourced financial services;
- (viii) Management services; and
- (ix) Any other kind of services as may be prescribed.

Question 2(6 marks)

Modified Report: An auditor's report is considered to be modified when it includes -

(A) Matters That Do Not Affect the Auditor's Opinion

- (i) **Emphasis of Matter paragraph:** Sometimes the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report provided the auditor has obtained sufficient appropriate audit evidence that the matter is not materially misstated in the financial statements. **(1 mark)**
- (ii) **Other Matter paragraph:** If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that, in the auditor's judgment, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report and this is not prohibited by law or regulation, the auditor shall do so in a paragraph in the auditor's report, with the heading "Other Matter", or other appropriate heading. **(1 mark)**

(B) Matters that Do Affect the Auditor's Opinion

- (i) **Qualified Opinion:** The auditor shall express a qualified opinion when-**(1 mark)**
 - (1) The auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or
 - (2) The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the

financial statements of undetected misstatements, if any, could be material but not pervasive.

- (ii) **Disclaimer of Opinion:** The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive. **(1/2 mark)**
- (iii) **Adverse Opinion:** The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements. **(1/2 mark)**

The auditor shall modify the opinion in the auditor's report when:

- (1) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or **(1 mark)**
- (2) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement. **(1 mark)**

Question 3(4 marks)(1 mark for each point)

External Confirmation Procedures:

- (i) **Determining the Information to be confirmed or Requested:** External confirmation procedures frequently are performed to confirm or request information regarding account balances and their elements. They may also be used to confirm terms of agreements, contracts, or transactions between an entity and other parties, or to confirm the absence of certain conditions, such as a "side agreement".
- (ii) **Selecting the Appropriate Confirming Party:** Responses to confirmation requests provide more relevant and reliable audit evidence when confirmation requests are sent to a confirming party the auditor believes is knowledgeable about the information to be confirmed. For example, a financial institution official who is knowledgeable about the transactions or arrangements for which confirmation is requested may be the most appropriate person at the financial institution from whom to request confirmation.
- (iii) **Designing Confirmation Requests:** The design of a confirmation request may directly affect the confirmation response rate, and the reliability and the nature of the audit evidence obtained from responses.
- (iv) **Follow-Up on Confirmation Requests:** The auditor may send an additional confirmation request when a reply to a previous request has not been received within a reasonable time. For example, the auditor may, having re-verified the accuracy of the original address, send an additional or follow-up request

Question 4(8 marks)

- (a) **Determination of Cost in Case of Exchange of Assets:** An enterprise may acquire an asset through exchange process. In the instant case, the company has acquired a motor car from a customer in exchange of amount due from him.

However, the motor car has not been registered in the name of the company on the date of the Balance Sheet. Having regard to the principle of substance over form, the auditor should see that the transaction is recorded though the car is not registered in the name of the auditee. **(1 mark)**

As far as determination of the cost is concerned, AS 10 broadly lays down the following principle:

"When a fixed asset is acquired in exchange for another asset, its cost is usually determined by reference to the fair market value of the consideration given. It may be appropriate to consider also the fair market value of the asset acquired if this is more clearly evident. An alternative accounting treatment that is sometimes used for an exchange of assets, particularly when the assets exchanged are similar, is to record the asset acquired at the

net book value of the asset given up; in each case an adjustment is made for any balancing receipt or payment of cash or other consideration.” **(1 mark)**

Consequently, it shall be more appropriate to record the cost of motor car at ` 5 lacs since the value of asset given up is more clearly evident than the fair value of assets acquired i.e. motor car which happens to be estimation on the part of directors. Accordingly, the customer’s account should also be credited by ` 5 lacs.

However, the directors may revalue the asset and write up the value of motor car to 5.25 lacs. Then ` 25,000 should be transferred to Revaluation Reserve. **(2 marks)**

(b) Non-provision of Interest:

The non-provision of accrued unpaid interest amounting to 25 lacs as also the penal interest amounting to `10 lacs payable to ICICI by the management is not the proper accounting treatment since the company has been unable to repay on the due date and penal interest is also payable in case of default as per terms of the contract. **(1 mark)**

The contention of the management is not tenable simply because application for rescheduling the repayment and waiver of a part of the accrued interest and the penal interest has been made to the ICICI. **(1 mark)**

In any case, a company has to follow accrual system of accounting as per section 128(1) of the Companies Act, 2013. As a matter of fact, the auditor must ensure that provisions for the entire amount of accrued interest as also the penal interest has been made since the same has not been waived on the date of audit. **(1 mark)**

Since the management does not wish to provide the above amounts, the auditor shall have to qualify the audit report as per the Institute’s statement on the subject. The qualification paragraph must bring out clearly the quantitative impact of non-provision of interest on the profits. **(1 mark)**

Question 5(8 marks) (1 mark for each point)

Audit Programme to Audit the Accounts of a Recreation Club:

- (i) Examine the constitution, powers of governing body and relevant rules relating to preparation and finalisation of accounts. In case, it is constituted as a company limited by guarantee, application of provisions of the Companies Act, 2013 should also be seen.
- (ii) Vouch the receipt on account of entrance fees with members’ applications, counterfoils issued to them, and minutes of the Managing Committee.
- (iii) Vouch Members’ subscription with the counterfoils of receipts issued to them. Trace receipts for a selected period to the Register of Members; reconcile the amount of total subscription due with the amount collected and the outstanding. Check totals of various columns of the Register of Members and tally them across. See the Register of Members to ascertain the Member’s dues which are in arrear and enquire whether necessary steps have been taken for their recovery. The amount considered irrecoverable, if any should be written off.
- (iv) Ensure that arrears of subscriptions for the previous year have been correctly brought over and arrears for the year under audit and subscription received in advance have been correctly adjusted.
- (v) Verify the internal check as regards members being charged with the price of foodstuffs and drinks provided to them and their guests as well as with the fees chargeable for the special service rendered such as billiards, tennis, etc. Trace debits for a selected period from subsidiary registers maintained in respect of supplies and services to members to confirm that the account of every member has been debited with amounts recoverable from him.
- (vi) Vouch purchase of sports items, furniture, crockery, etc., and trace their entries into the respective inventory registers. Vouch purchases of food-stuffs, cigars, wines, etc. and test their sale price so as to confirm that the normal rates of profit have been earned on their sales.

The inventory of unsold provisions and stores, at the end of the year should be verified physically and its valuation checked.

- (vii) Check the inventory of furniture, sports material and other assets physically with the respective inventory registers or inventories prepared at the end of the year.
- (viii) Inspect the share scrips and bonds in respect of investments, check their current values for disclosure in final accounts, also ascertain that the arrangements for their safe custody are satisfactory, check the accrual of income therefrom and provision of income tax thereon.

Question 6(8 marks)

While conducting an audit, the auditor comes across various matters in respect of which he is not able to obtain sufficient appropriate audit evidence. One such area involves verification of liabilities, in general, and contingent liabilities in particular. In such cases, it is advisable for the auditor to obtain a written representation from the management as to the fact whether all contingent liabilities have been disclosed and are complete in all respects. The fact remains that it is the management which is responsible for preparation of financial information. **(1 Mark)**

Therefore, it would be in order to obtain an appropriate certificate from the management that it has approved the financial information prepared by them. Now section 134(5) of the Companies Act, 2013 provides that the Board shall have to give a statement that financial statements are their responsibility. **(1 mark)**

SA-580, "Written Representations", deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance. Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence. Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. **(2 marks)**

Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions. The objectives of the auditor are:

- (a) To obtain written representations from management and, where appropriate, those charged with governance that they believe that they have fulfilled their responsibility for the preparation of the financial statements and for the completeness of the information provided to the auditor;
- (b) To support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations, if determined necessary by the auditor or required by other SAs; and
- (c) To respond appropriately to written representations provided by management and, where appropriate, those charged with governance, or if management or, where appropriate, those charged with governance do not provide the written representations requested by the auditor.

It makes it absolutely clear that written representations cannot be a substitute for other evidence that the auditor could expect to be reasonably available. **(4 Marks)**

Question 7 (4 Marks)

i) **Incorrect – (1 mark)**

According to the section 139(6) of the Companies Act, 2013, in the case of failure of the Board to appoint the auditor, it shall inform the members of the company.

ii) **Incorrect-(1 mark)**

Where a person appointed as an auditor of a company incurs any of the disqualifications after his appointment, he shall vacate his office as such auditor and such vacation shall be deemed to be casual vacancy in the office of the auditor.

iii) **Incorrect - (1 mark)**

According to section 144 of the Companies Act, 2013 an auditor appointed under this Act shall provide to the company only such other services as are approved by the Board of Directors or the Audit Committee,

iv) **Incorrect - (1 mark)**

As per section 143(1) of the Companies Act, 2013 every auditor of the company shall have right to access at all times to the books of account and vouchers of the company kept not only at the registered office of the company but also at any other place too.

Question 8(6 Marks)

Removal of Auditor before Expiry:

- i) As per sub-section (1) of Section 140 of the Companies Act, 2013, an auditor appointed under section 139 may be removed from his office before the expiry of his term only by a special resolution of the company, after obtaining the prior approval of the Central Government in that behalf as per Rule 7 prescribed under Companies (Audit & Auditors) Rules, 2014:
- (a) The application to the Central Government for removal of auditor shall be made in Form ADT-2 and shall be accompanied with fees as provided for this purpose under the Companies (Registration Offices and Fees) Rules, 2014.
 - (b) The application shall be made to the Central Government within 30 days of the resolution passed by the Board.
 - (c) The company shall hold the general meeting within 60 days of receipt of approval of the Central Government for passing the special resolution. **(3 Marks)**
- ii) It is important to note that before taking any action for removal before expiry of terms, the auditor concerned shall be given a reasonable opportunity of being heard. **(1 Mark)**
- iii) In the instant case, the first auditor was removed by the company before the expiry of his term without obtaining approval of the Central Government. **(1 Mark)**
- iv) Therefore, it may be concluded that the action of the company for removal of the auditor before expiry of term is not justified and auditor may be removed from his office only by following the above mentioned procedure. **(1 Mark)**
