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CA FINAL MAY 2017 EXAM

AUDITING

Test Code - F M J 4 0 1 2

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Answer-1 :

Audit Report: Section 143(1) of the Companies Act, 2013 requires the auditor to make an enquiry in respect of specified matters during the course of his audit. Since the law requires the auditor to make an enquiry, the Institute opined that the auditor is not required to report on the matters specified in sub-section (1) unless he has any special comments to make on any of the items referred to therein. If the auditor is satisfied as a result of the enquiries, he has no further duty to report that he is so satisfied. It is to be noted that the auditor is required to make only enquiries and not investigate into the matters referred to therein.

(2 Marks)

Clause (a) of Section 143(1) requires the auditor to inquire: “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”.

(1 Mark)

If the auditor finds that the loans and advances have not been properly secured, he may enter an adverse comment in the report but cannot probably doubt the true view of the accounts by reference to this fact so long the loans and advances are properly described and presented in terms of Part I of Schedule III to the Companies Act. Further the auditor to inquire whether or not the terms on which the loans or advances have been made are prejudicial to the interests of the company or its members. If it is, he should qualify his report

(1.5 Marks)

If trade receivables and trade payables are adjusted inter se, this amounts to merely book entries. The auditor, as per clause (b) of section 143(1), should enquire “whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company”. This proposition has got to be inquired into by reference to the effects of the book entries, unsupported by transactions, on the legitimate interests of the company. The auditor has to exercise his judgment based on certain objective standards”.

(1.5 Marks)

Regarding Personal Expenses, Clause (e) of section 143(1) requires the auditor to inquire: “Whether personal expenses have been charged to revenue account”. The charging to revenue of such personal expenses, either on the basis of the company’s contractual obligations, or in accordance with accepted business practice, is perfectly normal and legitimate or does not call for any special comment by the auditor. Where, however, personal expenses not covered by contractual obligations or by accepted business practice are incurred by the company and charged to revenue account, it would be the duty of the auditor to report thereon. It suffices to say that if the auditor finds that personal expenses have been charged to revenue and if the amounts are material, he should qualify his report also.

(2 Marks)

In the instant case, Mr. Kartik, the statutory auditor of Tesla Ltd., needs to enquire in light of above provisions, as a result of the enquiries if he is satisfied then there is no further duty to report on these matters.

Answer-2 :

1. As per SA 250 “Consideration of Laws and Regulations in an Audit of Financial Statement”, it is the responsibility of management, with the oversight of those charged with governance, to ensure that the entity’s operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity’s financial statements. **(1 Mark)**
2. The auditor is responsible for obtaining reasonable assurance that the financial statements, taken as a whole, are free from material misstatement, whether caused by fraud or error. **(0.5 Mark)**
3. In conducting an audit of financial statements, the auditor takes into account the applicable legal and regulatory framework. **(0.5 Mark)**

4. Owing to the inherent limitations of an audit, there is an unavoidable risk that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the SAs. **(1 Mark)**
5. If the auditor concludes that the non-compliance has a material effect on the financial statements, and has not been adequately reflected in the financial statements, the auditor shall express a qualified or adverse opinion on the financial statements. **(1 Mark)**
6. Further, as per Section 128 of the Companies Act, 2013, a company has to maintain proper books of account on accrual basis and according to the double entry system of accounting. **(1 Mark)**
7. Additionally, as per Section 43B of the Income Tax Act, 1961, there are certain expenses, which includes any sum payable by the assessee as an employer by way of contribution to any provident fund, which are allowed only on its actual payment. **(1 Mark)**
8. In the instant case, out of Rs.24 lakhs of provident fund contribution accounted in the books, only Rs.4 lakhs has been remitted to the authorities due to financial problems during the year. Hence, even though accrual principles have been followed, disclosure of non-payment is necessary. The auditor should disclose the fact of non-payment of Rs.20 lakhs in his report. **(1 Mark)**

Answer-3 (a) :

Areas excluded from scope of Peer Reviewer are:

- (i) Management Consultancy Engagements; **(0.5 Mark)**
- (ii) Representation before various Authorities; **(0.5 Mark)**
- (iii) Engagements to prepare tax returns or advising clients in taxation matters; **(0.5 Mark)**
- (iv) Engagements for the compilation of financial statements; **(0.5 Mark)**
- (v) Engagements solely to assist the client in preparing, compiling or collating information other than financial statements; **(0.5 Mark)**
- (vi) Testifying as an expert witness; **(0.5 Mark)**
- (vii) Providing expert opinion on points of principle, such as Accounting Standards or the applicability of certain laws, on the basis of facts provided by the client; and **(0.5 Mark)**
- (viii) Engagement for Due diligence. **(0.5 Mark)**

Answer-3 (b) :

- 1) The auditor has to comment on various specific issues as mentioned in the Long Form Audit Report of the bank. While evaluating the efficacy of internal controls over advances, the auditor should particularly examine those aspects on which he is required to comment in his long form audit report. **(1 Mark)**
- 2) Thus, he should examine-(i) Whether the loan applications are complete and in prescribed form;(ii) Procedural instructions regarding grant/ renewal/ enhancement of facilities have been complied with;(iii) Sanctions are within delegated authority and disbursements are as per terms of the sanction;(iv) Documentation is complete; and supervision is timely, effective and as per prescribed guidelines. **(1 Mark)**

- 3) The auditor can gather the requisite evidence by examining relevant documents (such as loan application forms, supporting documentation, sanctions, security documents, etc.) and by obtaining information and explanations from the branch management in appropriate cases. (1 Mark)
- 4) The auditors must familiarise themselves with those issues and guidance relating to the same and should cover the same during the regular course of audit of advances. (1 Mark)

Answer-3 (c) :

The following factors will be considered for determination of audit risk at financial statement level-

1. Integrity of Management; (1 Mark)
2. Management experience, knowledge and changes during the period; (1 Mark)
3. Unusual pressures on the Management; (1 Mark)
4. Nature of entity's business; (0.5 Mark)
5. Factors affecting the Industry in which the entity operates. (0.5 Mark)

Answer-4 (a) :

A)

1. As per Section 139(1), 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 (1 Mark)
2. The auditor appointed in the annual general meeting shall hold office from the conclusion of that meeting till the conclusion of the sixth annual general meeting, with the meeting wherein such appointment has been made being counted as the first meeting (1 Mark)
3. Provided that such appointment shall be subject to ratification in every annual general meeting till the sixth such meeting by way of passing of an ordinary resolution (1 Mark)
4. it is hereby clarified that, if the appointment is not ratified by the members of the company, the Board of Directors shall appoint another individual or firm as its auditor or auditors after following the procedure laid down in this behalf under the Act. (1 Mark)
5. In other words , if the appointment is not ratified at any AGM , the auditor shall have to vacate his office , and such vacancy shall amount to casual vacancy and the appointment will be done as per 139(8). (1 Mark)

B)

1. In this case , as per Section 139(10) where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company. (1 Mark)
2. Therefore , R & Co. can continue to be the auditors of the company.

Answer-4 (b) :

(i) Failure to take Permission before Accepting Employment:

- 1) As per Clause (11) of Part I of First Schedule to the Chartered Accountants Act, 1949, Mr. J will be held guilty since he has accepted the full time salaried employment in addition to the practice of Chartered Accountancy without obtaining permission of the Institute. (1 Mark)

- 2) The Chartered Accountants Regulation, 1988 provide that a Chartered Accountant in practice shall not engage in any business or occupation other than the profession of accountancy except with the permission granted in accordance with the provisions contained in Regulation 190A. Part (B) of Appendix 10 to the Chartered Accountants Regulations, 1988 requires member of the Institute in practice to engage in full-time or part-time employment after obtaining the specific and prior approval of the Council. **(1 Mark)**
- 3) Further, Mr. Jina will be held guilty of professional misconduct under Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949 if contravenes any of the provisions of the Act since he has failed to inform the Institute. **(1 Mark)**
- (ii) Failure to Observe the Regulations:**
- 1) As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member shall be held guilty of professional misconduct if he contravenes any provision of the Act or the regulations made thereunder. **(1 Mark)**
- 2) The chartered accountant, as per Regulations also, is expected to impart proper practical training. In the instant case, the articled clerk must have not been attending office on a regular basis and the explanation of the Chartered Accountant cannot be accepted particularly in view of the fact that the chartered accountant did not obtain certificate from the Principal to confirm the timings. **(1 Mark)**
- 3) It is also quite likely that the articled clerk would be availing leave quite often and coming late to the office. Under the circumstances, the Chartered Accountant is guilty of professional misconduct in regard to the discharge of his professional duties. **(1 Mark)**

Answer-5 (a) :

Investigation of suspected embezzlement of cash receipts: While doing investigation of suspected embezzlement of cash receipts of a departmental store, we would like to take below mentioned steps:

- (i) Before proceeding to investigate a suspected embezzlement, the investigating accountant should ascertain the exact duties of the person concerned who is suspected to have committed a fraud; his relationship to the general routine of the office, and the circumstances in which any known instances of defalcation have come to light. Such an enquiry would give a clue to promising avenues of investigation. Greater the authority of the individual suspected of a fraud, wider would be the field which would have to be covered by the investigation. **(2 Marks)**
- (ii) He should also examine the line of responsibility between the various members of the staff **(0.5 Mark)**
- (iii) He should have a look at the system of internal control in operation for spotting out the weaknesses, if any, that may exist in it. Relying on the above study, he should direct his enquiry towards those aspects of the business where there has been excessive control in the hands of single persons, without any supervision by any other person or any other inherent weakness that may be in existence in the system. **(1 Mark)**
- (iv) On the assumption that cash may have been diverted before being entered in the books, evidence as regards income received from different sources should be scrutinised, e.g., inventory, sales summaries, rental registers, correspondence with customers, advices of travelling salesmen and counterfoils or receipts. **(1 Mark)**
- (v) Carbon copies of receipts marked 'duplicate', should be scrutinised to confirm that they are in fact copies of receipts issued earlier. **(0.5 Mark)**

- (vi) By recalling paying-in-slips from the bank the details of cash deposited on each day should be compared with those shown in the Cash Book. **(0.5 Mark)**
- (vii) The record of sales of scrap of waste paper, that of collection of rents from labourers temporarily accommodated in the company's quarters, that of refunds of amounts deposited with the electric supply co., and other Government authorities should be examined for finding out if any of these amounts have been misappropriated. **(1 Mark)**
- (viii) Cash sales should be vouched in detail. Recoveries from customers and sundry parties should be checked with the copies of receipts issued to them; deductions made on account of cash discounts should be reviewed. **(1 Mark)**
- (ix) All withdrawals from the bank should be checked by reference to corresponding entries in the bank pass book **(0.5 Mark)**

Answer-5 (b) :

- 1) The need for Unexpired Risks Reserve arises from the fact that all policies are renewed annually except in specific cases where short period policies are issued. Since the insurers close their accounts on a particular date, not all risks under policies expire on that date. Many policies normally extend beyond this date into the following year during which risks continue. **(1 Mark)**
- 2) In other words, at the closing date, there is unexpired liability under various policies which may occur during the remaining term of the policy beyond the year end. The effort involved in calculating unexpired portion of premium under each policy is very time consuming therefore, a simple formula to derive a percentage of premium income to be allocated to reserve for unexpired risks is adopted **(1 Mark)**
- 3) According to the requirements of the Insurance Act, 1938, for the purpose of maintaining solvency margin, it is sufficient if the provision is made for unexpired risks at 50 per cent for Fire, Marine Cargo and Miscellaneous business except for Marine Hull which has to be 100 per cent. It may be mentioned that the insurance companies are governed by the provisions of Section 44 of the Income Tax Act, 1961. In this regard Rule 5 of the First Schedule to the Income Tax Rules-Computation of Profit & Loss of General Insurance Business-provides for creation of a reserve for unexpired risks as prescribed under Rule 6E of the said rules. **(2 Marks)**
- 4) According to this Rule, the insurance companies are allowed a deduction of 50 per cent of net premium income in respect of Fire and Miscellaneous Business and 100 per cent of the net premium income relating to Marine Insurance business. In view of this, the reserves are created at the rates allowed under the Income -tax Act. **(1 Mark)**