



**J.K. SHAH<sup>®</sup>**  
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**SUGGESTED SOLUTION**  
**CA FINAL NOVEMBER 2016 EXAM**  
**AUDIT**  
**Test Code - F N J 6 0 6 9**  
**BRANCH - (MUMBAI) (Date :18.09.2016)**

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**Answer-1 (a) :**

- (i) Failure to obtain information: Clause (8) of Part I of Second Schedule to the Chartered Accountants Act, 1949 states that if a Chartered Accountant in practice fails to obtain sufficient information to warrant the expression of an opinion or his exceptions are sufficient material to negate the expression of an opinion, the chartered accountant shall be deemed to be guilty of a professional misconduct.

In the instant case Mr. W, a practicing Chartered Accountant issued a certificate of circulation of a periodical without going into the most elementary details of how the circulation of a periodical was being maintained i.e, by not looking into the financial records, bank statements or bank pass books, by not examining evidence of actual payment of printers bills and by not caring to ascertain how many copies were sold and paid for.

The chartered accountant should not express his opinion before obtaining the required data and information. As an auditor, Mr.W ought to have verified the basic records to ensure the correctness of circulation figures.

Thus, in the present case Mr.W will be held guilty of professional misconduct as per Clause (8) of Part I of Second Schedule to the Chartered Accountants Act, 1949.

Alternative Solution is possible on the basis of Clause (7) of Part I of Second Schedule to the Chartered Accountants Act, 1949. **(3 Marks)**

- (ii) Failure to Observe the Regulations: 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 of the provisions of the Act or the regulations made thereunder or any guidelines issued by the Council. The chartered accountant, as per Regulations also, is expected to impart proper practical training. There is a specific circular issued which guides on timing for training for articleship.

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. 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 misconduct for making a misstatement to the institute in regard to the discharge of his professional duties.

**Note:** Alternative Solution is possible as per Schedule II, Part II, Clause (3), a member is deemed to be guilty of professional misconduct if he includes in any information, statement, return or form to be submitted to the Institute, Council or any of its Committees, Director (Discipline), Board of Discipline, Disciplinary Committee, Quality Review Board or the Appellate Authority any particulars knowing them to be false. In the instant case, Q knew about the college timing of his articled assistant and he had given false information to the institute knowing them to be false and hence he will be deemed to be guilty of professional misconduct. **(3 Marks)**

**Answer-1 (b) :**

- (i) Certification of Financial Forecast: Under Clause (3) of Part I of Second Schedule to The Chartered Accountants Act, 1949, a CA 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.

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. Hence, the offer can be accepted if the above requirements are complied with. **(2 Marks)**

- (ii) Bringing Disrepute to the Profession: A Chartered Accountant is expected to maintain the highest standard of integrity even in his personal affairs and any deviation from these standards, even in his non-professional work would expose him to disciplinary action.

A member is liable to disciplinary action under Section 21 of the Chartered Accountants Act, if he is found guilty of any professional or "Other Misconduct".

As per Clause (2) of Part IV of the First Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of other misconduct, if he 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.

The question whether a particular act or omission constitutes "other misconduct" should be based on fact and circumstances of each case.

Under Negotiable Instruments Act 1881, where any cheque drawn by a person for the discharge of any liability is returned by the bank unpaid, either for insufficiency of funds or the cheque amount exceeds the arrangements made by the drawer of the cheque, the drawer of such cheque shall be deemed to have committed an offence.

In the given case the cheque was dishonoured with the remark "refer to drawer". However, such dishonour need not necessarily be only due to insufficiency of funds. If it is proved that the cheques were dishonoured due to insufficiency of funds, the CA would be held guilty of "other misconduct".

**(2 Marks)**

- (iii) Failure to Communicate with the Previous Auditor: As per Clause (8) of Part I of First Schedule to the CA Act 1949, a chartered accountant in practice is deemed to be guilty of professional misconduct if he accepts a position as auditor previously held by another chartered accountant or a certified auditor who has been issued certificate under the Restricted Certificates Rules 1932, without first communicating with him in writing.

In the instant case, PQ & Co. accepted VAT – audit under State Level Act, carried out by another firm of chartered accountants in the previous year, without prior communication with the previous auditor.

A communication is mandatory requirement for all types of audit, if the previous auditor is a chartered accountant. Hence, the firm is guilty of professional misconduct. **(2 Marks)**

- (iv) In terms of Clause (11) of Part I of the First Schedule to the CA Act, 1949, a CA in practice cannot engage (unless permitted by the council) in any business or occupation other than the profession of Chartered accountant, but he can be a director of a company wherein he or any of his partners is not interested in such company as auditor.

However, public conscience is expected to be ahead of law and the requirement of independence should be interpreted much more strictly. Members should thus not place themselves in position which would either compromise or jeopardise their independence. In view of the above, an auditor of a subsidiary cannot be a director of a holding company as it will affect his independence. **(2 Marks)**

### Answer-2 (a) :

The main objective of Peer Review is to ensure that in carrying out the assurance service assignments, the members of the Institute- **(0.5 Mark)**

- (1) comply with Technical, Professional and Ethical Standards as applicable including other regulatory requirements thereto and **(0.5 Mark)**

- (2) have in place proper systems including thereof, to amply demonstrate the quality of the assurance services. **(0.5 Mark)**

Thus, the primary objective of peer review is not to find out deficiencies but to improve the quality of services rendered by members of the profession. The Statement of Peer Review also makes it clear that the peer review, "does not seek to redefine the scope and authority of the Technical

Standards specified by the Council but seeks to enforce them within the parameters prescribed by the Technical Standards". (1.5 Marks)

The peer review is directed towards maintenance as well as enhancement of quality of assurance services and to provide guidance to members to improve their performance and adherence to various statutory and other regulatory requirements. Such an objective of the peer review process makes it amply clear that the reviewer is not going to sit on the judgement of the practice unit while rendering assurance services but to evaluate the procedure followed by the practice unit in rendering such a service. (2 Marks)

Accordingly, where a practice unit is not following technical standards, the reviewers are expected to recommend measures to improve the procedures. To elaborate further, the key objective of peer review exercise is not to identify isolated cases of engagement failure, but to identify weaknesses that are pervasive and chronic in nature. For instance, absence of formal planning of an audit represents a serious deficiency that needs to be remedied by the practice unit (1.5 Marks)

An instance of the auditor not carrying out physical verification of furniture and fixture may not attract the same comment. However, certain items of assets are best verified through the physical verification process and not adopting the same procedure may rightly be viewed as a systemic failure. The conclusion, therefore, is that the peer review seeks to identify and address patterns of non-compliance with quality control standards. (1.5 Marks)

**Answer-2 (b) :**

- a) The **introductory paragraph** in the auditor's report shall :
1. Identify the entity whose financial statements have been audited. (0.5 Mark)
  2. State that the financial statements have been audited. (0.5 Mark)
  3. Identify the title of each statement that comprises the financial statement. (0.5 Mark)
  4. Refer to the summary of significant accounting policies and their explanatory information;  
and (0.5 Mark)
  5. Specify the date or period covered by each financial statement comprising the financial statements. (0.5 Mark)
- b) **Title** : The auditor's report shall have a title that clearly indicates that it is the report of an independent auditor. (0.5 Mark)
- c) **Addressee** : The auditor's report shall be addressed as required by the circumstances of the engagement. (0.5 Mark)
- d) **Place of Signature** :The auditor's report shall name specific location, which is ordinarily the city where the audit report is signed. (0.5 Mark)

**Answer-3 (a) :**

As per Section 143 (1) of the Companies Act, 2013, an auditor is required to make the following specific enquiries during the course of audit :-

1. 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)
2. Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company. (1 Mark)
3. 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". (1 Mark)
4. Whether loans and advances made by the company have been shown as deposits. (1 Mark)
5. Whether personal expenses have been charged to revenue account. (1 Mark)
6. 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.” (1 Mark)

**Answer-3 (b) :**

1. An Internal Control system can provide only reasonable assurance that the management’s objectives in establishing the system are achieved, i.e. it cannot provide absolute assurance that the control objectives are achieved. This is due to the fact that any internal control system has certain internal limitations. The limitations may arise due to:
  - (i) Controls have to be cost-effective. (0.5 Mark)
  - (ii) Most controls address transaction of usual and routine nature. They fail in respect of transactions of unusual nature. (0.5 Mark)
  - (iii) The potential of human error remains in any system of control. (0.5 Mark)
  - (iv) In any system of control, the possibility of circumvention of controls through collusion between two or more persons might exist. (0.5 Mark)
  - (v) A member of the management may himself override the controls. (0.5 Mark)
  - (vi) Controls may not keep pace with changes in condition. (0.5 Mark)
  - (vii) Management itself may manipulate transactions or accounting estimates. (0.5 Mark)
2. The inherent limitation of internal control system requires the auditor to perform substantive procedure to be able to express an opinion. (0.5 Mark)

**Answer-4 (a) :**

Audit Programme of Multiplex

- (i) Peruse the Memorandum of Association and Articles of Association of the entity (0.5 Mark)
- (ii) Ensure the object clause permits the entity to engage in this type of business. (0.5 Mark)
- (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 (1.5 Marks)
- (iv) Verify the internal control system and its effectiveness relating to the income from cafe shops, pubs etc., located within the multiplex (0.5 Mark)
- (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. (0.5 Mark)
- (vi) Verify the system of collection from the parking areas in respect of the vehicles parked by the customers. (0.5 Mark)
- (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. (1 Mark)
- (viii) Verify the system of payment of salaries and other benefits to the employees and ensure that statutory requirements are complied with. (0.5 Mark)
- (ix) Verify the payments effected in respect of the maintenance of the building and ensure the same is in order. (0.5 Mark)

**Answer-4 (b) :**

- (A) **Long form Audit Report:** The long form Audit Report has to be furnished by the auditor of a bank in addition to the audit report as per the statutory requirement. The matters which the banks require their auditor to deal with in the form of Long Form Audit Report have been specified by Reserve Bank of India. (2 Marks)

(B) **Audit of advances of a Bank:** The items to be covered in the concurrent audit of advances of a bank are as follows-

- (i) Ensure that loans and advances have been sanctioned properly (i.e. after due scrutiny and at the appropriate level). **(0.5 Mark)**
- (ii) Verify whether the sanctions are in accordance with delegated authority **(0.5 Mark)**
- (iii) Ensure that securities and documents have been received and properly charged/ registered. **(0.5 Mark)**
- (iv) Ensure that post disbursement supervision and follow-up is proper, such as receipt of stock statements, instalments, renewal of limits, etc. **(0.5 Mark)**
- (v) Verify whether there is any mis utilisation of the loans and whether there are instances indicative of diversion of funds. **(0.5 Mark)**
- (vi) Check whether the letters of credit issued by the branch are within the delegated power and ensure that they are for genuine trade transactions. **(0.5 Mark)**
- (vii) Check the bank guarantees issued, whether they have been properly worded and recorded in the register of the bank. Whether they have been promptly renewed on the due dates. **(0.5 Mark)**
- (viii) Ensure proper follow-up of overdue bills of exchange. **(0.5 Mark)**
- (ix) Verify whether the classification of advances has been done as per RBI guidelines.**(0.5 Mark)**
- (x) Verify whether the submission of claims to DICGC and ECGC is in time. **(0.5 Mark)**
- (xi) Verify that instances of exceeding delegated powers have been promptly reported to controlling/Head Office by the branch and have been got confirmed or ratified at the required level **(0.5 Mark)**
- (xii) Verify the frequency and genuineness of such exercise of authority beyond the delegated powers by the concerned officials. **(0.5 Mark)**