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SUGGESTED SOLUTION
CA FINAL NOVEMBER 2016 EXAM
AUDIT
Test Code - F N J 6 0 7 0
BRANCH - (MUMBAI) (Date :28.08.2016)

Head Office : Shraddha, 3rd Floor, Near Chinai College, Andheri (E), Mumbai – 69.

Tel : (022) 26836666

Answer-1 (a) :

Validity of appointment as a statutory auditor: To ensure that the appointment is valid, the incoming auditor should take the following steps before accepting his appointment:

1. Ceiling limit: Ensure that a certificate has been issued under section 139 of the Companies Act, 2013 so that the total number of company audits held by the firm (including the new appointment) will not exceed the specified number. **(1 Mark)**
2. Resolution at AGM: Verify that at AGM of the Company, a proper resolution is passed. Inspect general meeting minutes book to see that the appointment is duly recorded. **(1 Mark)**
3. Compliance with law: Satisfy that the legal procedure contemplated in section 139 and 140 of the said Act, dealing with the appointment and removal of existing auditor, have been followed. Also check whether section 139(5) and 139(7) (in case of a government company or any other company owned or controlled, directly or indirectly, by the Central Government, or by any State Government, or Governments, or partly by the Central Government and partly by one or more State Governments- appointment by the Comptroller and Auditor General of India) are attracted and complied with. **(2 Marks)**
4. Code of conduct: Communicate with the previous auditor, if any, in writing, to ascertain if there are any professional reasons for not accepting the appointment. **(1 Mark)**

Answer-1 (b) :

Appointment of the Auditor: Section 141 of the Companies Act 2013 (herein after referred as the Act) deals with the eligibility, qualifications and disqualifications of Auditors. Sub-section (3)(f) of the Section 141 of the Act, explicitly disqualifies a person from being appointed as an auditor of a company whose relative is a director or is in the employment of the company as a director or key managerial personnel. **(1 Mark)**

According to the code of ethics there is no direct restriction on a member to accept the audit of a company where his relative is director. Further, as per Clause 4 of Part 1 of the Second Schedule to the Chartered Accountants Act, 1949 there is professional misconduct if the member expresses his opinion on financial statements of any business or enterprise in which he, his firm or a partner in his firm has a substantial interest. Here also there is no mention of relative. But this clause has been inserted for the purpose of ensuring the independence of the auditor so that his opinion on the financial statements is an independent opinion free of any interest **(2 Marks)**

In August 2008 the council has issued a guideline in this respect. As per that guideline a member of the institute shall desist from expressing his opinion on financial statements of any business or enterprise in which one or more persons, who are relatives within the meaning of section 6 of the Companies Act, 1956 (now Section 2(77) of the Companies Act, 2013), have either by way of themselves or in conjunction with such members, a substantial interest in the said business or enterprise. Therefore if the director has substantial interest in the company then his relative should not accept the appointment of auditor of that company. **(2 Marks)**

In the instant case, Mr. Ramesh is the relative of a Director of the Company, therefore he should not accept the appointment as an auditor of that company.

Answer-2 (a) :

As per Section 141 ,The following persons shall not be eligible for appointment as an auditor of a company, namely:—

- (a) a body corporate other than a limited liability partnership registered under the Limited Liability Partnership Act, 2008; **(0.5 Mark)**
- (b) an officer or employee of the company; **(0.5 Mark)**
- (c) a person who is a partner, or who is in the employment, of an officer or employee of the company; **(0.5 Mark)**
- (d) a person who, or his relative or partner—
 - (i) 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: Provided that the relative may

- hold security or interest in the company offace value not exceeding one thousand rupees or Rs. 1,00,000.
- (ii) is indebted to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of Rs. 5,00,000; or
- (iii) has given a guarantee or provided any security in connection with the indebtedness of any third person to the company, or its subsidiary, or its holding or associate company or a subsidiary of such holding company, in excess of Rs 1,00,000; **(2 Marks)**
- (e) a person or a firm who, whether directly or indirectly, has business relationship with the company, or its subsidiary, or its holding or associate company or subsidiary of such holding company or associate company **(1 Mark)**
- (f) a person whose relative is a director or is in the employment of the company as a director or key managerial personnel; **(0.5 Mark)**
- (g) a person who is in full time employment elsewhere or a person or a partner of a firm holding appointment as its auditor, if such persons or partner is at the date of such appointment or reappointment holding appointment as auditor of more than twenty companies; **(1 Mark)**
- (h) a person who has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed from the date of such conviction; **(1 Mark)**
- (i) any person whose subsidiary or associate company or any other form of entity, is engaged as on the date of appointment in consulting and specialised services as provided in section 144. **(1 Mark)**

Answer-2 (b) :

- As per Section 128(3), the books of account and other books and papers maintained by the company within India shall be open for inspection at the registered office of the company or at such other place in India by any director during business hours. **(2 Marks)**
- Also the inspection in respect of any subsidiary of the company shall be done only by the person authorised in this behalf by a resolution of the Board of Directors. **(1 Mark)**
- Where an inspection is made , the officers and other employees of the company shall give to the person making such inspection all assistance in connection with the inspection which the company may reasonably be expected to give. **(1 Mark)**
- Therefore , Mr Nimit is entitled to an inspection of books of accounts provided he follows the procedure stated above. **(1 Mark)**

Answer-3 (a) :

As per SA 700, "Forming an Opinion and Reporting on Financial Statements", the auditor's report includes the following basic elements:

- A title; **(0.5 Mark)**
- An addressee, as required by the circumstances of the engagement; **(0.5 Mark)**
- An introductory paragraph that identifies the financial statements audited; **(0.5 Mark)**
- A description of the responsibility of management (or other appropriate term) for the preparation of the financial statements; **(0.5 Mark)**
- A description of the auditor's responsibility to express an opinion on the financial statements and the scope of the audit, that includes:
 - A reference to Standards on Auditing and the law or regulation; and
 - A description of an audit in accordance with those Standards; **(1 Mark)**
- An opinion paragraph containing an expression of opinion on the financial statements and a reference to the applicable financial reporting framework used to prepare the financial statements (including identifying the jurisdiction of origin of the financial reporting framework); **(0.5 Mark)**
- The auditor's signature; **(0.5 Mark)**
- The date of the auditor's report; and **(0.5 Mark)**
- The place of signature. **(0.5 Mark)**

Auditor's Report for Audits Conducted in Accordance with Both Auditing Standards issued by the Institute of Chartered Accountants of India and International Standards on Auditing.

Answer-3 (b) :

1. This case requires attention to SA 560 "Subsequent Events" and AS 4 "Contingencies and Events occurring after the Balance Sheet Date". **(1 Mark)**
2. As per AS 4 "Contingencies and Events occurring after the Balance Sheet Date", adjustments to assets and liabilities are required for events occurring after the balance sheet date that provide additional information materially affecting the determination of the amounts relating to conditions existing at the balance sheet date or that indicate that the fundamental accounting assumption of going concern (i.e., the continuance of existence or substratum of the enterprise) is not appropriate. **(1 Mark)**
3. AS 4 also requires disclosure of the non-adjusting event, in the report of the approving authority. **(1 Mark)**
4. Further, as per SA 560 "Subsequent Events", the auditor should assure that all events occurring subsequent to the date of the financial statements and for which the applicable financial reporting framework requires adjustment or disclosure have been adjusted or disclosed. **(1 Mark)**
5. The event took place after the close of the accounting year and does not relate to conditions existing at the balance sheet date. Thus, it will have no effect on items appearing at the balance sheet date because as per AS 4 "Contingencies and Events Occurring after Balance Sheet Date" have to be adjusted that provide evidence of conditions existing as at the balance sheet date. However, the auditor has to ensure that this loss will not materially affect the substratum of the enterprises as per its size, nature and complexity of operations. **(1 Mark)**
6. Thus, subject to satisfaction in respect of non-violation of going concern concept, the company has correctly accounted by not providing provision. However, the auditor is required to ensure the proper disclosure of abovementioned event. **(1 Mark)**

Answer-4 (a) :

1. As per SA 240, "The Auditor's responsibilities relating to Fraud in an Audit of Financial Statements", fraudulent financial reporting involves intentional misstatements or omissions of amounts or disclosures in financial statements to deceive financial statement users. **(1 Mark)**
2. It may be accomplished by manipulation, falsification, or alteration of accounting records or supporting documents from which the financial statements are prepared or Misrepresentation in, or intentional omission from, the financial statements of events, transactions or other significant information or intentional misstatements involve intentional misapplication of accounting principles relating to measurement, recognition, classification, presentation, or disclosure etc. **(1.5 Marks)**
3. It often involves management override of controls, misappropriation of assets etc that otherwise may appear to be operating effectively. Fraud can be committed by management overriding controls using such techniques as **(Any 7)**:
 - (i) Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives.
 - (ii) Inappropriately adjusting assumptions and changing judgments used to estimate account balances.
 - (iii) Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period.
 - (iv) Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements.
 - (v) Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity.
 - (vi) Altering records and terms related to significant and unusual transactions.
 - (vii) Embezzling receipts (for example, misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts).
 - (viii) Stealing physical assets or intellectual property (for example, stealing inventory for personal use or for sale, stealing scrap for resale, colluding with a competitor by disclosing technological data in return for payment).

- (ix) Causing an entity to pay for goods and services not received (for example, payments to fictitious vendors, kickbacks paid by vendors to the entity's purchasing agents in return for inflating prices, payments to fictitious employees).
- (x) Using an entity's assets for personal use (for example, using the entity's assets as collateral for a personal loan or a loan to a related party).

Any 7, 1/2 mark each, total 3 1/2 marks

Answer-4 (b) :

1. SA 710, "Comparative Information – Corresponding Figures and Comparative Financial Statements", establishes standards on the auditor's responsibilities regarding comparatives **(0.5 Mark)**
2. The auditor shall determine whether the financial statements include the comparative information required by the applicable financial reporting framework and whether such information is appropriately classified. **(1 Mark)**
3. For this purpose, the auditor shall evaluate whether:(i) The comparative information agrees with the amounts and other disclosures presented in the prior period; and(ii) The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed. **(2 Marks)**
4. If the auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. **(1 Mark)**
5. If the auditor had audited the prior period's financial statements, the auditor shall also follow the relevant requirements of SA 560 (Revised). **(0.5 Mark)**
6. As required by SA 580 (Revised), the auditor shall request written representations for all periods referred to in the auditor's opinion. The auditor shall also obtain a specific written representation regarding any prior period item that is separately disclosed in the current year's statement of profit and loss. **(1 Mark)**

Answer-5 :

1. The physical verification of fixed assets is the primary responsibility of the management. **(0.5 Mark)**
2. The auditor, however, is required to examine the verification programme adopted by the management. He must satisfy himself about the existence, ownership and valuation of fixed assets. **(0.5 Mark)**
3. In the case of Smith Ltd., the auditor has not been able to verify the existence and value of some machinery despite the verification procedure followed in routine audit. He accepted the certificate given to him by the management without making any further enquiry. **(0.5 Mark)**
4. As per SA 580 "Written Representations", when representation relate to matters which are material to the financial information, then the auditor should seek corroborative audit evidence for other sources inside or outside the entity. **(0.5 Mark)**
5. He should evaluate whether such representations are reasonable and consistent with other evidences and should consider whether individuals making such representations can be expected to be well informed on the matter. "Written Representations" cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. **(1 Mark)**
6. If the auditor is unable to obtain sufficient appropriate audit evidence that he believes would be available regarding a matter which has or may have a material effect on the financial information, this will constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter. Therefore, the approach adopted by the auditor is not right. **(1 Mark)**