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AUDITING

Test Code - I N J 1 0 0 2

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- i) In conducting a joint audit, the auditor(s) should bear in mind the possibility of existence of any fraud or error or any other irregularities in the accounts under audit. The principles laid down in SA 200, SA 240 and SA 299 need to be read together for arriving at any conclusion. **(0.5 Mark)**
- ii) The principle of joint audit involves that each auditor is entitled to assume that other joint auditor has carried out his part of work properly. **(0.5 Mark)**
- iii) However, in this case, if it can be assumed that the joint auditors E and S have exercised reasonable care and skill in auditing the accounts of X & Y Ltd. and yet the concealment of transaction has taken place, both joint auditors cannot be held responsible for professional negligence. However, if such concealment could have been discovered by the exercise of reasonable care and skill, the auditors would be responsible for professional negligence. **(2 Marks)**
- iv) Therefore, it has to be seen that while dividing the work, the joint auditors have not left any area unattended and exercised reasonable care and skill while doing their work. **(1 Mark)**

Ans.1. (b) Tenure of Appointment:

- i) 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. **(1 Mark)**
- ii) But in this regard it is to be noted that the company shall place the matter relating to such appointment of ratification by member at every Annual General Meeting. **(1 Mark)**
- iii) In case the annual general meeting is not held within the period prescribed, the auditor will continue in office till the annual general meeting is actually held and concluded. **(1 Mark)**
- iv) Therefore, Ninu shall continue to hold office till the conclusion of the annual general meeting. **(1 Mark)**

Ans.2. (a) Circumstances where Retiring Auditor Cannot be Reappointed:

In the following circumstances, the retiring auditor cannot be reappointed-

- (i) A specific resolution has not been passed to reappoint the retiring auditor. **(1 Mark)**
- (ii) The auditor proposed to be reappointed does not possess the qualification prescribed under section 141 of the Companies Act, 2013. **(1 Mark)**
- (iii) The proposed auditor suffers from the disqualifications under section 141(3), 141(4) and 144 of the Companies Act, 2013. **(1 Mark)**
- (iv) He has given to the company notice in writing of his unwillingness to be reappointed **(1 Mark)**
- (v) A resolution has been passed in AGM appointing somebody else or providing expressly that the retiring auditor shall not be reappointed. **(1 Mark)**
- (vi) A written certificate has not been obtained from the proposed auditor to the effect that the appointment or reappointment, if made, will be in accordance within the limits specified under section 141(3)(g) of the Companies Act, 2013. **(1 Mark)**

Ans.2. (b) Disclosure of Related Party Transaction:

- i) As per SA 550 'Related Parties', in examining the identified related party transactions, the auditor should obtain sufficient appropriate audit evidence as to whether these transactions have been properly recorded and disclosed. **(1 Mark)**
- ii) As per paragraph 23 of AS 18 'Related Party Disclosures', transactions of X Ltd. for the first quarter with Y Ltd. up to 30th June, 2014 only are required to be disclosed as related party transactions. **(1 Mark)**
- iii) The transactions for the period in which related party relationship did exist need not to be disclosed as related party transactions. **(1 Mark)**
- iv) As X Ltd. has correctly identified and disclosed the related party transactions, the auditor need not take any further action. **(1 Mark)**

Ans.3. (a) Legal Expenses Incurred by the Company:

- i) Legal expenses of Rs. 13 lakhs incurred to defend the patent of a product of the pharmacy company is revenue expenditure pertaining to the asset since by this expenditure neither any enduring benefit can be obtained in future in addition to what is presently available nor the capacity of the asset would be increased. **(1 Mark)**
- ii) Payment of legal fees is normally revenue expenditure irrespective of the amount involved unless same is incurred to bring any new asset into existence. **(1 Mark)**
- iii) Hence, treating such expenditure as capital expenditure is incorrect. **(1 Mark)**
- iv) This would result in overstatement of the value of asset and profit and calls for qualification in the audit report. **(1 Mark)**

Ans.3. (b) Powers of Comptroller and Auditor General:

The Comptroller and Auditor General's (Duties, Powers and Conditions of Service) Act, 1971 gives the following powers to the C&AG in connection with the performance of his duties-

- (i) To inspect any an office of accounts under the control of the union or a State Government including office responsible for creation of initial or subsidiary accounts. **(1 Mark)**
- (ii) To require that any accounts, books, papers and other documents which deal with or are otherwise relevant to the transactions under audit, be sent to specified places. **(1 Mark)**
- (iii) To put such questions or make such observations as he may consider necessary to the person in-charge of the office and to call for such information as he may require for preparation of any account or report, which is his duty to prepare. **(1 Mark)**

In carrying out the audit, the C&AG has the power to dispense with any part of detailed audit of any accounts or class of transactions and to apply such limited checks in relation to such accounts or transaction as he may determine. **(1 Mark)**

- Ans.3. (c)** As per SA 505 "External Confirmation", the reliability of external confirmations depends among other factors, upon the application of appropriate procedures by the auditor in designing the external confirmation request, performing the external confirmation procedures, and evaluating the results of the external confirmation procedures. **(1 Mark)**

The factors that affect the reliability of confirmations include:

- (i) The control which the auditor exercises over confirmation request and responses; **(1 Mark)**
- (ii) The character of respondents and **(1 Mark)**
- (iii) Any restrictions included in the response or imposed by the management **(1 Mark)**

- Ans.4.** Event occurring after the balance sheet date: This case requires attention to SA 560 "Subsequent Events" and AS 4 "Contingencies and Events occurring after the Balance Sheet Date".

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. **(2 Marks)**

AS — 4 also requires disclosure of the non-adjusting event, in the report of the approving authority. **(1 Mark)** 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. **(2 Marks)**

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. **(2 Marks)**

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)**

Ans.5. (a) SA 550 on “Related Parties” casts duty on auditor to obtain sufficient appropriate audit evidence regarding the identification and disclosure by management or related parties and the related party transactions that are material to the financial statement. **(1.5 Marks)**

In the present case, the transaction with the huge purchases from other entity of same management is prima facie, prejudicial to the interest of ABC Ltd. Auditor in this case, should perform additional extended audit procedures to confirm the adequacy of correctness and disclosure of related party transactions by the management. Auditor should demand management representation regarding the adequate disclosure of the same. **(1.5 Marks)**

If the management fails to disclose the related party transactions, the auditor should express qualified opinion or disclaimer of opinion in the audit report, as appropriate **(1 Mark)**

Ans.5. (b)

1. The auditor shall communicate in writing with those charged with governance when, in the auditor’s professional judgment, oral communication would not be adequate. Where matters required by this SA to be communicated are communicated orally, the auditor shall document them, and when and to whom they were communicated. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of the audit documentation. **(2 Marks)**

2. The auditor shall communicate with those charged with governance on a timely basis. **(1 Mark)**

3. The auditor shall evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. Inadequacy may lead auditor to suspicion about existence of misstatement. **(1 Mark)**

Ans.5. (c) Audit of receipts from Entry Fees of an Amusement Park:

(i) Evaluate the internal control system regarding entry and collection for entry tickets including rotation of staff. **(1 Mark)**

(ii) Ensure that tickets are pre numbered. **(1 Mark)**

(iii) Ensure that the deposit of cash collected into the bank account very same next day. **(1 Mark)**

(iv) Compute analytical ratios in respect of the receipts pattern i.e. on weekends, holidays, etc. and make comparisons to draw conclusions. **(1 Mark)**