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**IPCC NOVEMBER 2016 EXAM**

**AUDIT**

**Test Code - I N J 1 0 6 2**

**BRANCH - (MUMBAI) (Date :12.06.2016)**

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**Answer-1 :**

The auditor should consider the following matters in developing his overall plan for the expected scope and conduct of the audit :

- The terms of his engagement and any statutory responsibilities. **(0.5 Mark)**
- The nature and timing of reports or other communication. **(0.5 Mark)**
- The applicable legal or statutory requirements. **(0.5 Mark)**
- The accounting policies adopted by the client and changes in those policies. **(0.5 Mark)**
- The effect of new accounting or auditing pronouncements on the audit. **(0.5 Mark)**
- The identification of significant audit areas. **(0.5 Mark)**
- The setting of materiality levels for audit purposes. **(0.5 Mark)**
- Conditions requiring special attention, such as the possibility of material error or fraud or the involvement of parties in whom directors or persons who are substantial owners of the entity are interested and with whom transactions are likely. **(0.5 Mark)**
- The degree of reliance he expects to be able to place on accounting system and internal control. **(0.5 Mark)**
- Possible rotation of emphasis on specific audit areas. **(0.5 Mark)**
- The nature and extent of audit evidence to be obtained. **(0.5 Mark)**
- The work of internal auditors and the extent of their involvement, if any, in the audit. **(0.5 Mark)**
- The involvement of other auditors in the audit of subsidiaries or branches of the client. **(0.5 Mark)**
- The involvement of experts. **(0.5 Mark)**
- The allocation of work to be undertaken between joint auditors and the procedures for its control and review. **(0.5 Mark)**
- Establishing and coordinating staffing requirements. **(0.5 Mark)**

The auditor should document his overall plan. The form and extent of the documentation will vary depending on the size and complexity of the audit. A time budget, in which hours are budgeted for the various audit areas or procedures, can be an effective planning tool.

**Answer-2 :**

As per SA 230(Revised) "Audit Documentation", audit Working Papers are the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. **(1 Mark)**

Working papers are the

- (a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objective of the auditor; and **(0.5 Mark)**
- (b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements. **(0.5 Mark)**

Besides they serve a number of additional purposes, including the following:

- > Assisting the engagement team to plan and perform the audit. **(0.5 Mark)**
- > Assisting members of the engagement team responsible for supervision to direct and supervise the audit work, and to discharge their review responsibilities in accordance with SA 220. **(0.5 Mark)**
- > Enabling the engagement team to be accountable for its work. **(0.5 Mark)**
- > Retaining a record of matters of continuing significance to future audits. **(0.5 Mark)**
- > Enabling the conduct of quality control reviews and inspections in accordance with SQC 1. **(0.5 Mark)**
- > Enabling the conduct of external inspections in accordance with applicable legal, regulatory or other requirements. **(0.5 Mark)**

Standard on Quality Control (SQC) 1, "Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements", issued by the Institute, provides that, unless otherwise specified by law or regulation, working papers are the property of the auditor. He may at his discretion, make portions of, or extracts from, working papers available to clients, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance engagements, the independence of the auditor or of his personnel **(1.5 Marks)**

Retention of working papers: Working papers should be retained, long enough, for a period of time sufficient to meet the needs of his practice and satisfy any legal or professional requirement of record retention. SQC 1 requires firms to establish policies and procedures for the retention of engagement documentation. The retention period for audit engagements ordinarily is no shorter than seven years from the date of the auditor's report, or, if later, the date of the group auditor's report. **(1.5 Marks)**

**Answer-3 (a) :**

Right of Access to Minute Book:

- i) Section 143(1) of the Companies Act, 2013 grants powers to the auditor that every auditor has a right of access, at all times, to the books of account and vouchers of the company for conducting the audit. **(1 Mark)**
- ii) Further, he is also entitled to require from the officers of the company such information and explanations which he considers necessary for the proper performance of his duties as Auditor. Therefore, he has a statutory right to inspect the directors' minute book. **(1 Mark)**
- iii) In order to verify actions of the company and to vouch and verify some of the transactions of the company, it is necessary for the auditor to refer to the decisions of the shareholders and/or the directors of the company. It is, therefore, essential for the auditor to refer to the Minute Book. In the absence of the Minute Book, the auditor may not be able to vouch/verify certain transactions of the company. **(1 Mark)**
- iv) The refusal by Chairman to provide access to Directors' Minute Book shall constitute limitation of scope as far as the auditor's duties are concerned. The auditor may examine whether by performing alternative procedures, the auditor can substantiate the assertions or else he shall have to either qualify the report or give a disclaimer of opinion. **(1 Mark)**

**Answer-3 (b) :**

Board's Powers to Appoint an Auditor:

- i) As per Section 139(8) of the Companies Act, 2013, any casual vacancy in the office of an auditor shall-
  - a) In the case of a company other than a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Board of Directors within 30 days.  
If such casual vacancy is as a result of the resignation of an auditor, such appointment shall also be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and he shall hold the office till the conclusion of the next annual general meeting;
  - b) In the case of a company whose accounts are subject to audit by an auditor appointed by the Comptroller and Auditor-General of India, be filled by the Comptroller and Auditor General of India within 30 days.  
It may be noted that in case the Comptroller and Auditor-General of India does not fill the vacancy within he said period the Board of Directors shall fill the vacancy within next 30 days. **(2.5 Marks)**
- ii) In the given case, the Board of directors of X Ltd. has appointed Mr. Ram as the auditor due to resignation of the existing auditor(s). The appointment made by the Board is correct, however, such appointment should be approved by the company at a general meeting convened within 3 months of the recommendation of the Board and newly appointed auditor shall hold office till the conclusion of the next annual general meeting. **(1.5 Marks)**

**Answer-3 (c) :**

Ceiling on Number of Audits:

- i) Before appointment is given to any auditor, the company must obtain a certificate from him to the effect that the appointment, if made, will not result in an excess holding of company audit by the auditor concerned over the limit laid down in section 141(3)(g) of the Act which prescribes that 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 person or partner is at the date of such appointment or reappointment holding appointment as auditor of more than 20 companies. (2 Marks)
- ii) In the case of a firm of auditors, it has been further provided that 'specified number of companies' shall be construed as the number of companies specified for every partner of the firm who is not in full time employment elsewhere. (1 Mark)
- iii) If Mr. P, B and S do not hold any audits in their personal capacity or as partners of other firms, the total number of company audits that can be accepted by M/s PBS & Associates is 60. But, the firm is already having audit of 45 companies. (1 Mark)
- iv) So the firm can accept the audit of 15 companies only, which is well within the limit, specified by Section 141(3)(g) of the Companies Act, 2013. (1 Mark)

**Answer-4 (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)

**Answer-4 (b) :**

Adjustment and Disclosure of Surplus on Account of Changes in the Basis of Accounting and Non-recurring

Losses:

- i) AS 5 on "Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies" states that any change in an accounting policy which has a material effect should be disclosed. The impact of, and the adjustments resulting from such change, if material, should be shown in the financial statements of the period in which such change is made, to reflect the effect of such change. (1 Mark)
- ii) Transactions which are of an abnormal or non-recurring nature, may also be considered material, even though prima facie, they do not appear to be material. (1 Mark)
- iii) Materiality is an important and relevant consideration in determining whether or not such exclusion/non-disclosure will distort the true and fair view of the financial statements. Thus, it would be important that users must know the quantum of non-recurring loss. In offsetting and aggregating items care need to be taken to ensure that material items are not offset against each other. (1 Mark)
- iv) Accordingly, it would not be prudent to set off the surplus emanating from a 'change in the basis of accounting' against a 'non-recurring loss'. Accordingly, it would be better to disclose surplus on account of change in the basis of accounting and non-recurring loss separately. (1 Mark)

**Answer-4 (c) :**

Treatment of Amount Incurred to Repair and Overhaul the Machinery:

- i) The money spent on the repair and overhaul of the machinery can be treated as capital expenditure, irrespective of the amount, only if it results in increasing the earning capacity or reduction in the cost of production. In this case, neither the earning capacity has increased nor there is any reduction in the cost of production. (1 Mark)
- ii) In the absence of both these criteria, it is to be treated as revenue expenditure. (1 Mark)

- iii) The mere fact that maintenance expenditure is more than 25% of the original cost of the machinery would not change its nature, i.e. in revenue expenditure. **(1 Mark)**
- iv) If any expenditure of a revenue nature is treated as capital, then it would have the effect of inflating the profit for the year. Consequently, the auditor would be required to qualify his report. **(1 Mark)**

**Answer-5 :**

Disclosure of Related Party Transaction :

- i) As per definition given in the AS 18 "Related Party Disclosure" parties are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions. **(1 Mark)**
- ii) Related party transaction means a transfer of resources or obligations between related parties, regardless of whether or not a price is charged. **(1 Mark)**
- iii) Strong Ltd. is the holding company of weak Ltd. as it holds more than 50% of the voting power of weak Ltd. and thus should be treated as related parties as per AS-18. **(1 Mark)**
- iv) According to AS-18, in the case of related party transactions, following facts should be disclosed: (a) Related party relationship, name and nature of relationship. (b) If there is transaction between the related parties then descriptions of the nature of transaction, volume of the transaction outstanding at the Balance Sheet date etc. **(1 Mark)**
- v) Further, as per Section 188 of the Companies Act, 2013 also prescribes to take the permission of the Board of Directors by resolution at board meeting for such related party transactions. **(1 Mark)**
- vi) In the instant case since there is related party transaction the contention of Managing Director of strong Ltd is not correct. **(1 Mark)**
- vii) The auditor is required to verify the compliance of section 188 of the Companies Act and insist to make proper disclosure as required by AS-18 and if the management refuses, the auditor as per SA 550 "Related Parties", should express a qualified opinion. **(1 Mark)**