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PART A MCQs

Q.NO	ANSWER	MARKS
1	b	1
2	c	1
3	a	1
4	c	1
5	b	1
6	a	1
7	b	1
8	c	1
9	b	1
10	c	1

Q.NO	ANSWER	MARKS
11	b	2
12	d	2
13	a	2
14	d	2
15	c	2
16	b	2
17	d	2
18	b	2
19	d	2
20	d	2

PART B DESCRIPTIVE

ANSWER 1(a)

One of the following additional requirement as stipulated under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR Regulations”) on which Section 177 of the Companies Act, 2013 (relating to audit committee) is silent is – The Audit Committee should meet at least four times in a year and not more than one hundred and twenty days shall elapse between two meetings. The quorum shall be either two members or one third of the members of the audit committee, whichever is greater, but there should be a minimum of two independent directors present.

Besides, there is a mandatory review requirement and to review only monthly information system is not sufficient. Here the audit committee members reviewed only monthly information system of the company and the same is not sufficient as per LODR Regulations.

The Audit Committee shall mandatorily review the following information as per LODR Regulations:

- (i) Management discussion and analysis of financial condition and results of operations;
- (ii) Statement of significant related party transactions (as defined by the Audit Committee), submitted by management;
- (iii) Management letters / letters of internal control weaknesses issued by the statutory auditors;

- (iv) Internal audit reports relating to internal control weaknesses;
- (v) The appointment, removal and terms of remuneration of the Chief internal auditor shall be subject to review by the Audit Committee; and
- (vi) Statement of deviations: (a) quarterly statement of deviations including report of monitoring agency if applicable and (b) annual statement of funds utilized for purposes other than those stated in the offer document/ prospectus/ notice.

Applying the above, the decision taken by the audit committee is not in line with the LODR Regulations.

(5 MARKS)

ANSWER 1(b)

Reporting requirements in case of Uncertainty clamping on the Going Concern: As per SA 570 "Going Concern", if the auditor concludes that management's use of the going concern basis of accounting is appropriate in the circumstances but a material uncertainty exists, the auditor shall determine whether the financial statements : (i)adequately disclose the principal events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and management's plans to deal with these events or conditions; and (ii) disclose clearly that there is a material uncertainty related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern and, therefore, that it may be unable to realize its assets and discharge its liabilities in the normal course of business.

If adequate disclosure about the material uncertainty is made in the financial statements, the auditor shall express an unmodified opinion and the auditor's report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to:

- (i) Draw attention to the note in the financial statements that discloses the matters set out above; and
- (ii) State that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

In the instant case, M/s Aircraft Ltd. is running into continuous financial losses as well as reduction in sales due to stiff competition and frequent break down of its own aircrafts and management of Aircraft Ltd. is uncertain as of its ability to continue in near future. Therefore, a committee has been constituted to study this aspect and till the time study is completed management accordingly decided to suitable disclose this aspect in notes to accounts. Therefore, the auditor should disclose about the material uncertainty and express an unmodified opinion and in his audit report shall include a separate section under the heading "Material Uncertainty Related to Going Concern" to draw attention to the note in the financial statements that discloses the matters set out above; and state that these events or conditions indicate that a material uncertainty exists that may cast significant doubt on the entity's ability to continue as a going concern and that the auditor's opinion is not modified in respect of the matter.

(5 MARKS)

ANSWER 1(c)

Factors Influencing the amount of Working Papers: As per SA 230 "Audit Documentation", which refers to the record of audit procedures performed, relevant audit evidence obtained and conclusions the auditor reached, the amount of audit working papers depend on factors such as-

- (i) The size and complexity of the entity.
- (ii) The nature of the audit procedures to be performed.

- (iii) The identified risks of material misstatement.
- (iv) The significance of the audit evidence obtained.
- (v) The nature and extent of exceptions identified.
- (vi) The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
- (vii) The audit methodology and tools used.
- (viii) Timely preparation of Audit Documentation.

(4 MARKS)

ANSWER 2(a)

In the given case, certain weaknesses in the internal control procedure in the payment of wages in a large construction company were noticed by the statutory auditor and brought the same to the knowledge of the Managing Director of the company. In the subsequent year, a huge defalcation took place, the ramification of which stretched to the earlier year. The management of the company desires to sue the statutory auditor for negligence. **The precise nature of auditor's liability** in the case can be ascertained on the basis of the under noted considerations :

- (a) Whether the defalcation emanated from the weaknesses noticed by the statutory auditor, the information regarding which was passed on to the management; and
- (b) Whether the Statutory auditor properly and adequately extended the audit programme of the previous year having regard to the weaknesses noticed.

SA 265 on "Communicating Deficiencies in Internal Control to Those Charged with Governance and Management" clearly mentions that, "The auditor shall determine whether, on the basis of the audit work performed, the auditor has identified one or more deficiencies in internal control. If the auditor has identified one or more deficiencies in internal control, the auditor shall determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies. The auditor shall communicate in writing significant deficiencies in internal control identified during the audit to those charged with governance on a timely basis. The auditor shall also communicate to management at an appropriate level of responsibility on a timely basis". The fact, however, remains that, weaknesses in the design of the internal control system and non – compliance with identified control procedures increase the risk of fraud or error. If circumstances indicate the possible existence of fraud or error, the auditor should consider the potential effect of the suspected fraud or error on the financial information. If the auditor believes the suspected fraud or error could have a material effect on the financial information, he should perform such modified or additional procedures as he determines to be appropriate. Thus, normally speaking, as long as the auditor took due care in performing the audit work, he cannot be held liable.

The fact that the matter was brought to the notice of the managing director may be a good defence for the auditor as well. According to the judgement of the classic case. In re Kingston Cotton Mills Ltd., (1896) it is the duty of the auditor to probe into the depth only when his suspicion is aroused. The statutory auditor, by bringing the weakness to the notice of the managing director had alerted the management which is judicially held to be primarily responsible for protection of the assets of the company and can put forth this as defence against any claim arising subsequent to passing of the information to the management. In a similar case S.P. Catterson & Sons Ltd. (81 Acct. L. R. 68), the auditor was acquitted of the charge.

ANSWER 2(b)

When the Component(s) Auditor Reports on Financial Statements under an Accounting Framework is Different than that of the Parent: A component may alternatively prepare financial statements on the basis of the parent's accounting policies, as outlined in the group accounting manual, to facilitate the preparation of the group's consolidated financial statements. The group accounting manual would normally contain all accounting policies, including relevant disclosure requirements, which are consistent with the requirements of the financial reporting framework under which the group's consolidated financial statements are prepared. Thus, using group accounting policies as the financial accounting framework for components to report under, the principal/parent auditors should perform procedures necessary to determine compliance of the group accounting policies with the GAAP applicable to the parent's financial statements.

It may be noted that change in the selection of the method of depreciation is an accounting estimate and not an accounting policy as per Ind-AS 8. Accordingly, the entity should select the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method should be applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits in separate financial statements as well as consolidated financial statements.

Therefore, there can be different methods for calculation of depreciation for its assets, if their expected pattern of consumption is different. The method once selected in the stand-alone financial statements of the subsidiary should not be changed while preparing the consolidated financial statements.

In the given case, assets of R Co. Ltd. (subsidiary company) is depreciated using straight line method, assets of S Co. Ltd. (subsidiary company) are depreciated using written down value method and assets of parent company (H Co. Ltd.) are depreciated using straight line method, is in order. However, each part of an item of Property Plant and Equipment with a cost that is significant in relation to the total cost of the item should be depreciated separately under Component Method of Depreciation as per AS 10 on Property, Plant and Equipment. Thus, R Co. Ltd., though adopting straight line method but does not giving effect to component accounting of depreciation in respect of high value assets, is not in compliance with Ind AS 16/ Accounting Standard 10 Property Plan and Equipment.

(5 MARKS)

ANSWER 2(c)

Charging of Fees based on Percentage: Clause (10) of Part I to First Schedule to the Chartered Accountants Act, 1949 prohibits a Chartered Accountant in practice to charge, to offer, to accept or accept fees which are based on a percentage of profits or which are contingent upon the findings or results of such work done by him.

However, this restriction is not applicable where such payment is permitted by the Chartered Accountants Act, 1949. The Council of the Institute has framed Regulation 192 which exempts debt recovery services where fees may be based on a percentage of the debt recovered.

In the given case, CA. Prem has insisted for fees to be based on percentage of the debt recovered (which is exempted under Regulation 192). Hence, CA. Prem will not be held guilty for professional misconduct.

(4 MARKS)

ANSWER 3(a)

No Risk Assumption without Premium: No risk can be assumed by the insurer unless the premium is received. According to section 64VB of the Insurance Act, 1938, no insurer should assume any risk in India in respect of any insurance business on which premium is ordinarily payable in India unless and until the premium payable is received or is guaranteed to be paid by such person in such manner and within such time, as may be prescribed, or unless and until deposit of such amount, as may be prescribed, is made in advance in the prescribed manner. The premium receipt of insurance companies carrying on general insurance business normally arise out of three sources, viz., premium received from direct business, premium received from reinsurance business and the share of co- insurance premium.

Therefore, in the instant case, PQR Ltd. signed the insurance documents on 01.10.2018 but did not paid the premium. In case of non-payment of insurance premium if any accidental incident occurs insurance company will have no liability to pay claim. In the given case, fire is occurred on 10th October, 2018 in factory and premium has been paid on 15 October 2018, the ABC Insurance Company Ltd. will not be liable for claim for damages of plant and machinery.

(5 MARKS)

ANSWER 3(b)

Audit Programme of a Complex :

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

(5 MARKS)

ANSWER 3(c)

Students may not that assurance services shall not include :

- (i) Management Consultancy Engagements;
- (ii) Representation before various Authorities;
- (iii) Engagements to prepare tax returns or advising clients in taxation matters;
- (iv) Engagements for the compilation of financial statements;

- (v) Engagements solely to assist the client in preparing, compiling or collating information other than financial statements;
- (vi) Testifying as an expert witness;
- (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
- (viii) Engagement for Due diligence.

The phrase 'Assurance Services' is used interchangeably with Audit Services, Attestation Functions, and Audit Functions.

(4 MARKS)

ANSWER 4(a)

Considerations of Auditor for Assessing the Risk of Material Misstatement : As per SA 315 "Identifying and Assessing the Risk of Material Misstatement through understanding the entity and its Environment," the auditor shall identify and assess the risks of material misstatement at the financial statement level; and the assertion level for classes of transactions, account balances, and disclosures to provide a basis for designing and performing further audit procedures. For this purpose, the auditor shall :

- (i) Identify risks throughout the process of obtaining an understanding of the entity and its environment, including relevant controls that relate to the risks, and by considering the classes of transactions, account balances, and disclosures in the financial statements;
- (ii) Assess the identified risks, and evaluate whether they relate more pervasively to the financial statements as a whole and potentially affect many assertions;
- (iii) Relate the identified risks to what can go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and
- (iv) Consider the likelihood of misstatement, including the possibility of multiple misstatements, and whether the potential misstatement is of a magnitude that could result in a material misstatement.

(2.5 MARKS)

Auditor's Responses to the Assessed Risk of Material Misstatement : According to SA 330 "The Auditor's Responses to Assessed Risks", the auditor shall design and implement overall responses to address the assessed risks of material misstatement. In designing the audit procedures to be performed, the auditor shall :

- (i) Consider the reasons for the assessment given to the risk of material misstatement at the assertion level for each class of transactions, account balance, and disclosure, including :
 - (1) The likelihood of material misstatement due to the particular characteristics of the relevant class of transactions, account balance, or disclosure; and
 - (2) Whether the risk assessment takes into account the relevant controls, thereby requiring the auditor to obtain audit evidence to determine whether the controls are operating effectively; and
- (ii) Obtain more persuasive audit evidence the higher the auditor's assessment of risk.

(2.5 MARKS)

ANSWER 4(b)

In assessing the turnover which the business would be able to maintain in the future, the following factors should be taken into account:

- (i) **Trend:** Whether in the past, sales have been increasing consistently or they have

been fluctuating. A proper study of this phenomenon should be made.

- (ii) **Marketability:** Is it possible to extend the sales into new markets or that these have been fully exploited? Product wise estimation should be made.
- (iii) **Political and economic considerations:** Are the policies pursued by the Government likely to promote the extension of the market for goods to other countries? Whether the sales in the home market are likely to increase or decrease as a result of various emerging economic trends?
- (iv) **Competition:** What is the likely effect on the business if other manufacturers enter the same field or if products which would sell in competition are placed on the market at cheaper price? Is the demand for competing products increasing? Is the company's share in the total trade constant or has it been fluctuating?

(5 MARKS)

ANSWER 4(c)

Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III –The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

- (i) NBFCs have been allowed to present the items of the balance sheet in order of their liquidity which is not allowed to companies required to follow Division II. Additionally, NBFCs are required to classify items of the balance sheet into financial and non-financial whereas other companies are required to classify the items into current and non-current.
- (ii) An NBFC is required to separately disclose by way of a note any item of 'other income' or 'other expenditure' which exceeds 1 per cent of the total income. Division II, on the other hand, requires disclosure for any item of income or expenditure which exceeds 1 per cent of the revenue from operations or `10 lakhs, whichever is higher.
- (iii) NBFCs are required to separately disclose under 'receivables', the debts due from any Limited Liability Partnership (LLP) in which its director is a partner or member.

NBFCs are also required to disclose items comprising 'revenue from operations' and 'other comprehensive income' on the face of the Statement of profit and loss instead of as part of the notes.

(4 MARKS)

ANSWER 5(a)

Data Analytics : Generating and preparing meaningful information from raw system data using processes, tools and techniques is known as Data Analytics. The data analytics methods used in an audit are known as Computer Assisted Auditing Techniques of CAATs. When auditing in an automated environment, auditors can apply the concepts of data analytics for several aspects of an audit including the following :

- Preliminary analytics;
- Risk assessment;
- Control testing;
- Non - standard journal analysis;
- Evaluation of deficiencies;
- Fraud risk assessment.

(5 MARKS)

ANSWER 5(b)

Delegation of Authority to the Employee : As per Clause (12) of Part I of the First Schedule of the Chartered Accountants Act, 1949, a Chartered Accountant in practice is deemed to be guilty of professional misconduct "If he allows a person not being a member of the Institute in practice or a member not being his partner to sign on his behalf or on behalf of his firm, any balance sheet, profit and loss account, report or financial statements".

In this case CA. 'A' proprietor of M/s A & Co., went to abroad and delegated the authority to another Chartered Accountant Mr. Y, his employee, for taking care of routine matters of his office who is a member of the Institute of Chartered Accountants but not his partner.

The Council has clarified that the power to sign routine documents on which a professional opinion or authentication is not required to be expressed may be delegated and such delegation will not attract provisions of this clause 12 for example issue of audit queries during the course of audit, asking for information or issue of questionnaire, attending to routing matters in tax practice, subject to provisions of Section 288 of Income Tax Act etc.

- (i) In the given case, Mr. 'Y' , a chartered accountant being employee of M/s A & Co. has issued audit queries which were raised during the course of audit. Here 'Y' is right in issuing the query, since the same falls under routine work which can be delegated by the auditor. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.
- (ii) In this instance, Mr. "Y", CA employee of the audit firm M/s A & Co. has attended the Income tax proceedings for a client as authorized representative before Income Tax Authorities. Since the council has allowed the delegation of such work, the chartered accountant employee an attend to routine matter in tax practice as decided by the council, subject to provisions of Section 288 of the Income Tax Act. Therefore, there is no misconduct in this case as per Clause (12) of Part I of First schedule to the Act.

(5 MARKS)

ANSWER 5(c)

Relevant Sections and Steps involved in Audit of Government Companies: Section 143(5), 143(6) and 143(7) of the Companies Act, 2013 are relevant sections in case of Audit of Government Companies.

The following steps are involved in the audit of government companies:

- (i) **Appointment of Auditors under Section 139(5) and 139(7) read with section 143(5) of the Companies Act, 2013** - Statutory auditors of Government Company are appointed or re-appointed by the Comptroller and Auditor General of India.

The C&AG may direct the appointed auditor the manner in which the accounts of the Government company are required to be audited and thereupon the auditor so appointed shall submit a copy of the audit report to the Comptroller and Auditor-General of India which, among other things, include the directions, if any, issued by the Comptroller and Auditor-General of India, the action taken thereon and its impact on the accounts and financial statement of the company.

- (ii) **Supplementary audit under section 143(6)(a) of the Companies Act, 2013** - The Comptroller and Auditor-General of India shall within 60 days from the date of receipt of the audit report have a right to conduct a supplementary audit of the financial statement of the company by such person or persons as he may authorize in this behalf; and for the purposes of such audit, require information or additional information to be furnished to any person or persons, so authorised, on such matters, by such person or persons, and in such form, as the Comptroller and Auditor-General of India may direct.

(iii) Comment upon or supplement such Audit Report under section 143(6)(b) of the Companies Act, 2013 - Any comments given by the Comptroller and Auditor-General of India upon, or supplement to, the audit report shall be sent by the company to every person entitled to copies of audited financial statements under sub-section (1) of section 136 of the said Act

i.e. every member of the company, to every trustee for the debenture-holder of any debentures issued by the company, and to all persons other than such member or trustee, being the person so entitled and also be placed before the annual general meeting of the company at the same time and in the same manner as the audit report.

(iv) Test audit under section 143(7) of the Companies Act, 2013 - Without prejudice to the provisions relating to audit and auditor, the Comptroller and Auditor-General of India may, in case of any company covered under sub-section (5) or sub-section (7) of section 139 of the said Act, if he considers necessary, by an order, cause test audit to be conducted of the accounts of such company and the provisions of the Comptroller and Auditor-General's (Duties, Powers and Conditions of Service) Act, 1971, shall apply to the report of such test audit.

(4 MARKS)

ANSWER 6(a)

(i) Clause 16(c) of Form 3CD: A tax auditor has to report under clause 16(c) of Form 3CD on any escalation claim accepted during the previous year and not credited to the profit and loss account under clause 16(c) of Form 3CD.

The escalation claim accepted during the year would normally mean "accepted during the relevant previous year". If such amount are not credited to Profit and Loss Account the fact should be reported. The system of accounting followed in respect of this particular item may also be brought out in appropriate cases. If the assessee is following cash basis of accounting with reference to this item, it should be clearly brought out since acceptance of claims during the relevant previous year without actual receipt has no significance in cases where cash method of accounting is followed.

Escalation claims should normally arise pursuant to a contract (including contracts entered into in earlier years), if so permitted by the contract. Only those claims to which the other party has signified unconditional acceptance could constitute accepted claims. Mere making claims by the assessee or claims under negotiations cannot constitute accepted claims. After ascertaining the relevant factors as outlined above, a decision whether to report or not, can be taken.

(2.5 MARKS)

(ii) The following is an illustrative list of capital receipts which, if not credited to the profit and loss account, are to be stated under clause 16(e) of Form 3CD-

(a) Capital subsidy received in the form of Government grants, which are in the nature of promoters' contribution i.e., they are given with reference to the total investment of the undertaking or by way of contribution to its total capital outlay. For e.g., Capital Investment Subsidy Scheme.

(b) Government grant in relation to a specific fixed asset where such grant is shown as a deduction from the gross value of the asset by the concern in arriving at its book value.

(c) Compensation for surrendering certain rights.

(d) Profit on sale of fixed assets/investments to the extent not credited to the profit and loss account.

(2.5 MARKS)

ANSWER 6(b)

Issuing Certificate without having Certificate of Practice : As per Clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949, a member of the Institute, whether in practice or not, shall be deemed to be guilty of professional misconduct, if he contravenes any of the provisions of this Act or the regulations made thereunder or any guidelines issued by the Council.

This clause requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulations made thereunder. Any violation either of the Act or the Regulations by a member would amount to misconduct.

In the given case, C.A. Vineet has issued a certificate in respect of a consumption statement of raw material to the manager of ZedEx (P) Ltd., as a Chartered Accountant in practice when he had not even applied for the CoP to the Institute, thereby contravening the provisions of section 6 of the Chartered Accountants Act, 1949.

Therefore, CA. Vineet will be held guilty of professional misconduct in terms of clause (1) of Part II of Second Schedule to the Chartered Accountants Act, 1949 for contravention of provisions of this Act.

This clause requires every member of the Institute to act within the framework of the Chartered Accountants Act and the Regulations made thereunder. Any violation either of the Act or the Regulations by a member would amount to misconduct.

In the given case, CA. Vineet has issued a certificate in respect of a consumption statement of raw material to the manager of ZedEx (P) Ltd., as a Chartered Accountant in practice when he had not even applied for the CoP to the Institute, thereby contravening the provisions of section 6 of the Chartered Accountants Act, 1949.

(5 MARKS)

ANSWER 6(c)

Direct Assistance from Internal Auditor : As per SA 610 "Using the Work of Internal Auditor", the external auditor shall not use internal auditors to provide direct assistance to perform procedures that involve making significant judgments in the audit.

Since the external auditor has sole responsibility for the audit opinion expressed, the external auditor needs to make the significant judgments in the audit engagement.

Significant judgments include the following :

Assessing the risks of material misstatement;

Evaluating the sufficiency of tests performed;

Evaluating the appropriateness of management's use of the going concern assumption;

Evaluating significant accounting estimates; and

Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditor's report.

In view of above, Mr. Anand cannot ask direct assistance from internal auditors regarding evaluating significant accounting estimates and assessing the risk of material misstatements.

(4 MARKS)