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Head Office : Shraddha, 3rd Floor, Near Chinai College, Andheri (E), Mumbai – 69.
Tel : (022) 26836666

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DESCRIPTIVE QUESTION

ANSWER 1(A)

The main features of a qualified and independent audit committee to be set up under SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 are as follows:

(i) The audit committee shall have minimum three directors as members. Two-thirds of the members of audit committee shall be independent directors**, however, in case of a listed entity having outstanding SR (Superior Rights) equity shares, the audit committee shall only comprise of independent directors**;

(ii) All members of audit committee shall be financially literate and at least one member shall have accounting or related financial management expertise;

Explanation (i): The term "financially literate" means the ability to read and understand basic financial statements i.e. balance sheet, profit and loss account, and statement of cash flows.

Explanation (ii): A member will be considered to have accounting or related financial management expertise if he or she possesses experience in finance or accounting, or requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities.

(iii) The Chairperson of the Audit Committee shall be an independent director;

(iv) The Chairperson of the Audit Committee shall be present at Annual General Meeting to answer shareholder queries;

(v) The Audit Committee at its discretion shall invite the finance director or the head of the finance function, head of internal audit and a representative of the statutory auditor and any other such executives to be present at the meetings of the committee; provided that occasionally, the Audit Committee may meet without the presence of any executives of the listed entity;

(vi) The Company Secretary shall act as the secretary to the committee.

(5 MARKS)

ANSWER 1(B)

Consequence of an Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management-Imposed Limitation after the Auditor Has Accepted the Engagement: As per SA 705, Modification to the Opinion in the Independent Auditor's Report", if, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, the auditor shall request that management remove the limitation.

If management refuses to remove the prescribed limitation, the auditor shall communicate the matter to those charged with governance, unless all of those charged with governance are involved in managing the entity and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence.

If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

(i) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or

(ii) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:

1. Withdraw from the audit, where practicable and possible under applicable law or regulation; or
2. If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

If the auditor withdraws as discussed above, before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion.

(5 MARKS)

ANSWER 1(C)

Consolidated Financial Statements: According to Section 129(3) of the Companies Act, 2013, where a company has one or more subsidiaries, including associate company and joint venture, it shall, in addition to its own financial statements prepare a consolidated financial statement of the companyand of all the subsidiaries in the same form and manner as that of its own.

Further, as per Companies (Accounts) Rules, 2014, the consolidation of financial statements of the company shall be made in accordance with the provisions of Schedule III to the Act and the applicable accounting standards. However, a company which is not required to prepare consolidated financial statements under the Accounting Standards, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

However, an investment entity need not present consolidated financial statements if it is required, in accordance with Ind AS 110'Consolidated Financial Statements', to measure all of its subsidiaries at fair value through profit or loss. A parent shall determine whether it is an investment entity.

(An investment entity is an entity that(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services; (b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and (c) measures and evaluates the performance of substantially all of its investments on a fair value basis.)

In the given case, H Limited is an investment company preparing its financial statements in accordance with Ind AS and the company had invested 25% in SI Ltd., 50% in S2 Ltd. and 60% in S3 Ltd. of the respective share capitals of the investee companies. In view of provisions discussed in Ind AS 110, the Company is not required to prepare consolidated financial statements however, for the compliance of Companies (Accounts) Rules, 2014, it shall be sufficient if the company complies with provisions on consolidated financial statements provided in Schedule III of the Act.

Thus, it can be concluded that ultimate authority on consolidation is AS / Ind AS as prescribed by law and if they give some exemption it should be followed. If out of exemption some subsidiaries are not consolidated then list should be disclosed in notes to accounts with reason.

(4 MARKS)

ANSWER 2(A)

Under section 35 of the Companies Act, 2013 -

(1) Where a person has subscribed for securities of a company acting on any statement included, or the inclusion or omission of any matter, in the prospectus which is misleading and has sustained any loss or damage as a consequence thereof, the company and every person who—

(a) is a director of the company at the time of the issue of the prospectus;

(b) has authorized himself to be named and is named in the prospectus as a director of the company, or has agreed to become such director, either immediately or after an interval of time;

(c) is a promoter of the company;

(d) has authorised the issue of the prospectus; and

(e) is an expert referred to in sub-section (5) of section 26,

shall, without prejudice to any punishment to which any person may be liable under section 36, be liable to pay compensation to every person who has sustained such loss or damage.

(2) No person shall be liable under sub-section (1), if he proves—

(a) that, having consented to become a director of the company, he withdrew his consent before the issue of the prospectus, and that it was issued without his authority or consent, or

(b) that the prospectus was issued without his knowledge or consent, and that on becoming aware of its issue, he forthwith gave a reasonable public notice that it was issued without his knowledge or consent.

(3) Notwithstanding anything contained in this section, where it is proved that a prospectus has been issued with intent to defraud the applicants for the securities of a company or any other person or for any fraudulent purpose, every person referred to in subsection (1) shall be personally responsible, without any limitation of liability, for all or any of the losses or damages that may have been incurred by any person who subscribed to the securities on the basis of such prospectus.

Under section 448, an auditor is liable for criminal prosecution, if he, in any return, certificate, balance sheet, prospectus, statement or other document required by or for the purpose of the Act, makes a statement (a) which is false in any material particular knowing it to be false; or (b) which omits any material fact knowing it to be material. If convicted, he can be punished with imprisonment and also with fine as provided under section 447 of the said Act.

(5 MARKS)

ANSWER 2(B)

Facts Which Become Known to the Auditor After the Date of the Auditor's Report but Before the Date the Financial Statements are Issued: As per SA 560, "Subsequent Events", the auditor has no obligation to perform any audit procedures regarding the financial statements after the date of the auditor's report. However, when, after the date of the auditor's report but before the date the financial statements are issued, a fact becomes known to the auditor that, had it been known to the auditor at the date of the auditor's report, may have caused the auditor to amend the auditor's report, the auditor shall

(i) Discuss the matter with management and, where appropriate, those charged with governance.

(ii) Determine whether the financial statements need amendment and, if so,

(iii) Inquire how management intends to address the matter in the financial statements.

If management amends the financial statements, the auditor shall carry out the audit procedures necessary in the circumstances on the amendment. Further, the auditor shall extend the audit procedures and provide a new auditor's report on the amended financial statements. However, the new auditor's report shall not be dated earlier than the date of approval of the amended financial statements.

In the instant case, XYZ Company Ltd. received an amount of rupees 5800 crore on account of incentives pertaining to year 2017-18 in the month of May 2018 i.e. after finalisation of financial statements and signing of audit report. Board of Directors of XYZ Ltd. amended the accounts, approved the same and requested the Amudhan & Co. (auditor) to consider this event and issue a fresh audit report on the financial statements for the year ended on 31.03.2018.

After applying the conditions given in SA 560, Amudhan & Co. can issue new audit report subject to date of audit report which should not be earlier than the date of approval of the amended financial statements.

(5 MARKS)

ANSWER 2(C)

Soliciting Clients: As per **Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949,** a Chartered Accountant in practice is deemed to be guilty of professional misconduct if he solicits clients or professional work either directly or indirectly by circular, advertisement, personal communication or interview or by any other means except applying or requesting for or inviting or securing professional work from another chartered accountant in practice and responding to tenders.

Further**, section 140(4)(iii) of the Companies Act, 2013**, provides a right, to the retiring auditor, to make representation in writing to the company. The retiring auditor has the right for his representation to be circulated among the members of the company and to be read out at the meeting. However, the content of letter should be set out in a dignified manner how he has been acting independently and conscientiously through the term of his office and may, in addition, indicate, if he so chooses, his willingness to continue as auditor, if re- appointed by the shareholders.

The proposition of the auditor to highlight contributions made by him in strengthening the control procedures in the representation should not be included in such representations because the representation letter should not be prepared in a manner so as to seek publicity.

Thus, highlighting contributions made by him in strengthening the control procedures, while submitting representation U/S 140(4)(iii) of the Companies Act 2013, would amount to canvassing or soliciting for his continuance as auditor.

Therefore, **CA. Anoop will be held guilty for professional misconduct** under Clause (6) of Part I of First Schedule to the Chartered Accountants Act, 1949.

(4 MARKS)

ANSWER 3(A)

Following are the certain illustrative points, Auditors are required to follow during the Audit of Accounting or Premium :

1. Collection of Premium :

- Check whether there is **daily reconciliation process** to reconcile the amounts collected, entered into the system and deposited into the bank.
- Check that there is **appropriate mechanism to ensure all the collections** are deposited into the Bank on timely basis.

2. Calculation of Premium :

- Check that **Accounting system**, employed by the Company, calculates **premium amounts** and its respective **due dates correctly**.
- Check that system employed as such is equipped to **calculate all types of premium modes correctly.**

3. Recognition of Income :

- Check that **premium is recognised only on the basis of 'Issued Policies'** and not on underwriting date.
- Check that there is inbuilt mechanism the system **all the premium collected are correctly allocated** all various components of the Policies.
- Check that there is **appropriate mechanism in place to conduct reconciliation** on daily basis and reconciling items, if any, are rectified / followed up.

4. Accounting of 'Advance Premium' :

- Check, whether system has capability to **identity regular and advance premium.**

- Check whether there is a **<u>process of applying advance premium to a contract when premium is due.</u>**

5. Reporting of Premium figures to IRDA/ Management :

- Check the **<u>methodology for generation of MIS</u>** from the system and there is no manual intervention.
- Check the procedure for **<u>Maker/ Checker before finalising the MIS.</u>**
- Check whether there is a reconciliation process between premium Income as per financials and as reported.

6. Other Areas :

- Check whether there are **<u>appropriate SOPs</u>** developed by the Companies and are **<u>strictly followed</u>** by all the departments / branches of the Company.
- Ensure duly **<u>approved Delegation of Authority parameters matrix</u>** already in place for authorisation limits.
- Premium recognition and refund of premium are independent processes with adequate **<u>segregation of duties amongst the personnel</u>**.
- Check that the Company conducts premium reconciliation on daily basis.
- Check the **<u>robustness of interface between administration and accounting system.</u>**

Auditors may also refer to IRDA (Preparation of Financial Statements & Auditors Report of Insurance Companies) Regulations, 2000 for premium accounting.

(5 MARKS)

ANSWER 3(B)

Auditor's responsibilities in cases where audit report for an earlier year is qualified is given in SA 710 "Comparative Information – Corresponding Figures and Comparative Financial Statements". As per SA 710, When the auditor's report on the prior period, as previously issued, included a qualified opinion, a disclaimer of opinion, or an adverse opinion and the matter which gave rise to the modified opinion is resolved and properly accounted for or disclosed in the financial statements in accordance with the applicable financial reporting framework, the auditor's opinion on the current period need not refer to the previous modification.

SA 710 further states that if the auditor's report on the prior period, as previously issued, included a qualified opinion and the matter which gave rise to the modification is unresolved, the auditor shall modify the auditor's opinion on the current period's financial statements. In the Basis for Modification paragraph in the auditor's report, the auditor shall either :

(i) Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or

(ii) In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures.

(iii) In the instant Case, if P Ltd. does not make provision for doubtful debts the auditor will have to modify his report for both current and previous year's figures as mentioned above. If however, the provision is made, the auditor need not refer to the earlier year's modification.

(5 MARKS)

ANSWER 3(C)

Areas excluded from scope of Peer Reviewer are:

(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.

(4 MARKS)

ANSWER 4(A)

Basic system of Control: Internal Checks and Internal Audit are important constituents of Accounting Controls. Internal check system implies organization of the overall system of book-keeping and arrangement of Staff duties in such a way that no one person can carry through a transaction and record every aspect thereof.

In the given case of Navjeevan Hospital, the person-in-charge of inventory inflow and outflow from the store house is also responsible for purchases and maintaining inventory records. Thus, one of the basic system of control i.e. internal check which includes segregation of duties or maker and checker has been violated where transaction processing are allocated to different persons in such a manner that no one person can carry through the completion of a transaction from start to finish or the work of one person is made complimentary to the work of another person.

The general condition pertaining to the internal check system may be summarized as under-

(i) No single person should have complete control over any important aspect of the business operation. Every employee's action should come under the review of another person.

(ii) Staff duties should be rotated from time to time so that members do not perform the same function for a considerable length of time.

(iii) Every member of the staff should be encouraged to go on leave at least once a year.

(iv) Persons having physical custody of assets must not be permitted to have access to the books of accounts.

(v) There should exist an accounting control in respect of each class of assets, in addition, there should be periodical inspection so as to establish their physical condition.

(vi) Mechanical devices should be used, where ever practicable to prevent loss or misappropriation of cash.

(vii) Budgetary control should be exercised and wide deviations observed should be reconciled.

(viii) For inventory taking, at the close of the year, trading activities should, if possible be suspended, and it should be done by staff belonging to several sections of the organization.

(ix) The financial and administrative powers should be distributed very judiciously among different officers and the manner in which those are actually exercised should be reviewed periodically.

(x) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.

(6 MARKS)

ANSWER 4(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.

(4 MARKS)

ANSWER 4(C)

Reporting under CARO, 2016 for Registration under RBI Act, 1934 : As per **<u>Clause (xvi) of paragraph 3 of the CARO, 2016</u>**, the auditor is required to report whether the company is required to be registered under **<u>section 45 – IA of the Reserve Bank of India Act, 1934</u>**. If so, whether the registration has been obtained.

Audit Procedure and Reporting –

(i) The auditor should examine the **<u>transactions of the company</u>** with relation to the activities covered **<u>under the RBI Act</u>** and directions related to the Non – Banking Financial Companies.

(ii) The financial statements should be examined to ascertain whether company's **<u>financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income.</u>**

(iii) Whether the company has **<u>net owned funds</u>** as required for the registration as NBFC.

(iv) Whether the company has obtained the **registration as NBFC**, if not, the reasons should be sought from the management and documented.

(4 MARKS)

ANSWER 5(A)

Indebtedness to the Company: According to the section 141(3)(d)(ii) of the Companies Act, 2013, a person who is indebted to the company for an amount exceeding Rs. 5,00,000 shall be disqualified to act as an auditor of such company and further under section 141(4) he shall vacate his office of auditor when he incurs this disqualification subsequent to his appointment.

Further a person or a firm who directly or indirectly has business relationship with a company or its subsidiary or its holding or associate company, is also not qualified to be appointed as auditor of the company. But here business relationship does not include commercial transactions which are in the ordinary course of the business of the company at arm's length price.

However, where the person has liquidated his debt before the appointment date, there is no disqualification to be construed for such appointment.

In the given case, PQ & Co., an audit firm with P & Q as partners is appointed as statutory auditor of M/s Mango Orchards Hotel Ltd. and the audit firm is a regular customer of the hotel and the partners usually stay in the same hotel at various locations. They also settle the payments for such stay against quarterly bills raised by the company.

Assuming the balance amount at any time during the year due to the hotel does not exceed the prescribed limits of rupees 5,00,000, PQ & Co., is not disqualified to be appointed as statutory auditor of M/s Mango Orchards Hotel Ltd as per section 141(3)(d)(ii), in the absence of the same the auditor shall be disqualified to act as an auditor and shall vacate his office of auditor when he incurs this disqualification subsequent to the appointment.

Since in term of section 141(3)(e) of Companies Act, 2013 PQ & Co. is not 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 of such nature as may be prescribed, the auditor shall not be disqualified to act as an auditor and shall not required to vacate his office of auditor.

(5 MARKS)

ANSWER 5(B)

Assignment as Advisor and Consultant: The Council of the Institute of Chartered Accountants of India (ICAI) pursuant to Section 2(2)(iv) of the Chartered Accountants Act, 1949 has passed a resolution permitting "Management Consultancy and other Services" by a Chartered Accountant in practice. A clause of the aforesaid resolution allows Chartered Accountants in practice to act as advisor or consultant to an issue of securities including such matters as drafting of prospectus, filing of documents with SEBI, preparation of publicity budgets, advice regarding selection of brokers, etc. It is, however, specifically stated that Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services.

In the instant case, CA Natraj accepted an assignement as advisor and consultant to the public issue of shares by his client M/s Super Ltd. In addition, he also underworte the public issue of the companyto the extent of 25% at a commission of 1%. Contention of CA. Natraj that advisor, consultant and underwriting work is part of management consultancy work and permitted by the council is not correct as Chartered Accountants in practice are not permitted to undertake the activities of broking, underwriting and portfolio management services.

Conclusion: In view of this, CA. Natraj would be guilty of misconduct under the Chartered Accountants Act, 1949.

(5 MARKS)

ANSWER 5(C)

C&AG's Role – The Comptroller & Auditor General of India plays a key role in the functioning of the financial committees of Parliament and the State Legislatures. He has come to be recognised as a 'friend, philosopher and guide' of the Committees.

(i) His Reports generally form the basis of the Committees' working, although they are not precluded from examining issues not brought out in his Reports;

(ii) He scrutinises the notes which the Ministries submit to the Committees and helps the Committees to check the correctness of submissions to the Committees and facts and figures in their draft reports;

(iii) The Financial Committees present their Report to the Parliament/ State Legislature with their observations and recommendations. The various Ministries / Department of the Government are required to inform the Committees of the action taken by them on the recommendations of the Committees (which are generally accepted) and the Committees present Action Taken Reports to Parliament / Legislature ;

(iv) In respect of those Audit Reports, which could not be discussed in detail by the Committees, written answers are obtained from the Department / Ministry concerned and are sometimes incorporated in the Reports presented to the Parliament / State Legislature.

This ensures that the Audit Reports are not taken lightly by the Government, even if the entire report is not deliberated upon by the Committee.

(4 MARKS)

ANSWER 6(A)

Investigation on Behalf of the Bank for Advances: A bank is primarily interested in knowing the purpose for which a loan is required, the sources from which it would be repaid and the security that would be available to it, if the borrower fails to pay back the loan. On these considerations, the investigating accountant, in the course of his enquiry, should attempt to collect information on the under mentioned points:

(i) The purpose for which the loan is required and the manner in which the borrower proposes to invest the amount of the loan.

(ii) The schedule of repayment of loan submitted by the borrower, particularly the assumptions made therein as regards amounts of profits that will be earned in cash and the amount of cash that would be available for the repayment of loan to confirm that they are reasonable and valid in the circumstances of the case. Institutional lenders now-a-days rely more for payment of loans on the reliability of annual profits and loss on the values of assets mortgaged to them.

(iii) The financial standing and reputation for business integrity enjoyed by directors and officers of the company.

(iv) Whether the company is authorised by the Memorandum or the Articles of Association to borrow money for the purpose for which the loan will be used.

(v) The history of growth and development of the company and its performance during the past 5 years.

(vi) How the economic position of the company would be affected by economic, political and social changes that are likely to take place during the period of loan.

To investigate the profitability of the business for judging the accuracy of the schedule of repayment furnished by the borrower, as well as the value of the security in the form of assets of the business already possessed and those which will be created out of the loan, the investigating accountant should take the under-mentioned steps:

(a) Prepare a condensed income statement from the Statement of Profit and Loss for the previous five years, showing separately therein various items of income and expenses, the amounts of gross and net profits earned and taxes paid annually during each of the five years. The amount of maintainable profits determined on the basis of foregoing statement should be increased by the amount by which these would increase on the investment of borrowed funds.

(b) Compute the under-mentioned ratios separately and then include them in the statement to show the trend as well as changes that have taken place in the financial position of the company:

  (i) Sales to Average Inventories held.

  (ii) Sales to Fixed Assets.

  (iii) Equity to Fixed Assets.

  (iv) Current Assets to Current Liabilities.

  (v) Quick Assets (the current assets that are readily realisable) to Quick Liabilities.

  (vi) Equity to Long Term Loans.

  (vii) Sales to Book Debts.

Return on Capital Employed

(c) Enter in a separate part of the statement the break-up of annual sales product- wise to show their trend.

Steps involved in the verification of assets and liabilities included in the Balance Sheet of the borrower company which has been furnished to the Bank- The investigating accountant should prepare schedules of assets and liabilities of the borrower and include in the particulars stated below:

(1) Fixed assets - A full description of each item, its gross value, the rate at which depreciation has been charged and the total depreciation written off. In case the rate at which depreciation has been adjusted is inadequate, the fact should be stated. In case any asset is encumbered, the amount of the charge and its nature should be disclosed. In case an asset has been revalued recently, the amount by which the value of the asset has been decreased or increased on revaluation should be stated along with the date of revaluation. If considered necessary, he may also comment on the revaluation and its basis.

(2) Inventory - The value of different types of inventories held (raw materials, work- in-progress and finished goods) and the basis on which these have been valued.

Details as regards the nature and composition of finished goods should be disclosed. Slow-moving or obsolete items should be separately stated along with the amounts of allowances, if any, made in their valuation. For assessing redundancy, the changes that have occurred in important items of inventory subsequent to the date of the Balance Sheet, either due to conversion into finished goods or sale, should be considered.

If any inventory has been pledged as a security for a loan the amount of loan should be disclosed.

(3) **Trade Receivables, including bills receivable -** Their composition should be disclosed to indicate the nature of different types of debts that are outstanding for recovery; also whether the debts were being collected within the period of credit as well as the fact whether any debts are considered bad or doubtful and the provision if any, that has been made against them.

Further, the total amount outstanding at the close of the period should be segregated as follows:

(i) debts due in respect of which the period of credit has not expired;

(ii) debts due within six months; and

(iii) debts due but not recovered for over six months.

If any debts are due from directors or other officers or employees of the company, the particulars thereof should be stated. Amounts due from subsidiary and affiliated concerns, as well as those considered abnormal should be disclosed. The recoveries out of various debts subsequent to the date of the Balance sheet should be stated.

(4) **Investments -** The schedule of investments should be prepared. It should disclose the date of purchase, cost and the nominal and market value of each investment. If any investment is pledged as security for a loan, full particulars of the loan should be given.

(5) **Secured Loans -** Debentures and other loans should be included together in a separate schedule. Against the debentures and each secured loan, the amounts outstanding for payments along with due dates of payment should be shown. In case any debentures have been issued as a collateral security, the fact should be stated. Particulars of assets pledged or those on which a charge has been created for re-payment of a liability should be disclosed.

(6) **Provision of Taxation -** The previous years up to which taxes have been assessed should be ascertained. If provision for taxes not assessed appears in be inadequate, the fact should be stated along with the extent of the shortfall.

(7) **Other Liabilities -** It should be stated whether all the liabilities, actual and contingent, are correctly disclosed. Also, an analysis according to ages of trade payables should be given to show that the company has been meeting its obligations in time and has not been depending on trade credit for its working capital requirements.

(8) **Insurance -** A schedule of insurance policies giving details of risks covered, the date of payment of last premiums and their value should be attached as an annexure to the statements of assets, together with a report as to whether or not the insurance-cover appears to be adequate, having regard to the value of assets.

(9) **Contingent Liabilities -** By making direct enquiries from the borrower company, from members of its staff, perusal of the files of parties to whom any loan has been advanced those of machinery suppliers and the legal adviser, for example, the investigating accountant should ascertain

particulars of any contingent liabilities which have not been disclosed. In case, there are any, these should be included in a schedule and attached to the report.

(10) The impact on economic position of the company by economic, political and social changes those are likely to take place during the period of loan.

Finally, the investigating accountant should ascertain whether any application for loan to another bank or any other party has been made. If so, the result thereof should be examined.

(6 MARKS)

ANSWER 6(B)

In a controls – based audit, the audit approach can be classified into three broad phases comprising of planning, execution, and completion. In this approach, the considerations of automated environment will be relevant at every phase as given below :

I. Risk Assessment Process

- Identify significant accounts and disclosures.
- Qualitative and Quantitative considerations.
- Identify likely sources of misstatement
- Consider risk arising from use of IT systems.

II. Understand and Evaluate

- Document understanding of business processes using Flowcharts/ Narratives.
- Prepare Risk and Control Matrices (RCM)
- Understand design of controls by performing walkthrough of end – to – end process.
- Process wide considerations for Entity Level Controls, Segregation of Duties.
- IT General Controls, Application Controls.

III. Test for Operating Effectiveness

- Assess Nature, Timing and Extent (NTE) of controls testing.
- Assess reliability of source data ; completeness of population.
- Testing of key reports and spreadsheets.
- Sample testing.
- Consider competence and independence of staff / team performing controls testing.

IV. Reporting

- Evaluate Control Deficiencies.
- Significant deficiencies, Material weaknesses.
- Remediation of control weaknesses.
- Internal Controls Memo (ICM) or Management Letter.
- Auditor's report.

(4 MARKS)

ANSWER 6(C)

While conducting the operational audit the auditor has to come across many irregularities and areas where improvement can be made and therefore he gives his suggestions and recommendations.

These suggestions and recommendations for improvements may not be accepted by the hostile managers and in effect there may be cold war between the operational auditor and the managers. This would defeat the very purpose of the operational audit.

The Participative Approach comes to the help of the auditor. In this approach the auditor discusses the ideas for improvements with those managers that have to implement them and make them feel that they have participated in the recommendations made for improvements. By soliciting the views of the operating personnel, the operational audit becomes co – operative enterprise.

This participative approach encourages the auditee to develop a friendly attitude towards the auditors and look forward to their guidance in a more receptive fashion. When participative method is adopted then the resistance to change becomes minimal, feelings of hostility disappear and gives room for feelings of mutual trust. Team spirit is developed. The auditors and the auditee together try to achieve the common goal. The proposed recommendations are discussed with the auditee and modifications as may be agreed upon are incorporated in the operational audit report. With this attitude of the auditor it become absolutely easy to implement the proposed suggestions as the auditee themselves take initiative for implementing and the auditor do not have to force any change on the auditee.

Hence, Operational Auditor of DLF manufacturing unit should adopt above mentioned participative approach to tackle the hostile management of DLF.

(4 MARKS)