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SUGGESTED ANSWERS

CA FINAL

Test Code – JK-AUD-22

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Answers

Questions No. (1-10) carry 1 Mark each

1. (d

2. (a)

3. (c)

4. (d)

5. (a)

6. (a)

7. (a)

8. (b)

9. (c)

10. (b)

Question 11-20 carry 2 Marks each

11. (d)

12. (c)

13. (b)

14. (b)

15. (d)

16. (d)

17. (c)

18. (b)

19. (a)

20. (b)

Division B-Descriptive Questions

Q.1

(a)

a. Impact of Modification in the predecessor auditor's report:

- SA710"Comparative Information-Corresponding Figure and Comparative Financial Information deals with the auditor's responsibilities regarding comparative information in audit of financial statements.
- As per SA 710, if the auditor's report on the prior period, as previously issued, included a modified 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: **(2 marks)**
  - a) 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
  - b) 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.
- Further, if the financial statements of the prior period were audited by a predecessor auditor and the auditor is permitted by law or regulation to refer to the predecessor auditor's report on the corresponding figures and decides to do so, the auditor shall state in an Other Matter paragraph in the auditor's report: **(2 marks)**
  - a) That the financial statements of the prior period were audited by the predecessor auditor
  - b) The type of opinion expressed by the predecessor auditor and if, the opinion was modified the reasons therefor; and
  - c) The date of that report,

In the instant case, it was observed from the modified audit report of the financial statements of Ram Ltd. for the year ended 31st March, 2019 that depreciation of ₹ 2.50 crore for the year 2018-19 had been charged off to the statement of Profit and Loss instead of including it in "Carrying value of asset under construction **(1 mark)**

Conclusion: Modification in the predecessor audit report will impact the current period audit report.

(b)

Impact of uncorrected misstatements identified during the audit:

- SA 450 "Evaluation of Misstatements identified during the audit" deals with the auditor's responsibility to evaluate the effect of identified misstatements on the audit and of uncorrected misstatements, if any, on the financial statements,
- In accordance with SA 450, the auditor shall determine whether uncorrected misstatements are material, individually or in aggregate. In making this determination, the auditor shall consider the size and nature of the misstatements, both in relation to particular classes of transactions account balances or disclosures and the financial statements as a whole.

(1 Mark)

- The auditor shall request the management that uncorrected misstatements be corrected. If management refuses to correct some or all of the misstatements communicated by the auditor the auditor shall obtain an understanding of management's reasons for not making the corrections.

(1 Mark)

- Prior to evaluating the effect of uncorrected misstatements, the auditor shall reassess materiality determined in accordance with SA 320, to confirm whether it remains appropriate in the context of the entity's actual financial results.

(1 Mark)

- The auditor shall communicate with TCWG, uncorrected misstatements and the effect that they Individually or in aggregate, may have on the opinion in the auditor's report.

(1 Mark)

- The auditor shall request a written representation from management and, where appropriate those charged with governance whether they believe the effects of uncorrected misstatements are immaterial, individually and in aggregate, to the financial statement as a whole. **(1 Mark)**

(c)

Situations in which new engagement letter is required in case of recurring audit:

- ♦ SA 210"Agreeing the Terms of Engagement" deals with the auditor's responsibilities in agreeing the terms of the audit engagement with management. As per SA 210, in case of recurring audits, the auditor shall assess whether circumstances require revision in terms of the audit engagement and whether there is a need to remind the entity of the existing terms of the audit engagement
- ♦ The auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:

(0.5 marks each)

1. .Any indication that the entity misunderstands the objective and scope of the audit
2. Any revised or special terms of the audit engagement.
3. A recent change of senior management.
4. A significant change in ownership
5. A significant change in nature or size of the entity's business.
6. A change in legal or regulatory requirements.
7. A change in the financial reporting framework adopted in the preparation of the ES.
8. A change in other reporting requirements.

Q.2

(a)

There are several steps that should be followed to achieve success with CAATs and any of the supporting tools. A suggested approach to benefit from the use of CAATs is given below:

- Understand Business Environment including IT;
- Define the Objectives and Criteria;
- Identify Source and Format of Data;
- Extract Data;
- Verify the Completeness and Accuracy of Extracted Data;
- Apply Criteria on Data Obtained;
- Validate and Confirm Results

(0.5 marks each)

(b)

Control Objectives:

The objectives of internal control systems are determined by the management, after considering the nature of business, scale of operations, the extent of professionalism of the management etc. The objectives of internal controls relating to the accounting system are:

(i) Transaction are executed through general or specific management authorization

(1 mark)

(ii) All transactions are promptly recorded in an appropriate manner permit the preparation of financial information and to maintain accountability of assets.

(1 mark)

(iii) Assets and records are safeguarded from unauthorized access, use or disposition.

(1 mark)

(iv) Assets are verified at reasonable intervals and appropriate action is taken with regard to the discrepancies.

(1 mark)

Precisely, the control objectives ensure that the transactions processed are complete, valid and accurate. The basic accounting control objectives which are sought to be achieved by any accounting control system are:

(1 mark)

a) whether all transactions are recorded
b) whether recorded transactions are real.
c) whether all recorded transactions are properly valued
d) whether all transactions are recorded timely:
e) whether all transactions are properly posted:
f) whether all transactions are properly classified and disclosed:
g) whether all transactions are properly summarized

(c)

Rotation of Auditor & Cooling Off Period Provisions: The provision related to Rotation of Auditor & Cooling Off Period is newly inserted by section 139(2) of the Companies Act, 2013 read with Rule 5 of the Companies (Audit & Auditors) Rules, 2014, which is discussed as under:

The provisions related to rotation of auditor are applicable to those companies which are prescribed in Companies (Audit and Auditors) Rules, 2014, which prescribes the following classes of companies excluding one person companies and small companies, namely:-

Class of Companies for Rotation of Auditor
↓
including Listed Companies
+
excluding OPC (One Person Company) and Small Companies

All unlisted public companies having paid up share capital ≥ ₹ 10 crore	All private limited companies having paid up share capital ≥ ₹ 50 crore	All companies having paid up share capital of below threshold limit mentioned, but having public borrowings from financial institutions, banks or public deposits ≥ ₹ 50 crore

(i) All unlisted public companies having paid up share capital of ₹ 10 crore or more;

(ii) All private limited companies having paid up share capital of ₹ 50 crore or more;

(iii) All companies having paid up share capital of below threshold limit mentioned above, but having public borrowings from financial institutions, banks or public deposits of ₹ 50 crores or more.

(2 marks)

As per Section 139(2) of the Companies Act, 2013, no listed company or a company belonging to such class or classes of companies as mentioned above, shall appoint or re-appoint-

(a) An individual as auditor for more than one term of 5 consecutive years; and

(b) An audit firm as auditor for more than two terms of 5 consecutive years.

In the given case, Duryodhan Ltd. is a private company having paid up share capital of ₹ 5 crore and public borrowings of ₹ 100 crore. The company has appointed M/s karna & Co., a chartered accountant firm, as the statutory auditor in its AGM held at the end of September, 2017 for 11 years.

(2 marks)

The provisions relating to rotation of auditor will be applicable as the public borrowings exceeds ₹ 50 crore. Therefore, Duryodhan (P) Ltd. can appoint M/s karna & Co. as an auditor of the company for not more than one term of five consecutive years twice i.e. M/s Karna & Co. shall hold office from the conclusion of this meeting upto conclusion of sixth AGM to be held in the year 2022 and thereafter can be re-appointed as auditor for one more term of five years i.e. upto year 2027. The appointment shall be subject to ratification by members at every annual general meeting of the company. As a result, the appointment of M/s karna & Co. made by Duryodhan Ltd. for 11 years is void.

(1 mark)

Q.3

(a)

Differences between Division II (Ind- AS- Other than NBFCs) and Division III (Ind- AS- NBFCs) of Schedule III –The Ministry of Corporate Affairs (MCA) vide notification dated October 11, 2018 introduced Division III under Schedule III of the Companies Act, 2013, wherein a format for preparation of financial statements by NBFCs complying with Ind- AS has been prescribed.

The presentation requirements under Division III for NBFCs are similar to Division II (Non NBFC) to a large extent except for the following:

(1 mark each)

(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.

(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.

(iii) 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.

(iv) 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.

(v) 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.

(b)

Other **Misconduct**: CA Kumar has engaged his Articled Assistant for his own election campaigning for the central Council elections of ICAI. This aspect is covered under „Other Misconduct‟ which has been defined in Part IV of the First Schedule and Part III of the Second Schedule.

(2 mark)

These provisions empower the Council even if it does not arise out of his professional work This is considered necessary because a Chartered Accountant is expected to maintain the highest standards of integrity even in his personal affairs and any deviation from these standards, even in his non- professional work, would expose him to disciplinary action.

(2 mark)

Thus, when a Chartered Accountant uses the services of his Articled Assistant for purposes other than professional practice, he is found guilty under„ Other Misconduct‟. Hence, CA Kumar is guilty of 'Other Misconduct'

(1 mark)

(c)

Applicability of CARO, 2016:

- The Companies (Auditor's Report) Order (CARO), 2016, applies to all companies including foreign companies except certain companies which are specifically accepted.

(1 mark)

- CARO, 2016 exempts private limited companies not being a subsidiary or holding of a public company, from its application which fulfills certain conditions.

(1 mark)

- In the present case M/s X Pvt. Ltd. Is a subsidiary of a listed entity and its management believes that the company satisfies all conditions as required under CARO, 2016.

(1 mark)

Conclusion: Exemption from CARO is not available to a private company which is subsidiary of a public company. Hence contention of the management that company being a private limited company and satisfies all the conditions required for exemption, is not correct.

(1 mark)

Q.4

(a)

Sale/Purchase of NPA: **(1 mark each)**

- RBI issued guidelines to banks in respect of sale/purchase of NPAs which requires Board of Directors of the banks to lay down policy in respect of the aspects relating to sale/purchase of NPAS, including procedure for purchase/sale, valuation procedure, delegation of powers & accounting policy etc. Any purchase/sale of non performing financial assets should be conducted in accordance with the policy approved by the Board.
- Banks should, while selling NPAs, work out the NPV of the estimated cash flows associated with the realisable value of the available securities net of the cost of realization. The sale price should generally not be lower than the NPV so arrived.
- A bank may purchase/sell non performing financial assets from/to other banks only on without recourse basis

- Banks should ensure that subsequent to sale of the non-performing financial assets to other banks, they do not have any involvement with reference to assets sold and do not assume operational, legal or any other type of risks relating to the financial assets sold.
- A non-performing asset in the books of a bank is eligible for sale to other banks only if it has remained a non-performing asset for at least two years in the books of the selling bank
- NPAs can be sold to other banks only on cash basis. The entire sale consideration should be received upfront and the asset can be taken out of the books of the selling bank only on receipt of the entire sale consideration.
- A non performing financial asset (NPFA) should be held by the purchasing bank in its books at least for a period of 15 months before is sold to other banks. Hanks should not sell such assets back to the bank, which had sold the NPFA.

(b)

Money of Clients to be Deposited in Separate Bank Account: Clause(10) of Part I of Second Schedule states that a Chartered Accountant shall be deemed to be guilty of professional misconduct if "he fails to keep money of his clients in separate banking account or to use such money for the purpose for which they are intended".

(2 mark)

In the instant case, CA. Guru received sum of rupees 20 lakh from his client who is a film artist for monthly installment payment of Goods and Service Tax. This money should have been deposited in a separate bank account. CA. Guru utilized the amount of last installment for his own advance tax payment, though he paid the same along with interest and bore the interest due to short fall in remittance of tax of his client.

(2 mark)

As per fact of the case CA. Guru has failed to keep the sum of rupees 20 lakh received on behalf of his client in a separate Bank Account and utilized the same for his own advance tax payment amounts to professional misconduct under Clause (10) of Part I of Second Schedule.

(1 mark)

(c)

Audit Programme for conducting audit of a public trust:

1. **Preliminary: Obtain the following from the trust:**
   - A copy of resolution from the trust so as to determine the scope of audit
   - A list of accounting records maintained by the trust.
   - A certified true copy of trust deed.
   - Trial Balance as at end of accounting period.
   - Balance Sheet and Profit & Loss account of the trust authenticated

(1 mark)

2. **Compliance and Substantive Checking**

   (i) Examine the system of accounting and internal control.

   (ii) Vouch the transactions of the trust so as to ensure the following

      (a) transaction falls within the ambit of the trust:

      (b) transaction is properly authorized by the trustees or other delegated authority

      (c) Proper accounting of all incomes and expenses on the basis of the system followed by the trust:

      (d) Amount applied towards the object of the trust are covered by the objects of trust as specified in the trust deed.

   (III) Check whether the financial statements agrees with the trial balance

(2 mark)

3. **Issuing Audit Report Audit Report shall be furnished in Form No. 10B**
   - Annexure to Form 10B requires certain information to be provided by the auditor, which need to be obtained from the trustees

(1 Marks)

Q.5

(a)

Investigation of Hidden Liabilities:

In order to estimate hidden liabilities, the auditor should pay his attention to the following areas

- Any show cause notice which have not matured in demand but may be material and important
- Contingent liabilities not shown in books
- Company may have sold some subsidiaries/businesses and may have agreed to take over and indemnity all liabilities and contingent liabilities of the same prior to the date of transfer
- Product and warranty liabilities, product returns & discounts, liquidated damages. Etc
- Tax liability under direct and indirect taxes.
- Long pending sales tax assessment
- Cases of custom duty where only provisional assessment has been made and final assessment is yet to completed
- Agreement to buy back shares at a stated price
- Claims against the company including third party claims.
- Unfunded retirement benefit of employees
- Labour claims under negotiations.

(2.5 marks – 0.5 each)

Regularly Overvalued assets: The auditor shall have to specifically examine the following areas Uncollectable receivables

- Obsolete, slow and non-moving inventories and inventories valued above net realizable value. if any
- Obsolete and unused plant and machinery and their spares.
- Assets value which have impaired due to sudden fall in market value.
- Assets Shown in the books above market value due to capitalization of expenditure/foreign exchange fluctuation or capitalization of revenue expenditure
- Assets under litigation
- Investment shown at cost whose market value is much lower
- Investment carrying very low rate of return
- Infructuous project expenditure.
- Intangibles of no value **(2.5 marks – 0.5 each)**

(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.

(2 mark)

- 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.

(1 mark)

- 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.

(1 mark)

- 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

(1 mark)

(c)

Written Representations: As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", the auditor shall obtain written representations from management and, where appropriate, those charged with governance whether they believe significant assumptions used in making accounting estimates are reasonable.

SA 580, "Written Representations" discusses the use of written representations. Depending on the nature, materiality and extent of estimation uncertainty, written representations about accounting estimates recognised or disclosed in the financial statements may include representations:

(i) About the appropriateness of the measurement processes, including related assumptions and models, used by management in determining accounting estimates in the context of the applicable financial reporting framework, and the consistency in application of the processes.

(ii) That the assumptions appropriately reflect management's intent and ability to carry out specific courses of action on behalf of the entity, where relevant to the accounting estimates and disclosures.

(iii) That disclosure related to accounting estimates are complete and appropriate under the applicable financial reporting framework.

(iv) That no subsequent event requires adjustment to the accounting estimates and disclosures included in the financial statements.

(1 mark each)

Q.6

(a)

Disclosure of Information to third Party: Clause (1) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 states that a chartered accountant in practice shall be deemed to be guilty of professional misconduct if he discloses information acquired in the course of his professional engagement to any person other than his client, without the consent of the client or otherwise than as required by law for the time being in force.

SA 200 on " Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing" also reiterates that, "the auditor should respect the confidentiality of information acquired during his work and should not disclose any such information to a third party without specific authority or unless there is a legal or professional duty to disclose".

In the instant case, Mr. Bindesh is a Chartered Accountant in practice and he was invited to deliver a seminar on GST which was attended by professional as well as by representatives of various industries. During his session, a query was raised on particular issue and Mr. Bindesh used the actual data of one of his clients with full identification of client details displayed to explain and elaborate such query. Applying the above provision, the auditor cannot disclose the information in his possession without specific permission of the client. Thus, CA. Bindesh will be liable for professional misconduct under clause 1 of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

(5 Marks)

(b)

Eligibility criteria to be a Peer Reviewer:

a. A Peer Reviewer shall:

- Be a member with at least 10 years of experience in practice;
- Is in Practice as per the Chartered Accountants Act, 1949,
- Should have undergone the requisite training as prescribed by the Board
- Should furnish a declaration as prescribed by the Board, at the time of acceptance of Peer Review appointment.
- Should have signed the Declaration of Confidentiality as prescribed by the Board

- Should have conducted audit of Level I Entities for at least 7 years to be eligible for conducting Peer Review of Level I Entities as referred to in Para Il of this Statement.

b. For being a Reviewer, a member should not have:

- Disciplinary action/proceedings pending against him
- Been found guilty by the Council or the Disciplinary Board or Committee at any time
- Been convicted by a Competent Court Whether within or outside India of an offence involving moral turpitude and punishable with transportation or imprisonment.
- Any Obligation or conflict of interest in the Practice Unit or its Partners/Personnel.

(5 Marks)

(c)

Factors to be considered while planning performance audit:

1) Significance and the needs of potential users of the audit report.
2) Obtaining an understanding of the program to be audited.
3) Legal and regulatory requirements,
4) Management controls.
5) Identifying the criteria needed to evaluate matters subject to audit
6) Identify significant findings and recommendations from previous audits that could affect the current audit objectives.
7) Potential sources data that could be used as audit evidence and consider the validity and reliability of these data
8) Consider whether the work of other auditors and experts may be used to satisfy some of the auditors' objectives.
9) Providing sufficient staff and other resources to do the audit.
10) Preparing A written audit plan.

(0.5 each- any 8)